



## Moderator

Good morning everyone and thank you for waiting. Welcome to *BB Seguridade's* 2<sup>nd</sup> 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. 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.bbseguridaderi.com.br/en](http://www.bbseguridaderi.com.br/en). 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 involves risks and uncertainties that can 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

Thank you and good morning, everyone. Welcome to our second quarter 2018 earnings call.

I am going to take you through the presentation, so let us start on slide number 2, where we have the main highlights of the quarter. Our accounting net income reached R\$ 1.1 billion in the second quarter this year, 11% YoY. It is worth mentioning that in the second quarter, we have classified two events as one-off. So, the first one impacted *Companhia de Seguros Aliança do Brasil*, which actually is a SH1 subsidiary driven by some changes in regulations that now establishes the requirement to the liability of equity test, and which products that have premiums recorded on a different timeframe from the individual risk external to the insurance policy, we can now look at the provisions on a global basis. That is, we can use the actuarial surplus of some products to offset the actuarial deficit of some other products. And considering this new rule, we realized that we were over-provisioned, so we had in this second quarter, a reversal in these provisions that were in excess, according to the new rule, and these had a positive impact on *BB Seguridade's* net income of roughly R\$ 232 million, which we set apart to calculate our recurring net income. And the second impact is on *Mapfre Seguros Gerais*, which is an SH2 subsidiary, and this one was related to the work that has been in progress to reconcile the accounting balances of claims to be recovered from reinsurance, and also the equalization of the balance of third parties' deposits. So, differently from the previous one, this effect was negative and impacted our net income by R\$ 79 million, which we also setup as a one-off both effects, one that was related to change in regulation, and this one we don't believe it is going to be recurring, it was just one time, so that is why we think that it makes sense to split those two effects.

And the recurring net income reached R\$ 910 million in the second quarter, down 4.8% YoY. And as you can see here, on your lower left-hand side, the decline in the recurring net income was totally driven by the net investment income, which was down 34% YoY, while our non-interest operating result, maintained the upward



trend and even accelerated from the 3.5% growth in the first quarter, to 5.4% growth in Q2 despite the still challenging economic environment. An here two key drivers were the increase of 11.8% in premiums written at SH1, we retained premiums growing at an even stronger pace, at 13.3% YoY, with credit life on the spotlight up 41% YoY. Pension assets under management grew 13% to R\$ 243 billion, and premium bonds collection grew 20% YoY, another very important highlight this year.

And finally, on dividends, our board of directors has approved the 80% payout of the net income for the first half 2018, which means that we are going to pay R\$ 1.6 billion in dividends. It is important to note here that dividends will be paid considering the accounting net income, which is higher than the recurring net income.

Coming to financial results on page 3, as usual, we are going to cover the main variables that affected our net investment income. And as you can see on this page, our financial results were negatively impacted considering almost every aspect here, and this explains the 34% drop YoY, representing the all-time low contribution to earnings, roughly 18% on the second quarter.

So, on the upper left-hand side, we have the expect negative impact from the lower average Selic rate. The average Selic rate is down by roughly 40% on a YoY basis, which had a very material impact on our floating securities. On the upper right-hand side, you can see the net investment income, also hit by the spike in the forward yield curve, which caused some mark-to-market losses in our zero-coupon bonds and pre-fixed securities in general. And at the bottom of the slide, we also had a negative impact from inflation. The IGP-M, which recorded deflation in the 2Q last year, and increased materially in the second quarter of this year to 3.9% as compared to a 3.7% inflation. And this had a direct impact on the financial expenses at *Brasilprev*, another hit, and another hit that we consider temporary. This one and the negative effect coming from the spike in the forward yield curve, we think that they are both temporary. The lower average Selic rate for this year was a one-off event, but these two, we believe that we can recover it a little bit in the... from the third quarter on.

Moving on to the performance of our main business lines, starting on page 4 with SH1, in terms of commercial performance, as I mentioned in the beginning, premiums written grew roughly 12% YoY. The effect of a very strong performance of credit life, which grew 41% YoY but term life and rural also presented a good performance; term life was up 8.5% and rural grew 7.7%. Regarding the operating metrics, loss ratio was up 530 bps YoY, and this was totally given to a higher frequency of claims in term life, it is very usual during winter time, and higher frequency and severity of claims related to rural machinery, and an increased volume of claims related to crop insurance, and here was regarding to the drought that affected the corn crops in some states in Brazil. Acquisition cost, we made it almost flat on a YoY basis, and G&A ratio was down 230 bps, partially offsetting the increase in the loss ratio, but not enough to avoid the impact in the combined ratio, as you can see on the lower left-hand side, which worsened by 3.1% YoY. Financial results were down 18% on a lower average Selic rate, partially offset by the increase in the volume of financial investments, and the higher inflation in IPCA which helped somewhat the accruals on inflation protected securities classified as held-to-maturity. And when we look at the final outcome of all these moving parts, net income on a recurring basis was down 11% reaching a ROAE of 52%.

Going now to our P&C business, on page 5, premiums written were down 4.3% YoY dragged by casualties in general in the independent broker channel, while the auto insurance premiums were up 4% YoY. Regarding the operating performance, loss ratio increased by 200 bps, on a better performance in the auto insurance



segment, commission ratios remained flat on a YoY basis, while G&A worsened by 160 bps, dragged by higher impairment in premiums receivables. As a result, combined ratio improved by 4 bps YoY while financial results was down 41%, pretty much in line with the decline in Selic rate. So, the recurring net income dropped by 58% YoY with 3.1% ROE.

On the next page, we have our performance on private pension plans. Contributions were down 13.6% YoY, and redemption ratio increased by 30 bps, mainly due to the volatility of the forward yield curve throughout this quarter, which scared a bit our clients, and made our life more difficult in terms of raising new deposits for pension accounts. As a result, net inflow amounted to 1 billion, down 69% YoY. Pension reserves stood at 243 billion, 13% over the last twelve months which is helping management fees to keep growing, 15% growth YoY despite of keeping that trend of declining the average management fee charged, very much in line with what we have been seeing in the former quarters, 1 to 2 bps down per quarter. Cost to income ratio increased by 610 bps while financial results declined by 6.3% - worth reminding here that the financial results of the second quarter last year were helped by the IGP-M deflation, what we didn't seen in 2018. So, that is why the financial results declined, and as a result, net income increased 14% YoY, which is equivalent to a ROAE of 43%.

On premium bonds, on page 7, we managed to keep a very strong sales performance, with collections growing 20% YoY this quarter, but on the other hand, we recorded a net investment loss, given the spike in the forward yield curve; our net interest margin was compressed here by 300 bps, reaching 0.6% in the second quarter. So, the company is very sensitive to financial results, is the most sensitive that we have in the conglomerate, we ended the second quarter almost at break-even, with a loss of R\$ 654 thousand as opposed to a net income of R\$45 million in the second quarter last year.

And finally, on page 8, our insurance broker, as you can see on the upper left-hand side, a strong performance in sales in credit life, mortgage life, and the premium bonds rose the brokerage income up 4% YoY, but the net income of the segment declined by 3% YoY given weaker financial results, and the compression of the EBIT margin. The compression in the EBIT margin was totally driven by the increase in the total items sold. As you can see here in the chart, in the lower right-hand side, total items sold rose 134% YoY in Q2, and 66% YTD to June, and it is worth clarifying that, given the still challenging economic environment, we decided to shift sales effort a bit more towards lower-ticket products like from sort of term life insurance products and home insurance, to enable us to keep selling without committing too much of clients disposable income. We are also going to offer some up-selling opportunities in the future as the macroeconomic environment in Brazil improves. But on the flipside, this strategy takes a toll on the EBIT margin in the first moment, as the cost of the product sold consumes a bit part of the commission, and it is worth noting here that the cost stayed... the reimbursement cost is paid on a cash basis, while the brokerage commission is deferred throughout the risk term of the product. That is why it is common to see some margin compression when we have this spike in the number of items sold but this is a one-time effect that might be diluted overtime.

And to wrap up the presentation, on page 9 we have our guidance monitor. So, YTD through June we underperformed the guidance. Our recurrent net income was down 6.8% when we expected the net income to stay within the range of -2% to +2% for the full year. And, it is worth mentioning that as we discussed in our last earnings call, this underperformance in this first half of the year was already expected, given the scenario of interest rates in 2018 as opposed to the scenario of interest rates in 2017. We were expecting to see a convergence to the range in the second half of this year, as we were expecting easier comps for the interest



rate. But the main point that led us to revise the guidance range from -2% to +2%, to -6% to -4%, was related that besides being expected, the pace of decline that we saw YTD through June at -6.8% was slightly higher than the one that we were predicting. But, it is worth noting that throughout the semester, many indicators behaved differently from what we were expecting like some internal factors, we saw the trucker's strike... and also external factors, like rising estimates for interest rates in the US. So, the consensus for GDP growth is lower now than the one that we had when we released the guidance. The unemployment rate stopped to improve. And there was a huge volatility in the forward yield curve, which impacted not only our financial results but also the return on our clients' pension accounts. So, given this background, we decided to suit our estimates, we adjusted the net income variation to this new scenario, but if we were to look more carefully and understand why we have this underperformance in the first half, the main deviation from our estimates came in the performance of SH2. I would say that roughly three quarters of it came from the commercial performance in... sorry, came from the operating performance at SH2, and the balance came from a weaker than expected performance in pension plans. So, both effects, they were... they can be considered as temporary. The current situation in SH2 is already addressed. Just as an update, we received the first one of four approvals. We received the approval from the Brazilian anti-trust agency some weeks ago. And also regarding to the commercial performance at the pension business, it is more a matter of the current economic environment, which we expect that might improve when these uncertainties reduce, when we know who is going to be the next president of the country. So, that is something that emphasize why we think that these can be considered temporary. But it is worth highlighting here that despite the tougher environment, we managed to increase our operating results by 4.5% YTD which can be a good proxy of how much earnings could have been growing without the negative hit from the lower interest rates and financial results. And there is another important point here, in line with... when you look at the line that is showing the fastest growth rate - credit life - it's the one that has the longest period of deferral. I mean, we are not seeing yet the benefits of this strong commercial recovery, in SH2, SH1. It is going to accrue in the P&L over the next 2 to 3 years. We can make it tangible by analysing unearned commissions at *BB Corretora*, which reached the balance of roughly 1.7 billion up 8.4% in 12 months. So, it is future results that are going to accrue to the P&L. We are quite confident that we are building a very strong future earnings stream, and we are committed to delivering an earnings performance within this new revised range for 2018.

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

**Moderator**

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

\*\*\*\*\*

Our first question comes from Mario Pierry with Bank of America.

**Mario Pierry**



Good morning, everybody. Let me ask you two questions. First one, the strong growth that we saw in credit life premiums up 41% YoY, I wanted to hear from you the sustainability of this growth, what is driving this growth, at what level or at what range can this be maintained. The second question is related to the capitalization business. You mentioned, right, that this business is the most sensitive to interest rates, or to lower rates; you are running at a loss right now. Historically you used to post around R\$ 45 to 50 million per quarter in gains. Do you think you can return back to those levels if rates don't move or is this the new sustainable profitability of this business with interest rates at the current levels of 6.5%? So, I am trying to get from you is much more of a sensitivity of the net income to interest rates at *Brasilcap*. Thank you.

**Werner Suffert (23:23)**

Hi Mario, Werner speaking. First, about credit life, the growth that we had during this quarter is a very strong one, 41% or 55% in the first half of this year, is a very strong one. Of course, this is not the level that we expect to sustain throughout the years, as we are rebuilding this portfolio in our company. This is the kind of business we will have the first quarters. At the debt, of course, of higher premiums coming from this, this portfolio, it would be harder to sustain the same level of growth. But from the first quarters, first months of this new cycle, is the kind of level that we have. Of course, when we have SME's credit life improving at the same pace, this will boost even more this growth coming from this shorter term for credit life products, comparing with this payroll loans in credit life products that are longer than the SME products. So, the effect that we will have in the coming quarters will be positive from this line, and because Banco do Brasil, they are also doing a very strong effort to increase their payroll loans, and we believe that we will be able to increase our penetration inside this payroll loan book from Banco do Brasil, we are quite confident that this pace will continue and be very strong in the coming quarters, with a positive impact in SH1, with a very strong positive effect also in our broker. So, this is for credit life.

For the premium bonds business, we of course have now in this business our results coming, they are coming from two sides which we need to, to look at in this business... And looking the distribution side and the, our... the... the part that we have in *Brasilcap*, so of course that ROE is now... smaller than the one that we had last years. Because of the level of interest rates that we have nowadays, that with an interest rate increasing in 2018, like it is expected by Focus estimates, to something close to 8%, this will be enough to bring a very good level of profitability to the business again. And with the commissions that flows to the broker helping to improve our margin. So, this will continue to be an important product. Of course, clients that we believe that they are able to move to... from these shorter term-accumulation products to products that are longer life, pension plans, we are also trying to do this effort, trying to move them from these premium bonds to pension plans, as soon as we are able to change their mindset and change their goals and making them choose... they will be able to understand that these longer term products are better in the long term.

So, this is a long-term objective for *BB Seguridade*, but until we reach this kind of cultural awareness from our clients, we will continue to have as our peers, good contributions coming to the premium bonds business *Brasilcap*. So, this level will change from now to higher interest rates, like 7.5% or 8%, that's the average Selic rate for 2019, it will be enough to improve the ROE of this business but not enough to reach the same level that we have when the interest rates were higher than 14% for one year. So, this new level will keep our growth coming but in a different profitability than the ones that we had in the past.



**Mario Pierry**

Ok, Werner. Very clear. Since you mentioned *Brasilprev*, you're trying to make people shift their investments of their choices into longer-term products... We saw *Brasilprev* declining contributions as well. If you can give us some colour here that this drop in contributions... is it related to your market share normalizing, or does it reflect the slower environment for the market?

**Werner Suffert**

Mario, there is a blend of these effects, of course. We have reached in the last quarters, levels of market share that are very above our fair share in this market; reaching more than 50% in net inflow, or even more than 43% in contributions. So, this is much more than we have in all bancassurance products. Besides, of course, rural insurance, but all other products we have less than, or I'd say close to 25%... from 20 to 25% of market share. In this case, our AuM from this business is close to 30% of the market share. We are enabled to sustain this level of market share in reserves, and this is our main goal. So, of course, with this change in the mix that would have with clients who with smaller, smaller tickets coming from insurance products as Rafael explained, and also from pension plan products, to change this... the quality of this increase in reserves to a more... to decrease the concentration that we have nowadays in high net worth individuals, to clients from the retail banking part of Banco do Brasil clients... So, this is a very important strategy in the long run, but of course there is a price to pay in the first quarters. This is part of this strategy, but also an effect of the competition that changes and increased in recent quarters. And on the other hand, you have also this short-term effect that we had in the end of May, beginning of June, linked to the strike from the truck drivers, and this affected the forward yield curve and affected the return on June. So, when we look at this and use the information that is already available on the market, looking at the performance that we have from June on, we will be able to see that the returns are increasing again.

And when you look at the YTD-returns from the same funds that we have, comparing with our peers, *Brasilprev* is very well positioned in the first products with higher returns distributed in Brazil. So, we are quite confident that this trend will continue but as you said, of course, this... in some quarters, we achieved some very high levels of market share and now this is starting to stabilize. It is important to mention that we will remain leaders in the segment, if we look the contributions, we are leaders in reserves as well. So, our target remains in the leadership, with very good margins coming from these products.

**Mario Pierry**

Thank you very much!

\*\*\*\*\*

Our next question comes from Carlos Macedo with Goldman Sachs.

**Carlos Macedo**



Hi, good afternoon, gentlemen, Werner, Rafael. There are a couple of questions, just following up on Mario's third question, on *Brasilprev*. You say you are moving to... away from the prime, or based on focusing not as much on the prime, going to lower tickets to reach out investors, maybe try to bring in some of the people that, perhaps, some of your clients that were investing in *Brasilcap*... what kind of potential do you see in that specific market? How much do you think you can penetrate, incrementally rather... I have to imagine that you already penetrated with some degree today but how much do you think *Brasilprev* can gain going into that, how much would that represent in adding to your reserves?

Second question, you talk about... you talked about earlier, of an inflection point coming. And that would, that would be slightly delayed... when you look at the year over year growth for most metrics in terms of... written premiums across most of the businesses, it's a very "hit-the-bottom" and it is now moving up, even though it is still negative in many places. Is it going to be a slow recovery because of the way the GDP behaved, or is it just going to be a lower peak when that finally recovers... What should we expect, giving that you guided lower net income? Does that mean that net income next year in grow is going to be higher, because you are going to be at the same level, or really just push that up [unintelligible]?

#### **Werner Suffert**

Thank you, Macedo, for your questions. The first one is linked to the lower ticket products in *Brasilprev*. This is a trend we, our... one of our goals there, and it is an strategic initiative that we have in place. To reduce the concentration of clients that are responsible for these reserves in *Brasilprev*. Of course, this is also linked to some cultural aspects. So, we need to increase this portfolio in the... in the *Estilo* client base is more difficult than in this. In the retail banking segment, broadly, this is linked to some changes in the cultural behaviour of the average Brazilian. We are trying to do that, we think that lower interest rates environments, they are a good way to do that. So, and also, we think that with this new platform, this digital approach, trying to sell these products and clients trying now to have access to this kind of products via digital platforms, this will increase the size of this market, and we will try to move up our client base, that already *Banco do Brasil's* client base to these products. We already have these kinds of products available in our mobile platform for *Banco do Brasil*, and we are trying to increase this portfolio as fast as possible to capture this growth. But we don't think that this will be a short-term change in these reserves. It is something that we need to start now, and there is also our initiative in *Ciclic* trying to capture these non-banking clients. We want to have these pension plan products. But trying to... we are trying to reach all the alternatives to improve the quality of this increase of this AuM on *Brasilprev*, and we think that this initiative in place, to reduce the concentration on our client base for *Brasilprev* is a very good way to reduce the pace of reduction, of decrease of the fees that we are charging there. So, it is reducing each quarter, and one initiative in place to reduce this pace, is this change in the concentration of our client base. Not something that will have an effect in the next couple of quarters, it is something that we will have a positive impact in the long term. But it is very important to start now, because in this interest rate environment we believe that this is a good initiative to implement.

On the other question that you had...?

#### **Carlos Macedo**



It was regarding the growth, I mean, you already mentioned... [In terms of growth...] The question I think I should rephrase it. You lowered your earnings expectations for growth for this year. For next year, are you still the same earnings level or do you lower that too, do you expect the minimum rate, or possibly going higher next year...do you think you can accelerate growth next year then?

**Werner Suffert**

I'd say that when you look at the operational results, that improved 5.4% in the quarter and 4.5% in the semester, and it will continue to improve throughout the year. So, this is – I'd say – the best way to look to 2019. We are not going to have this headwind coming from financial results, and also maybe the average Selic rate for 2019 will be even a little bit higher than the ones than we had in 2018. So, this will bring some, some tailwin for us. And this will be the first time at the 3-years of this help coming from financial results. And at the same time, this new portfolio that we are rebuilding from credit life, will help a lot. We will have more the revenue stream coming from the broker, the credit life products linked to the... to inter-commissions side... revenues coming from the broker, linked to this credit life product and also the impact, the positive impact coming from SH1 with higher profitability, will guide to higher... higher numbers in 2019. It is very hard to say that now and we don't have a guidance yet for 2019, but we believe that 2019 will be easier than 2018 without this headwind coming from financial results and with better operational performance coming from our products, mainly the credit-linked products.

**Carlos Macedo**

Ok, thank you very much.

\*\*\*\*\*

**Moderator**

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

\*\*\*\*\*

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**

Well, I would like to thank you everyone for joining our Q2 earnings call, and I may emphasize that the main factors that led us to revise the guidance, they were temporary. We believe that they are not structural, and one of them, the issue that we had with the P&C business, we already addressed it. And the current - I will say - challenge that we still have in terms of raising new deposits for long-term investments in pensions plans and we believe that this is something that is going to be over once we know who is going to be the next president





of the country, once this huge uncertainty is over. We believe that post-election, the environment is going to improve a lot. But something that we might see, maybe a more stronger inflows , maybe just in 2019. And we believe that we have been building a very strong earnings' stream. We talked about the unearned commissions at the broker, which reached 1.7 billion, it is growing again roughly 8% on a YoY basis. This is totally related to future earnings that are going to accrue into the P&L of the broker, it's going to accrue into the P&L of the insurance company. So, we are quite confident that we reached the bottom, we are committed to delivering earnings within the revised range of the guidance but for 2019, we are much more optimistic considering these improvements that I mentioned, besides counting on the financial results as a tailwind from next year on, instead of a headwind like last years ... it is what we are seeing in 2018. So, thank you once again, and have a good day!

**Moderator**

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