BB SEGURIDADE – EARNINGS CONFERENCE CALL 4Q17

Moderator

Good morning everyone and thank you for waiting. Welcome to the *BB Seguridade*'s 4th Quarter 2017 Earnings Conference Call. This transcription 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. Should any participants need assistance during this call, please press *02 to reach the operator.

The presentation is available in the financial information presentation section of *BB Seguridade*'s IR website at www.bbseguridadri.com.br. Before proceeding, let me mention that forward-looking statements that may be made during the company's conference call regarding expectations, growth estimates, projections, and future strategies of *BB Seguridade* are based on managements' 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 can extrapolate the control of management. For more information on the statements of the company, please check on the MD&E.

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

Good morning, everyone and thank you for joining our Earnings Call.

So, let's start on page 3, where you have the main highlights of the 4th quarter. Our non-recurring net income reached R$ 941 million, which is equivalent to a Return on Equity of 42%. Year-on-year, the net income was down 12.5% and dragged by lower financial results, in addition here to the decrease that we are have on the non-interest operating results, which was driven by higher G&A at the insurance companies in SH1 and in SH2. I can recall something more detailed on the next pages.

On page 5, besides the increase in G&A we could see in both companies, in SH1 and SH2, an improvement in the Loss Ratio. Mainly at SH1, driven by Life & Credit life. In the Pensions segment, pensions kept doing well with the net income arriving from this segment, amounting to a growth of 4.5% YoY with a Redemption Rate declining 2 percentage points, pretty much close to its lowest historical levels, allowing the pensions assets under management to grow almost 19% in the last 12 months.

On the brokerage side, revenues were up 37% YoY and helped by improved sales performance in Credit life and in Rural. On the commercial performance, I would like to highlight here the strong recovery that we managed to reach in the second half of the year. So, when we analyse the main business lines in comparative performance, in the second half versus the performance that we delivered in the first half, we can see that, when we look on a combined basis, premiums grew roughly 15.3%. The collections at *BrasilCap* increasing by 58%, contributions from pensions plans grew nearly 15%, and also bringing the income from SH1 growing 15%. So, we had a strong recovery in the second half, despite a more volatile environment ending in the first half of the year.

And finally, on dividends, our Board has approved the distribution of R$ 1.9 billion in dividends, which is equivalent to 90% of the accounting net income in the second half. So, considering this amount in addition to the one that we have distributed regarding the first half of 2017, we paid out nearly 85% of the accounting net income, which is equivalent to a growth of 4.4% as compared to the amount that we have distributed in 2016. So, despite the increase of only 0.9% in the accounting net income, dividends grew at 4.4%.

On page 4, we have the breakdown of the one-off items. So, in the 4Q, the one-off items added up to R$ 33 million. So, to provide you with some colour on it, the first one was related to the right-down of the commissions receivable by the broker. So, we are doing the process of deploying the ERP system within *BB Seguridade*, *BB Seguros* and *BB Corretora*. We realised that we had to right up 15 million… actually, 26 million in gross brokerage commissions receivable. And the other effect was R$ 17 million post-taxes, regarding the revision of the insurance operations database at SH2, in order to comply with the SUSEP, the insurance regulator in Brazil… the rules of SUSEP. So, both adjustments were non-recurring, and we don't expect them to happen again going forward. So, the accounting net income in the 4Q was 908 million, down 7.5% adjusted by non-incurring events.

The recurring income was down 12.5%. For the full year, added to these effects that I have mentioned, we also had the disposal of part of our investment at IRB which amounted to 171 million post taxes, and when we look at the accounting net income for the full year it was up 0.9%, adjusted by non-recurring events, down 4.8%. We had a Return on Equity of merely 46% on recurring basis.

On page 5, we have the biggest challenge that we had in 2017: financial results. So, financial results declined by 12% in 2017, and accounted for 28% of the net income, down from 31% in 2016. The most straight-forward impact from that comes from the deduction in the Selic rate. As you can see on the upper left hand-side, now down from 14% to 10% the average rate for the year, 17.25% at year end.

Inflation was also down for both indexes, IPCA and IGPM, which in fact there can be the return of inflation impact on securities [???] that helped their maturity. And on the positive side, we had some movements that helped somewhat to upset these negative effects of a lower Selic and lower inflation for the financial results. So, regarding the lower inflation, the lower IGPM helped the financial expenses at BrasilCap, so they were lower on the client benefit plans. And on the upper right hand-side we have the downwards movement of the forward yield curve in 2017, which provided a gain on mark to market on zero coupon bonds. So, these factors have helped but were not enough to fully upset the decline of the Selic rate, and that's why the financial results were down 12% on a yearly basis.

On page 6, I am going to start covering the performance per business segment. So, starting on SH1, Life and Rural, premiums with them were up 13% YoY on the fourth quarter. In 2017, premiums grew 4.1%, and in both comparisons, the premium growth was led by Rural, Credit life and to a lesser extent, Mortgage life. So, Credit life showed a very impressive performance on the second half, so just to remind you, YTD tree on Credit life was down roughly 30%, so in the second half, Credit life grew nearly 60% year over year, and in 2017 growing 12%, on lower cancellations and also improving… originating mainly on the individual segment. Now, the individual portfolios have grown 28% YoY in 2017.

Moving to the operational performance on page 7, the loss ratio showed a very strong trend throughout 2017, despite the uptake in the third quarter, and ended the year down 3.6%. But despite this improvement in the loss ratio, we have had some deterioration in the combined ratio, mainly in the 3rd and 4th quarters which were driven by the other two reliable years. So, the increase in commission ratio which was a result of the adjustments that we have made on the commissions of some life insurance products sold in the [???] channel. There is a commercial incentive for the second half but actual leading the results of BB Seguridade… in spite increasing the expenses at the equity insurance companies, it provides more commissions to the growth person. On a combined basis this is a positive effect for BB Seguridade.

And the second variable here we can see the increase in the G&A ratio playing in the fourth quarter to the impairment of nearly R$ 30 million regarding unrecoverable insured claims which are the result of the process of revising the databased of reinsured operations started in the first quarter of 2017. And the second effect that we had which has led to an increase in the G&A ratio was related to higher tax expenses, which were unusually lower in the 4th quarter of 2016, mainly due to the change in the accounting methodology which we dealt with here in the operation of the tax asset related to temporary differences in PIS and COFINS tax rates.

On page number 8, we can see that despite the increase in commission, the underwriting result managed to grow 1% YoY on the 4th quarter and declined only 1% in 2017 thanks to the lower loss ratio. Financial results were up 44% YoY on the 4th quarter due to the capital gains and the disposal of some securities that were being… had been shared at book value in the balance sheet of some insurance companies using SH1. On a yearly basis, financial results here were down 8% mainly affected by the reduction in the Selic rate. And we now come off to what we have discussed here in these three pages, net income was down 15% YoY on the fourth quarter, and 10% on a yearly basis with Return on equity of 42% in 2017.

On PNP page 9, premiums written were down 4.2% YoY, 2.2% on the yearly comparison here, and dragged down by Auto insurance and DPVAT which is a mandatory insurance in Brazil. So, the Government reduced the price of this mandatory insurance because of lower points, and it's had a direct effect on premiums. 2017 was too a very tough year for Auto and PNP overall for us but it's worth mentioning that it was according to the announcement that we have made earlier this month, we are working together with Mapfre in order to redesign the business that we have together, and we are pretty much sure that we will find the best solution for both partners.

On page 10, we have the operating performance of the PNP business. So, on the upper left hand-side we have the loss ratio, which actually improved in both comparatives, in the fourth Quarter YoY and for the full year 2017, driven mainly by little acquainting casualties. The commission ratio was that mainly on a higher commission paid to independent brokers for Auto insurance, so distantly from SH1, it is not a good trend because this commission flows to independent brokers.

G&A also increased 1.1% YoY and 2.1% in 2017, basically because of the same reasons that we talked about in SH1, related to the changing in the accounting methodologies or tax expenses. And in addition to that we have also had some higher impairments related to receivables and that own because of [???].

And as the outcome of these dynamics, the lower loss ratio that on the other hand higher G&A and commissions, the combined ratio deteriorated by 1.7% YoY on the fourth quarter, and 1.8% in 2017.

On the next page we can see that a lower loss ratio is not enough to upset the increasing commissions. So, the underwriting result was down 8% YoY in the fourth quarter, and down 6% in the yearly comparison. The net investment income, i.e. financial results, as expected were down 20% YoY and 36% in 2017. This is totally explained by the lower Selic rate. So, when we add the increasing G&A ratio to these analyses we can see that all these effects combined led at SH2 to a net loss of R$ 59 million in the fourth quarter and a net income of R$ 16 million in 2017.

On page - as I'm turning here - on page 12, gross deposits dropped 26% YoY, and it's worth reminding you that the fourth quarter reached the all-time high in terms of gross deposits, on a very hard comparable, even though we posted a decline YoY as we managed to sustain the market share which was about a third of the market in gross deposits… which it was like we have been able to capture throughout 2017. So, the redemptions ratio here kept declining throughout the year and ended the fourth quarter at 2% down YoY, and when related on the yearly basis, the redemptions ratio went down 0.9%; and helped reserves to grow 19% over 12 months, reaching R$ 235 million, dragging us with management fees increased 16% YoY on the fourth quarter, and 22% in 2017. And when we add to the increasing revenue with management fees, the improvement that we saw in the cost to income ratio, these were the main drivers for the 5% grow YoY of the net income in the fourth quarter, and also they were the main drivers for the 8% growth in net income in yearly basis, reaching 43.1% of return on equity, which was 1.3 percentage points higher than the one that we reported in 2016.

On premium bonds, age 13, collections kept improving on a QoQ basis growing 23% QoQ and dropping 1% YoY. On a yearly basis, collections went down 13%. On a flip side, the financial results continued to fall, dragged by the lower Selic rate. So, the net interest margin was compressed by 270 bps YoY, and 110 bps in 2017. So, given these weaker financial results and the declining collections, the net income was down 65%

YoY and 42% in 2017. In way of business, fewer critical we had a return on equity of 62% in 2017, 39% in the fourth quarter using a very good return, despite the low interest rate environment.

At the broker on page 14, brokerage income adjusted for the one-off events was 3.7% YoY helped by the increasing commission charged on certain life insurance products, as well as on the new premium port portfolio, along with a very strong performance in sales of Credit life and Rural insurance. In 2017, brokerage revenues grew 0.4% and helped by Life, which was driven by increasing commissions, Credit Life and Rural insurance increasing the portfolios of insurance premiums… which more than all set the decline in the other different clients, in pensions and in premiums. But such improvement along with a better and bigger marketing was not enough to offset the weaker financial results. The net income was down 2% YoY and 1% in 2017. And same, the effect in that year was the deduction on the net margins.

On page 15, we have the accountability that we are driving the 2017 guidance, so net income change according to the estimates of intra market was -5 to -1, we believe in -4.8% in 2017, on a recurring basis. And finally, on page 16 we have our guidance for 2018, so our expectation that the changes in the recurring net income will be within the -2 to +2 range. Although 2018 is already showing some economic recovery, to it will be a difficult year from the point of view of the financial result. So, 2017 ended with an average Selic rate at 10% and yet the focus with the Brazilian Central Bank points to an average Selic rate of 6.75% for 2018, so interest rate might decline by 33% in relative terms which is even more than the reduction that we saw in 2017. So, the financial results will continue to be a strong headwind that we have to gear again in 2018. And we need to deliver creating increasing operating results that can offset, fully or in part, the decline in financial results.

So, that's all I would like to emphasize, and we may now go to the Q&A session.

Moderator

Ladies and gentlemen, we will now begin the question and answer session. If you have a question, please press *9 in your touch tone phone now. To withdraw the question, please press *9 again. Please hold while we collect the questions.

Ladies and gentlemen, as a reminder, if you would like to pose a question, please press *9 now on your touch tone phone.

Our first question comes from Tiago Batista with BBA, with Itau BBA.

Tiago Batista

Yeah. Hi guys, thanks for the opportunity. Rafael and Werner, I have a follow up from the Portuguese conference call. When I ask about the implied financial result in the guidance, you mention a decline pretty much in line with the Selic rate, that means something close to 30% in 2018. To have the earnings of around, of fattish earnings, you are mainly saying that the operating results will depend on low double digits, and inaugurating 13% percent of the operating results. These numbers are feasible, this level of growth for the operating… in order… I know I don't have the guide but this level of expansion of the operating result is feasible in 2018?

Rafael Sperendio

Hi Tiago, Rafael speaking. So, your estimate is pretty much in line with ours. So, it's totally feasible.

Tiago Batista

And do you have any idea which lines will lead the expansion?

Rafael Sperendio

Mainly an improvement in the commercial performance of some business lines. It's worth mentioning there was a very strong increase that we saw in Credit life in the second half. We start to accrue results in 2018, despite to the… the sales that will be made also throughout the year. But we will start to get the benefits of this strong sales performance in Credit life that we had in the second 2017, and also some improvements in the expenses side. So, we have very strict… I'll say, cost control when we were defining the budget for all the affiliated companies for 2018. So, we will be looking at these expenses very carefully throughout the year and we believe that this will bring some improvements for the non-interest operating result. So, these are the two most important business lines... sorry, segments that we believe will being some improvement to the operating side of the business.

Tiago Batista

Yeah. Thanks a lot.

Moderator

Our next question comes from Lucas Lopes with Credit Suisse.

Lucas Lopes

Thanks for taking my question. It is a very simple one. You have announced the higher pay-out ratio for the second half of 2017. Can you show us the rationale for the increase in the pay-out, and whether or not this is sustainable for this year as well, or if this should be the new target of management for the medium to long term?

Rafael Sperendio

Hi Lucas, this is Rafael. So, regarding the rationale behind increasing the pay-out ratio, it is worth mentioning that our intention is to maximise the distribution of dividends to shareholders. So, if we don't find that we have good investment opportunities at a return that we think that makes sense, we will distribute it to the shareholders. So, we also analyse and we find disclosed economic environment… of various prospects from 2019 on, these two are in a transition phase, and we found interesting the option for increasing the pay-out ratio in order to offset a temporary lower pace of growth in net income. So, regarding the accounting net income growing 0.9% as I previously mentioned in the presentation, we managed to increase dividends by 4.4% and we had the same strategy in 2016, when we increased the pay-out ratio from 80% to 82%, now we are increasing it again from 82% to 85%. And this is going to be our intention from now on: maximise as much as we can the distribution of dividends to our shareholders, unless we have other investment opportunities, but this is not the case now.

Lucas Lopes

Ok, Rafael. That is very clear, thank you.

Moderator

Ladies and gentlemen, as a reminder, if you would like to pose a question, please press *9.

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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.

Rafael Sperendio

I would like to thank you all once more for listening to our Earnings call. In terms of upsides, we are very committed to 2018 with very strong operating results despite a very tough year in terms of financial results. We believe that we will be able to build a very strong operating revenue stream in 2018, as we did in the second half of 2017, and to get benefits of this improving commercial performance, which causes improving in the operating performance and get all these benefits in 2019, when we won't have these headwinds coming from the financial results anymore, and get over to the potential growth rate that we believe that the company is able to achieve. And in the meantime, we will keep working on alternatives to maximise the return on equity and to increase and to improve the capital allocation among the main business lines that we have. So, thank you all and have a good day.

Moderator

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