

Q3 2017 Earnings Call

Company Participants

- Jos   Maur  cio Pereira Coelho, CEO, President of Executive Board & Director
- Rafael Sperendio, Unknown
- Werner Romera S  ffert, CFO, IR Director & Member of Executive Board

Other Participants

- Carlos G. Macedo, VP
- Lucas Lopes, Equity Research Analyst
- Thiago Bovolenta Batista, Research Analyst

Presentation

Operator

Good morning, everyone. And thank you for waiting. Welcome to BB Seguridade's Third Quarter 2017 Earnings Conference Call. This event is being recorded. (Operator Instructions) The presentation is available in the Financial Information Presentation section of BB Seguridade's IR website at www.bbseguridaderi.com.br.

Before proceeding, let me mention that forward-looking statements that may be made during the conference call regarding expectations, growth estimates, projections and future strategies of BB Seguridade are based on management's current expectations, projections of the future events and other 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 statement of the company, please check on the MD&A.

With us today are Mr. Werner S  ffert, 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 Third Quarter earnings call.

I'd like to begin the presentation on Page 3. We have our Third Quarter headwinds. So the recovering net income rose 3% year-over-year, helped by the 7% growth in the

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noninterest operating results, which more than offset the 6% decline in financial results. The spotlight in the quarter was on the recovery of the commercial performance, which presented a very unusual dynamic since the IPO, the most represented lines. So an increase on a quarter-on-quarter basis. So we would not use it to (inaudible) 2017. And this was a very positive movement that we saw in this Third Quarter that we would like to highlight.

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As an example, in the SH1 premiums written grew 4% year-over-year helped by credit life, which grew roughly 80% year-over-year and 28% quarter-on-quarter. For pensions, net income rose 9% year-over-year helped by improvement of performance in contribution in the lower redemption rate impact 10 bps year-over-year and very strong financial results, as we're going to see on the next page. And as an outcome of these rebounding (rate) commercial performance in addition to the adjustments that we have made in the commissions space by some life insurance products and also in some premium bonds products. They helped the brokerage income, the declared total. So brokerage revenues grew 9.4% year-over-year.

On next page, we have a brief summary and how we set apart the extraordinary events. So in this Third Quarter, we had just one one-off item, which was the sale of part of the economic stake that we have at IRB. So it went down from 20.4% to roughly 15.2% after the IPO. And it generated a extraordinary gain of BRL 171 million. So when we look at the accounting net income, which is BRL 1.2 billion, 20.7% up year-over-year. And when we adjusted the net income for the one-off item, net income was BRL 1 billion, 3.4% higher year-over-year and 6.8% up quarter-on-quarter.

On Page 5, I'm going to cover what have been one of our biggest challenge this year the financial results and how we can manage to offset the declining in the Selic rate, which is the most straightforward negative impact in financial results. So Selic is down from 14.15% to 9.18% this quarter. The biggest impact is on insurance companies in SH1 and SH2, which are the ones that have the highest exposure to float in securities.

On the right-hand side, we have the dynamics of the forward yield curve during the Third Quarter last year and the Third Quarter this year. So the light colors which show the beginning of the quarters. And the dark color shows the end of the quarters. The blue ones for the Third Quarter 2016. The yellow ones for the Third Quarter 2017.

So it is here we can see that we had a deeper downward move in the forward yield curve as compared to the one seen in the Third Quarter last year, which helped to offset part of the decline the Selic rate. And this movement was very positive mainly at Brasilcap, which is the company that has the highest exposure to 0 coupon bonds.

And finally, on the inflation. Inflation is down this year. And this has been impacting negatively. The return on inflation-protected securities as part -- as held to maturities. We have some exposure in all the companies. So lower inflation means a lower return on these type of bonds in these classification. But on the other hand, it helps Brasilprev, which was the company that posted the highest increase in financial results year-over-year mostly due to the deflation seen in IGPM. So it's worth reminding that Brasilprev has the

nearly BRL 8 billion to BRL 9 billion in the definite benefit pension plan. And out of this BRL 8 billion to BRL 9 billion, nearly 70% of it is tied to inflation, IGPM, plus 6% real rate. So this IGPM deflation is bringing some positive impact in the financial expenses as for the rest of the year going now. And this is helping to boost the net investment income of this company. And the consequence, financial results were down 6% year-over-year, accounting for roughly 26% of the net income in the Third Quarter.

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On Page 6, I'm going to start to cover our performance for business segments. So for stage one: life, rural, mortgage life. Premiums written were up 4.4% year-over-year and helped by credit life, which grew nearly 80%, as I've mentioned in the very beginning of the presentation. And also supported by very good performance seen in rural and mortgage life.

Term life is a hard comparable in the Third Quarter this year. It's worth reminding that in the Third Quarter last year we launched a new portfolio. We've had an impressive performance. And then mobilized it thereafter. But it's worth noting here, the strong recovery over the Second Quarter. So term life grew roughly 6% quarter-on-quarter, showing what we were saying in the last conference call when we were talking about the Second Quarter earnings. We were expecting a recovery in the commercial performance. And it is what we have been seeing now, apart from rural that has its own dynamics. The life and credit life, that accounts for nearly to 60%, 70% of all our other premiums, they are posting increase even on quarter-on-quarter basis, which was something very unusual (inaudible).

Rural keeps doing well. And we prefer to look at it on a year-to-date basis to avoid these changes in the seasonalities. So it's growing 13%. And not only in crop insurance. But also in credit life in farmers, which is up 28% year-to-date. And even in rural lien, which rose 7% year-to-date.

Moving to the operational performance on Page 7. The loss ratio increased at 1.1percentage point and driven by term life as a result of higher frequency of claims, meaning from natural death and -- with people with higher amount of coverages.

And G&A was well behaved, reaching the lowest level in 12 months, 10.6% in the quarter.

Commission ratio increased sharply. And here it was a result of the adjustments that we have made on the commissions of some life insurance products sold in the Bancassurance channel. The commercial incentive for the second half, as we disclosed, in a material effect. And it helps a lot, the commissions at the bell curve. So we are going to see when we will talk about BB Corretora's performance. And as a result of the higher loss ratio and the increasing commissions, combined ratio rose 75 -- sorry, rose 5percentage points to 75% in this Third Quarter.

On Page 8. We can see that the increasing in commissions as well as in the loss ratio, meaning in term life, above the expected (track) down the underwriting result, minus 20% year-over-year. Financial results were down 33%, mainly as a result of the decline in the Selic rate. As we can see on the bottom right-hand side that the company has a high

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exposure to floating security. And as announced, come off what we have discussed, the net income was down 24% year-over-year and 19% quarter-on-quarter.

Moving to P&C on Page 9. We have premiums hitting down 1.2% year-over-year. And the main highlight for this segment was the recovery in auto insurance given the adjustments that we have made on price. And we have been more selective in terms of the risks that we have been accepting. So auto insurance premiums are growing. And due to these more, I'd say, cautious view in which we said we have been effect -- accepting, as you can see on Page 10. The result of it, loss ratio is down to 57% and keep going down since the Fourth Quarter 2016.

Commission ratio was up. And here mainly on higher commissions paid to independent brokers or property insurance, mainly in large risks.

G&A, obviously increased. It was mainly a result of the -- some impermanent in premiums that we have recorded in the quarter and also high expenses with civil contingencies and affects expenses.

And the outcome of the lower loss ratio that increased G&A and commissions. The combined ratio remained almost flat year-over-year.

On Page 11, we can see that the impact of the lower loss ratio was very positive in terms of the underwriting result, which grew 5% year-over-year. But considering the increase in G&A and also that we have better financial results explained by the same reasons that we talked about in sequence. So higher exposure to floating securities. So the net investment income was down 37%. And naturally, the increase in G&A, the net income was down 58% in the quarter on a year-over-year basis.

Moving to pension plans on Page 12. We have good news almost everywhere here. Contributions were up 4% year-over-year, 17% quarter-on-quarter. The redemption ratio reached its lowest levels since 2012 at 7.7% on a realized basis and down 10 bps year-over-year. Reserves grew 24% in 12 months. Management fee grew 19% year-over-year helped by the increasing reserves. And the average management fee showing the expected decreasing trend of 1 bp per quarter. And the cost to income ratio also improved 40 bps.

Financial results, helped by the IGPM deflation and also lower financial expenses, grew 31% year-over-year. And as the outcome of all of these positive factors, the net income grew 9% year-over-year to 17% quarter-on-quarter, reaching an annualized return on average equity of 47%.

In premium bonds on Page 13. Collections were down 1% year-over-year. In the business line, mainly I'd like to highlight the 40% growth quarter-on-quarter, showing a very strong recovery in the year. So the highest level in contributions for our premium bonds in 2017 was recorded in the Third Quarter. We remain very optimistic about the recovery of this line throughout the year.

And also, the company was helped by the downward move that we talked about when we were discussing the financial results. So the downward move -- the deeper downward move of the forward yield curve helped the net investment income of these companies. We've reached the net-interest margin of 720 bps in the Third Quarter. And helped a little bit the financial results to offset the decline in the Selic rate. That's why in spite Selic decreasing 35%, the financial results were down just 13% year-over-year in the quarter.

The net income was down 29%, mainly on lower financial results and higher commissions that the new portfolio is paying to the broker.

Let's turn now to Page 14. The recovery in the commercial performance along with these adjustments that I mentioned about the increase in commissions with some life insurance products, along with the change in commissions paid by some premium bonds. And the yield portfolio launched late last year helped the brokerage income to grow 9% year-over-year and 22% quarter-on-quarter. So when we look, this rebound in commercial performance was very important to recover the performance at the BB Corretora, which accounts for more than 40% of our net income. And as a result of that, net income of the broker grew 7% year-over-year, 19% quarter-on-quarter, at a slower pace as compared to the pace that we achieved in revenues. But these are mostly explained by the lower financial results, most part of the financial investment at the broker is invested in floating securities, repos and so forth.

On Page 15. To wrap up the presentation, we have our year-to-date performance as well as our guidance for the year. Year-to-date September, our net income was down 2.1%, which was in line with the guidance of minus 5 to minus 1.

And that's all I'd like to emphasize. And we may now move to the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Thiago Batista with Itau BBA.

Q - Thiago Bovolenta Batista {BIO 15398695 <GO>}

I have 2 questions. The first one about the commissions negotiations. We have discussed this in the particular call. But this negotiation of the commissions in the broker business that the SH1 with the broker. Is it possible to say that this should happen again next year or this is impossible to have this type of negotiation in '18? And my second question is about the pension business. If you could comment about the main trends you're seeing or the main trends that you are expecting to see in the pension business in '18 regarding the inflows, the AUM and also the management fees. I know you don't have formal guidance yet. But if only you could give your main views about this business.

A - Werner Romera SÃ¼ffert

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Thiago, Wern speaking. So about the commissions on the broker level and regarding the commissions from SHI. This negotiation that we have this year is something that -- we want to remain doing this. We are talking with our partners. And they understand that we are -- this business, SHI and the channel, Banco do Brasil, branches and clients. They are bringing a very good quality of margin to this company through SHI. So we were able to increase the commissions in 2017. And this is something that we would want to remain doing. Of course, we have this approved for 2017. But our goal is to remain talking with them and showing that we are providing a very good quality channel for the business. And in doing this, we will be able to get through a little bit more of this -- the value that this channel brings to our partnership via broker commissions. So this is how we are dealing with this -- with our partners. We have this agreement for 2017. And we will discuss this in 2018 for -- if we'll continue to have the same approach that we have now.

A - Jos   Maur  cio Pereira Coelho {BIO 16644227 <GO>}

About the trends that you have mentioned, Thiago, in the pension plan business, of course, we will face from now on a type of environment we hope to see that we have never experienced in Brazil until now. So a low interest rate environment and a low-inflation environment, which we see that it's the best environment to develop, not just the pension plan industry in Brazil. But we're going to see increasing in the real income of the people. People are now looking for different alternatives for savings and so. But also for life insurance, for credit life, with lower rate in the loans and so forth. But insurance industry as a whole is going to be a very positive environment. But it's a new one. We had never experienced this type of environment until now. We see it as very positive but it can also bring some competition. Regarding the pension business, specifically, we're already seeing it. Competition is increasing. But one of the most frequent asked question is how we can defend our management fee in this type of environment with low interest rate? And in our opinion, something that does not depend just on our cycles. We are going to see a big effort from our side and from all the pension industry in Brazil in order to financially engage the customer, in order to lead them to a bit less risk-averse. The higher concentration in the assets under management that we have nowadays in fixed income and most part of this in government bonds. That's not just because of the way that we chose to invest these assets. That's because the clients, they don't want to have exposure to the stock market. They are always the profile -- very conservative profile, that people, they saw such a high volatility in the stock market some years ago. They prefer to keep investing their long-term assets in types of funds with a very conservative profile. And they are used to double-digit Selic rate, which is not the scenario anymore. So it's going to depend on our service to financially educate the customer. It's going to depend on the customer to realize that these returns will not come back anymore and they will need to change their asset allocation. And so on, which is very positive for the market, for the economy as a whole but hard to have a kind of forecast of sensitives about these movements because we had never experienced a scenario like this. But we are very optimistic if these low interest rate scenario, low inflation scenario remains the new normal for Brazil from now on.

Operator

Our next question comes from Carlos Macedo with Goldman Sachs.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Couple of questions. First question on growth. I mean you could see that the growth kind of came back online. And it has to do with lending of Banco do Brasil rural and the credit life line. But on the term life and some other products like auto, it's still a little bit sluggish even on the pension side. A bump up from a week's Second Quarter. But year-over-year its growth is nothing to be very excited about. I wanted to ask, when do you expect in terms of growth economies coming back? Is that going to be still driven more by Banco do Brasil clients? And obviously, those are your clients. But is there anything that you can do to accelerate that process and bring growth back to your line? Second question on your financial income. Obviously, weighed down by inflation, Selic, et cetera. With the Selic now down to 7.5% and likely only being down a little bit more, do you see the -- and inflation probably as low as it gets, do you see this line being stable on out? Or do you still see more pressure in upcoming quarters?

A - Werner Romera SÃ¼ffert

This is Werner speaking. So regarding the growth from BB Seguridade for next quarters, we believe that most of -- a good part of this growth will continue to come from Banco do Brasil channels. So we are improving the incentives and initiative that we have with Banco do Brasil to increase and bring to these managers more information on how to sell these new products to Banco do Brasil clients. And in doing this, for more recurrence to -- progress with more recurrence, this will bring the kind of flow that's important for the long term. So we still believe that our main channel will remain Banco do Brasil branches. And all the other channels at Banco do Brasil, they have to contact their clients. So apps and Internet and call centers also. They are very good ways to sell our products. And we are doing this nowadays. So this will remain our main channels for the next quarter. They will be enough to offset the financial -- the drop in financial results that will continue to happen in the next quarters. So looking at the numbers that we have in this quarter, we believe that financial results will continue to drop because we are moving from a Selic -- average Selic rate that is 9 -- close to 9% that -- and we will achieve something closer to 7%, if the (caucus) consensus is right. So this will put pressure in our and NII. And our way to offset this, we will be more operational results coming from all our companies. So the efficiency initiative that we have in place will continue to increase in all our subsidiaries and all our companies. And mostly in SH1, where we have to groom to increase products like the ones that you said, credit life and rural. I'd like to emphasize that life for farmers, that increased 28% in accumulated -- in year-over-year when you look nine months in 2017 compared with 2016. And it's a very good margin, a positive -- better, high margin. And this is the kind of growth that will be emphasized by us and by Banco do Brasil sales force to continue to improve the quality of our growth because as you said, we have other segments that the performance is not improving in the top line, like auto insurance, for example. But we are doing -- and we have the numbers showing this quarter that improving the operational side. So that's very important for us to start to have better operational results coming from SH2. And after that, we will be able to move again to a growth momentum. So now, we are emphasizing progress from SH1, from pension plan side. And of course, when we have a better environment for auto, we will be doing the same. But in the credit life, this facet is important to mention that we have different, I would say, levels of growth coming from the individuals portfolio and the portfolio from SME. The credit life for SME, the pace is still very slow comparing with some quarters ago. But for our credit life for individuals, the growth is very strong. And the cancellation of this

premiums dropped very quick. So we have a very good perspective for this segment for 2017 and on. So this is the point that I would like to emphasize.

Operator

Our next question comes from Lucas Lopes with Cr dit Suisse.

Q - Lucas Lopes {BIO 18956724 <GO>}

I have 2 questions as well. The first one is a follow-up on term life insurance. I want to -- I was wondering whether how such side you are with the current performance of the product. The second half of last year was, in fact, quite good. Penetration within premiums of the new portfolio, close to 20%. Now in first half, it was disappointing, in my view, penetration declining to only 5%. And now, it's starting to improve again from the return of the semester. Are you at the pace of sales that you're expecting when you launched the new portfolio? Or are you still behind the original goal? And the second question is a more specific one. You mentioned in the MD&A that the holding expenses declined because of the end of some of the advisory services. I understand that the device was focused on cost. And you also mentioned that the -- so I would like -- I was wondering how -- what was the initiative that have resulted from the advisory services. And this is related to the -- some sharing in the holding expenses with subsidiaries. Those are my questions.

A - Werner Romera S ffert

So this is Werner speaking. So regarding life insurance, as you said -- as you know, we launched the portfolio -- a new portfolio for life insurance last year, second -- Third Quarter last year. So the high -- very strong numbers that we have last year, they were linked to this -- the launch process of this new product. And after that, we have all the scenario, deteriorated a lot for the economy as a whole. So we have to move from this product to other products. And we started 2017 focused strongly in pension plans. And we mentioned this in the First Quarter earnings call that it was very strong in pension plan and we need to bring back to the growth product from life insurance and credit life. And we changed it a little bit. The program that we have inside Banco do Brasil channel to incentivize it, working for us to sell our product. And doing this is small change. We have a big response from these managers. And they started to sell again our life insurance and credit life insurance products. So it's an environment where we have a lot of -- when the economy is not doing quite well, all this seems we need to move at the same time. It's not easy to have growth coming from all the segments. So we -- until the first half of this year, this was different area. And now we move to a new scenario where the GDP growth is increasing, the unemployment rate is decreasing. And it's been -- I'm not going to say that it's easier. But it's more effective to sell products to our clients in an environment like once that we are facing now. So life insurance starts to improve. And we will continue to improve from this quarter on. So you are right that this is not our initial estimate for the year. We believe that we can do -- we can increase even better levels of the growth for life insurance. And with the help that we have from Banco do Brasil managers inside Banco do Brasil branches in all the channels to do that, we will continue to have a good quality of growth coming from life insurance -- the new portfolio of life insurance in Banco do Brasil channel. And Rafael will answer the second question.

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A - Rafael Sperendio {BIO 18963159 <GO>}

Lucas. So regarding the decline, the expenses with specialized technical services, I think that you are referring to these expenses at the holding level. So last year, we had an increase in this line because -- the 2 main sources were we hired a advisory company to help us to deploy an ERP at BB Seguridade to integrate the ICCs that we have at holding level with the bank and also with the affiliate companies. So we hired this. Next year, we are almost done with this service. The expenses related to the ERP should be residual from now on. And the second source was the digital strategy. So we hired an adviser to help us to develop our independent -- cross-fired an independent digital strategy, of course, that we keep working on it with Banco do Brasil to make our products available at Banco do Brasil platform, ATMs, mobile, net banking and so on. But we are working on independent digital strategy to reach non-Banco do Brasil clients. So we hired had an adviser last year and this -- with this service, we are also done. We are now running on a separate company, as we disclosed in the announcement to the market early this week.

Operator

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

A - Rafael Sperendio {BIO 18963159 <GO>}

Well thank you once again for joining our conference call. This was a quarter that we classify as very positive in terms of recovering the commercial performance in the line -- higher (inaudible), SH2, BB Seguridade earnings. So they all presented improvement on a quarter-on-quarter basis, something that used to be very unusual until now. And also just to emphasize what we were saying in the conference call when we were discussing the Second Quarter results. So now the performance is improving. We remain very optimistic with the commercial performance until the end of the year, which we will maximize as much as we can, the earnings for 2017. Thank you.

Operator

With this, we conclude BB Seguridade's conference call for today.

As a reminder, the material used in this conference call is available on BB Seguridade's Investor Relations website, www.bbseguridaderi.com.br.

Thank you very much for your participation. And have a nice day. You may now disconnect.

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