

Q1 2018 Earnings Call

Company Participants

- Rafael Sperendio, Head, Investor Relations
- Werner Romera Suffert, Chief Financial Officer

Other Participants

- Carlos Macedo, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, everyone, and thank you for waiting. Welcome to BB Seguridade's First Quarter 2018 Earnings Conference Call. This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After this, there will be a question-and-answers session. At that time, further instructions will be given. (Operator Instructions)

The presentation is available in the Financial Information Presentation section of BB Seguridade's IR website at www.bbseguridaderi.com.br/en. Before proceeding, let me mention that forward-looking statements that may be made during this conference call regarding expectations, growth estimates, projections and future strategies of BB Seguridade are based on management's current expectations, projections of future events and financial trends that may affect the business of the group and do not guarantee future performance since these projections involve risks and uncertainties that could extrapolate the control of management. For more information on the statements of the company, please check on the MD&A.

With us today are Mr. Werner Suffert, BB Seguridade's CFO; and Mr. Rafael Sperendio, Head of Investor Relations. Please, Mr. Sperendio, you may now begin.

Rafael Sperendio {BIO 18963159 <GO>}

Good morning, everyone, and thank you for joining our Q1 earnings call. Let's start on slide number two, where we have the main highlights of the quarter. The net income adjusted by one-offs reached 907 million, down 8.6% year-over-year, driven by the Selic rate fall as you can see on your -- if you look on your left hand side, you can see on the -- that Selic rate led to the 37.3% decline in the net investment income while the non-interest operating result grew 3.5%. And the main drivers for this improvement in the non-interest operating result was mainly the commercial performance at SHI, our life and rural

business with retained premiums up 8% over the same period a year ago and being [ph] credit life the top performer in this business line.

Another important driver here will be commercial performance in premium bonds where collections rose 23% year-over-year. And finally, the retention business was also an important piece that helped to build our operating results with AUM growing 16% year-on-year and the redemption ratio falling 70 bps, reaching one of the lowest levels ever recorded by (inaudible)

On page three, we have the breakdown of our adjusted net income. So in the first quarter we have classified just one event as extraordinary which was then in addition of provision for pending judicial claims at MAPFRE Seguros Gerais which is a subsidiary of MAPFRE BB SH2. So during the fourth quarter, we have revised our data base of pending judicial claims and we decided that at MAPFRE Seguros Gerais we were under provision. So we had to increase those provisions which generated a net effect to BB Seguridade's net income of BRL21 million. So our accounting net income reached 886 million, down 11%, but setting apart these one-off events, the adjusted net income fell 8.6% year-over-year to 907 million.

On page four, we have our main headlines for the year, the financial results. So in the first quarter we had the hardest comparable for the year, so financial results dropped 37% and accounted for only 20% of our net income, being the 47% [ph] decline that we saw in the average Selic rate, the main drag on financial results.

On your upper right hand side, you can see that the continued downward revision of the expected year-end Selic rate led the forward yield curve to move downwards. We generated some mark-to-market gains on our exposure in zero coupon bonds that helped somewhat to offset a little bit the lower Selic rate in the quarter. On the other hand, the lower IPCA weighed on inflation-protected securities classified as held to maturities while the higher IGPM brought a negative effect, increasing the financial expenses at Brasilprev in the defined benefit pension plan.

Now from page five on I will go over the main highlights of our main business lines and starting with SH1, our life and rural business. Premiums written grew roughly 5% with spotlight on credit life as I mentioned in the beginning of the presentation that grew 76% over the same period last year. Term life increased 2% while mortgage life rose 12.3%. On the other hand, rural was down 8.8%, as explained here by the 34% decline in crop insurance. And this is something that (inaudible) does not concern as much as we expect the biggest volumes of working capital loans should be granted now in the second quarter recently from what happened last year where we had much earlier disbursements started in mid February last year.

The other rural insurance line, I mean, credit life for farmers and rural lien, they are doing really well, rose 29% credit life and rural lien grew 7%. So they have been performing really well. The main issue is comparable year's crop insurance. So if we were to exceed the performance of crop insurance and DPVAT, the mandatory insurance for vehicles in Brazil, that does not depend on this. It had a price reduction this year. But if we were to

exclude both lines' premiums we can -- have been grown 15% year-on-year which shows a good decent performance.

So talking about retained premiums here, these lower volumes in crop insurance, which is the line that we see the most for reinsurance, retained net premiums grew 7.6% as compared to first quarter last year.

About operational performance on page six, we can observe that the improvement about 120 bps in the loss ratio over the same period last year supported by the more than expected loss ratio in rural, we were expecting very severe damage coming from La Nina, but didn't happen in this last cycle, which helped a lot this loss ratio for rural, mainly in crop insurance in the first quarter this year.

Commission ratio rose 520 bps year-on-year, driven by the increase in commission in part of our term life portfolio vis-a-vis in the Bancassurance channel since the third quarter last year. We would think the revenue increased as commissions increased at a good level of the average commission chartered [ph] in SHI, but it's something that hurt somewhat the performance in the company itself, but for BB Seguridade as a whole, it's very positive as the portfolio found these increasing commissions will flow through our own broker BB Corretora. So this is on a combined basis this is very positive.

And the G&A ratio fell 220 bps over the same period one year ago driven by the release of some provision for impairment of overdue premiums that we managed to recover. So we worked those provisions and the outcome of these dynamics, our combined ratio deteriorated by 180 bps year-on-year as a result of the increase in commission ratio that the decrease in loss ratios in the lower G&A was then able to offset.

On page seven, we can see that this increase in commission is dragging down the underwriting results, which fell 11% year-on-year to 640 million. Net investment income down 49%, pretty close to the decline we have at Selic rate and both the increase in commissions and the lower financial results dragged down the net income of these business units to 15% to 336 million with a return on average equity of 49.7%.

Talking about premium, page number eight. Premiums were up 1.3% driven mainly by auto insurance sold in the independent broker channel, auto grew 4.7% compared to the first quarter last year.

On page nine, we have the operating performance of these business lines. We can see that the combined ratio of these businesses improved by 130 bps, as you can see on the lower right hand side here, driven by the improvement in the loss ratio, mainly in casualties and the lower G&A ratio, also driven by the release of some provisions for the impairment of overdue premiums and claims to be recovered from the insurance. These two effects led the G&A ratio to decline another 30 bps year-on-year. On the other hand, commission ratio was up 150 bps driven mainly by an increase in commissions chartered from independent brokers when signing our insurance.

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Page number 10, we can see that this increase in commissions paid to independent brokers for auto insurance dragged down the underwriting results which fell 1% year-on-year. Financial results down 16% as a consequence of the lower Selic rate. And finally, this business unit recorded a net loss of BRL18 million as compared to a net loss of BRL4 million in the first quarter last year.

On page 11, our pension business Brasilprev, we'd like to highlight here that in the first quarter we had a different strategy than the one we adopted last year. Last year the distribution network had total (inaudible) raising funds for periodic pension plans, we were -- sporadic pension plans. In this year, we created more incentives to them to focus more on periodic contributions in nearly half of this first quarter and this explains the 24% decline in the deposits and 59% decline in net inflows as the average ticket of periodic contributions is much lower than the one for the sporadic contributions, but it's a very important source for a more stable revenue stream going forward. When we look at the quality of these funds that have been raised, redemption ratio declined, maintaining this positive trend of declining down 70 bps to 7.4% in the quarter, one of the lowest levels ever recorded by Brasilprev.

In terms of assets under management, reserves grew 16% over the last 12 months and drove the increase of 10% in management fee, to 628 million in the first quarter this year. The average management fees kept its pace of decline of 1 bps [ph] per quarter, that is something that was totally expected because of the (inaudible) now the lower Selic rate. Our cost to income ratio for this business improved 40 bps year-on-year, but on the other hand, the higher IGPM dragged down the financial results of this business. Financial results dropped 20% year-on-year, that's why despite management fees growing 10%, the net income grew 6%, mostly because of these lower financial results.

On page 12, we have this year our premium bonds business. So collections were up 23% year-on-year, so keeping the very strong commercial trend that started in the third quarter last year. We also had a very good performance in terms of cost on this business with G&A falling 9% year-on-year. But on the flip side, because of the lower Selic rate, financial results were down 50% and the net interest margin was down 220 bps year-on-year. That's why this business' totally spread based net income was down 53% year-on-year, but delivering return on equity which is still very attractive 53.4% well above our cost of capital.

And finally on page 13, we have our broker, BB Corretora. As you can see on your upper left-hand side here, the strong performance in sales up credit life, mortgage life and our premium bonds more than offset the weaker performance in pension and the P&C linked Bancassurance channel. So, the brokerage income rose 1% year-on-year, with a slight improvement in the EBIT margin. But on the other hand, this lower interest rate environment dragged down the financial results of the brokers where the investments are almost totally invested in floating securities. That's why despite increase of 1% and improvement in the EBIT margin, the net income was down 3% and the same factors explain the decline of 240 bps in the net margin.

And to wrap up the presentation, on page 14, we have our accountability with our guidance for 2018. So, in the first quarter, we underperformed the guidance where

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recurring net income was down 8.6% and when we expect the net income to stay within the range of minus 2 to plus 2 for the full year. But it's worth mentioning here that this underperformance in the first half was already expected given the scenario of interest rates this year versus 2017. So, we had the hardest comparable in terms of financial results in the first quarter with Selic rate falling roughly 50% year-on-year. But the expected dynamics for interest rates implies a slowdown of this pace of decline in financial results which is going to help the earnings to gradually converge to the forecasted interval in the 2018 guidance.

So, although, the consensus for the average interest rate for the year has been revised downwards, it is now lower than we had the assumption for the guidance, but it's still feasible. In addition to this, we also need to account on improvement in the commercial performance. It has been doing well in most of the lines as we talked about in credit life, in mortgage life, premium bonds, but we still have some homework to do in term life and pension, and also need to count on the recovery of the crop insurance from the second quarter on. It's not an easy task, but the guidance is still feasible considering all these moving parts.

Well, that's all I would like to emphasize and we can now jump into the Q&A session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-session. (Operator Instructions) Our first question comes from Phillip Picardi [ph] with Itau BBA.

Q - Unidentified Participant

Hi, good morning, Werner, Rafael and thank you for taking the questions. The first question is regarding Ciclic. Could you give us an update about the company? I know that the company is still in early stage, but could you share with us your first impressions or maybe some numbers about this? And do you expect to expand the products offered at Ciclic in the near future? And the second one is regarding the (inaudible) points as an incentive for the sales force. How are the results from last year and are you still using these to help sales? Thank you.

A - Werner Romera Suffert {BIO 18657101 <GO>}

Phillip, Werner speaking. First of all, Ciclic as you said is our company that's dedicated to digital channel, outside Banco do Brasil channels. So we are talking here in the open market trying to sell products to clients that they are not clients from Banco do Brasil and they are not reached by Banco do Brasil channels. So, it's in the, as you said, in the early stage. We just don't have numbers to share with you. But as initiative in this channel, we think that we are in the right direction. This second partner which [ph] know more about this client, this kind of client that they are not our main target, but they will be in the near future very important for the operation. So we are understanding how this channel works,

how this bank they want to have information about insurance and pension plan products, and this is the main important initiatives linked to Ciclic.

And talking a little bit about the other products that we will be able to offer using Ciclic, this broker, our goal is to start with pension plans, but we will increase this throughout the years when we have more information about this client and what kind of product they want to buy, we will increase other products and we will offer them all products linked to the companies that we have and maybe other products that they will need to have -- we want to have via a platform like Ciclic.

So moving to the second questions about (inaudible) we started this effort last year and to have different ways to incentivize Banco do Brasil managers, employees to sell our products. This is completely in line with Banco do Brasil initiatives. It's inside their other programs that they have to incentivize products being sold using Banco do Brasil channels. And performance has started last year, I will say, in the second half of 2017 and now we are entering the, I will say, the growing phase of this strategy. So the managers they can see on a daily basis how much they will receive as (inaudible), because of the product that they are selling. And this is helping them to have more information about the -- how much they will receive back as in this program that, as I told you, it's a complementary program besides the others that Banco do Brasil they have to incentivize their sales force. But this is a very important one. We launched last year and we are increasing the pace this year to help us on the main drivers of growth that Rafael explained during the presentation.

Q - Unidentified Participant

Okay. Thank you. That's very clear.

Operator

Our next question comes from Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thanks. Good morning, gentlemen. I have just one question really. Could you talk a little about the restructuring process they're going through in SH2. What -- have they had any hard things that you can share with us or hard data that you can point to where maybe we are going to get -- that we can expect some changes by trying to understand because it could shape the company and change how the company looks and operates? So, just trying to get an idea of how it could set up for the future. Thanks.

A - Werner Romera Suffert {BIO 18657101 <GO>}

Thank you, Macedo, for the question. About the restructuring of SH2 and SH1, our partnership with MAPFRE, the main movements, the main changes that we will have is to sell our -- that is already in -- that we have already disclosed to the market, but it's still in place. It's to sell -- the company is dedicated to independent broker channel back to MAPFRE and also our auto insurance and large risk insurance business that we have part of them in Alianca do Brasil de Seguros in SH2 and other insurance related products from

the Bancassurance in Brazil vehicles. So this -- in this business we will be only distributing products via BB Corretora using Banco do Brasil channels to do that and we will continue exclusivity with MAPFRE products for these two segments.

So largely if in the non-insurance, we will sell with exclusivity products from MAPFRE, but without the underwriting risk of this business in this regard. So our main driver of growth will be bringing in top line and they will do the underwriting part of this business. On the other hand, all other Bancassurance products will be in the new SHI and there our goal is to -- we will continue to be increasing the top line but with high margin products like the ones that we are operating now, trying to continue and focus even more in this product to increase the profitability of SHI and as a consequence of it, the profitability of the broker as well and this will guide to higher and better numbers for the holding level.

Q - Carlos Macedo {BIO 15158925 <GO>}

Perfect. Thank you. Just one question -- a couple of questions, a follow-up one. There are parts of SHI particularly in the life insurance business that are sold by third-party brokers, would that be also sold off as part of this? And the second, could you -- is there any timetable for these changes to become effective?

A - Werner Romera Suffert {BIO 18657101 <GO>}

Yeah. Above the independent brokers in life related products, we are doing -- our goal is to sell this product. We will focus completely our operation in Bancassurance. So all Banco do Brasil channels and clients will be our target for this product and -- but regarding the timetable, we don't have a deadline to close this negotiation. But we are -- we have some points -- few points to reach an agreement with our partner, but when we have some new information about it, we will disclose it to the market.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay, thank you.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I'd like to invite Mr. Rafael Sperendio to proceed with his closing statements. Please, Mr. Sperendio, go ahead.

A - Rafael Sperendio {BIO 18963159 <GO>}

Thank you all once again for joining our earnings call. Just to highlight that we will give the guidance because we believe that's still hopefully feasible despite underperforming this first quarter. It was already expected because of the hardest comparable that we had in terms of financial results mainly for the fact that Selic rate dropping by nearly 50% year-on-year. It's very hard to offset this impact in the short term, but we believe that there will be improvement in the commercial performance and counting on the improvement mainly in the rural and pension. We will be able to gradually convert to this guidance range mainly in the second half, (inaudible) in the 4Q, which was one of the weakest last year to (inaudible) historically usually the fourth quarter is the strongest one. So we are going to

have some easy comps in the second half. That's why we believe the guidance is still feasible and of course it's challenging, but feasible. Thank you and have a good day.

Operator

With this, we conclude BB Seguridade's conference call for today. As a reminder, the materials used in this conference call is available on the BB Seguridade's Investor Relations website. Thank you very much for your participation and have a nice day. You may now disconnect.

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