

1Q17 Conference Call Transcript – Q&A – SULAMÉRICA

Operator

We will now start the Q&A session. Our first question comes from Mr. Thiago Kapulskis – Btg Pactual

Thiago Kapulskis (Btg Pactual)

Good morning everyone, thank you for the opportunity of asking a question. I have two questions. The first one regards your dynamics in health, we have seen this significant improvement in group loss ratio, around 300 bps and what we ask to ourselves is how better can it get? What I mean is that you are getting closer to the vertical players' ratio. So my first question is what could we expect from now on in terms of loss ratio and what is the main driver line behind this improvement? Is it co-payment, is it the management which you have been doing with Healthways, if you could elaborate on that, I would thank you. And my second question is related to the ROE. We saw SulAmérica achieving around 15% ROE last year, and we know that the interest rate will be lower this year, so the question here is if the operational improvement will be able to offset the worse financial result so that you can sustain the 15% of ROE? How do you see the profitability issue for the Company? Thank you.

Maurício Lopes (Vice President of Health and Dental)

Hello Thiago this is Maurício, thank you for the question. Apart from the guidance that we not disclosure, I can't tell you where the loss ratio will go from now on. What I can tell you are two things: as Arthur mentioned in the beginning we are making great efforts in terms of homogenize the loss ratio throughout the year, there is a set of initiatives that operations department has done to standardize the payment schedule so that it affect less the composition of the Company's reserves. The more stable payment schedule leads to a more stable loss ratio that leads to a more stable Company's run off triangle and, obviously, a more stable result. We are attempting to homogenize the loss ratio throughout the year, since 2015, so we are in the second year of this effort. What is happening in the matter of overall loss ratio is that all the initiatives that were implemented in the last years, and you have mentioned some of them as an example Healthways in health management, just to remember, we have three processes with Healthways; Coaching, part of the complex management and great part of chronic management, so we have 3 blocks here, but it is not just Healthways, we have a large set of initiatives in health management, claim management and underwriting management and this initiatives are maturing faster than expected giving us the chance to deliver better claims control to our clients.

When we look to the amount of claims that we are able to avoid on behalf of our clients we see very optimistically the trend that we have been delivering over the past few years. Obviously nothing would work if we didn't have an aware and weighted underwriting we have. Our client's management and commercial department have been very diligent in control risk appetite to not burden our portfolio because of sub-repricing or by having contracts that would not be profitable. These two departments are very diligent seeking what we agreed in our strategy for having a more profitable portfolio, meanwhile operations and other departments of the Company seeks consistent loss reduction on behalf of our clients.

Thiago Kapulskis (Btg Pactual)

Perfect. Obviously you don't disclosure numbers but can we imagine that the loss ratio level could get closer to vertical player or do you think not, even considering all aforementioned initiatives?

Maurício Lopes (Vice President of Health and Dental)

I think we need to be careful in this discussion, loss ratio is the ratio between claims and premiums, each operator will have its own target in order to remunerate its operation. Obviously vertical operators have more administrative expenses and should have lower loss ratio regardless of claim or premium their have. We have our own loss ratio target in our premium/claim composition that we do not disclosure obviously, but the fact is that you can't compare directly due to the difference in cost structure between two operations. If you look just at the loss ratio you are likely to compare things that are fundamentally unequal in the operator's cost structure.

Thiago Kapulskis (Btg Pactual)

Perfect.

Arthur Farme (Vice President of Control and Investor Relations)

Thiago this is Arthur. Coming back to your point on return, we not going to give guidance for the year, but you mentioned about if we would be able to work on offset the smallest contribution of the financial result due to the lower interest rate. Of course yes, the operation is positioned in this way and it is something that we can manage, the result will be achieved not only by the financial side but also by the other elements under our management.

Thiago Kapulskis (Btg Pactual)

Perfect, thank you for answering.

Operator

Our next question comes from Mr. Gabriel Gusan – Bradesco

Gabriel Gusan (Bradesco)

Hello, good morning everyone. I'll ask two questions. First I wanted to understand if there was any calendar effect in health loss ratio, I ask that because in the 4th quarter there was a negative effect so I want to understand if there is something this quarter that would be a positive compensation due to the 4Q-1Q effect that we can see as a non-recurrent event and still on this question I wanted to understand a bit more what happened with the individual plans since we saw 400 BPS worsening and I know that this segment is smaller and should be more volatile but I'm wondering if there was any effect this quarter specifically. Thank you.

Maurício Lopes (Vice President of Health and Dental)

Gabriel its Maurício. Thank you. The issue of the quarter I think that part of the answer is in our effort homogenize the payment calendar, continuously we are struggling to bring stability to it so, yes, can be any calendar effect. We talked about it in the last quarter that we saw claims anticipation; I don't know if you do remember, It was a complex year to everyone providers included and the calendar didn't help much in terms of medical accounts, so yes that may had been some effect, but more than a calendar effect there are this great effort of the departments, specially operations department in terms of having a better claims payment schedule providing more stability. In the matter of the individual I think you said the right thing that this portfolio is increasingly more volatile, it is reducing quickly, the churn is greater than 7%, we didn't have it for a long time, it is 7.45% to be exact and this reduction is bringing more and more volatility so it is possible see good quarters and bad quarters in this portfolio more frequently, it is getting more and more complex modeling but, in the other hand, smaller. Today it represents only a fraction of our total members. We went out of almost 190 thousand lives to 174 thousand comparing year-on-year which represents 7.5% drop and the trend remains the same, it will be increasingly residual in our operation.

Gabriel Gusan (Bradesco)

Perfect, if I could ask one more question, could you give us an overview of the medical inflation rates, since we saw the readjustment ratios to SME below 30 lives released last week and your price adjustment ratio was 19.2%, a bit lower than last year, but that was not true for the rest of the players, some big player re-priced higher they did last year, above 20%. So if you can give an overview of what you are seeing in terms of medical inflation would be great.

Maurício Lopes (Vice President of Health and Dental)

It is Maurício again. We model the composition of inflation in two different ways. So, you have a model that have a lag of some price index and this lag can varies depending on the portfolio, in other words, if you have a short of lag, and again each portfolio has its own modelling, than you are going to see lower medical inflation rates in the next periods, if it is a bit longer you are still going to see some higher inflation henceforth. The VCMH impact seeks the inflation, it isn't homogeneous among the portfolios on contrary it is pretty different in each PC portfolio. We have released a lower readjustment than we did last year in the portfolio below 29 lives object of RN-309 pool as you have seen, that's because we've find an also lower inflation rate in this portfolio. It is not homogeneous among all players obviously, there are players that increased rates and there are others that decreased too, each player has its own reality, but for us, we have already found a more controlled medical inflation, possible as a result of all the initiatives mentioned in the beginning of this call by Gabriel, Arthur and myself which regards to the loss ratio stability, claim management, underwriting management and medical management. The composition of the three blocks impacts faster in some portfolios and not so fast in others, SMEs portfolio is showing a strong adherence to some of the initiatives which has led to a lower readjustment.

Gabriel Gusan (Bradesco)

It is perfect Maurício, thank you.

Operator

Our next question comes from Mr. Marcelo Cintra – Goldman Sachs

Marcelo Cintra (Goldman Sachs)

Hello, good morning everyone. I have two questions. The first is related to competition, when we see SulAmérica's loss ratios improving for the quarter and Health ROE outperforming – at the same time we look to an also big player which reported its number one week – outperforming considerably, I wanted to understand how do you see the competition in health segment, if you don't have any concern at all, if SulAmérica should continue outperforming the industry, and in terms of re-pricing, once SulAmérica is outperforming all the players at the loss ratio side, can we expect lower readjustments than market average or not? Will you continue releasing readjustments in line with others?

Maurício Lopes (Vice President of Health and Dental)

Marcelo it is Maurício once again, thank you for your question. This peer comparison is not something that we comment on and I'm not going to give you many details. We have a very clear strategy about what we have been intending to do and I think that when Gabriel mentioned in the beginning of

the call that we are investing for a long time now, this is a fact, this movement didn't start now neither last year, on the contrary, I think since 2012 the company started its transformation process in several departments of Health & Dental products and it's has shown accelerated levels of maturity, as I had commented, and this obviously leads us to a price adjustment for the next cycle that is very particular of our Company. I can't tell you about the strategy of the other players, obviously, and I would not comment on that even if I knew. But about our strategy, we know very clear what we want to do, we think we can be consistent in our actions that we are engaged and we'll see if we are able to effectively prove our thesis in the next quarters as we have been proving for many quarters in spite of all the complex dynamics that the health market has, not only in Brazil but throughout the world, in Brazil it is aggravated because it has been affected by the economic crises and complex regulation.

Marcelo Cintra (Goldman Sachs)

Great, thank you. I just wanted to do a follow up on your last comment about the economic crises. Are you already seeing a recovering internally, do you see more demand, maybe April was a better month for you, how is this short term evolution?

Maurício Lopes (Vice President of Health and Dental)

We do not give any disclosure for April, we are closing the quarter. From the previous quarter, based in our numbers, what I can tell you is that we have a great mix to offset the losses because of the work of the commercial department. This department has been working in a very diligent way and the post-sales department has found good ways to achieve relevant client retentions. Commercial department has been able to transform complex clients in more stable contracts, for example, introducing co-participation or also making contractual arrangements that allow the customer to have a higher longevity in the Company despite of the significant loss of lives within the operations of these clients. So the creativity shown by the sales, post-sales and retention departments has been resulting on maintenance of relevant balance. Obviously the whole country wants the economy to pick-up again so we do not have to discuss this topic in a day-to-day agenda. But this is a conversation to the next quarters. Let's see how it'll take place.

Marcelo Cintra (Goldman Sachs)

Perfect, thank you.

Operator

Our next question comes from Mr. Gustavo Lobo – JP Morgan

Gustavo Lobo (JP Morgan)

Good morning guys. I have two questions; first I just wanted to go back to the smoothing of health results issue. I would like to understand what is the loss ratio trend? Because when we look last year's number we saw an improvement in group loss ratio in the first 3 quarters of the year and a worsening in the last quarter but in the full year vision remained stable. Now, the year have started and we are seeing an improvement in loss ratio in the first quarter again, so is it an improvement trend or is it a smoothing signal, thinking in the full year 17 is it a stability scenario, an 300 BPS improvement scenario? After that I'll have my second question. Thank you.

Maurício Lopes (Vice President of Health and Dental)

Gustavo I would like to give you guidance, I swear to you, would make my life simpler, but anyway, we cannot give guidance, unfortunately we can't. I think that there's consistency in our work. It is the only thing that I can tell you.

Gustavo Lobo (JP Morgan)

It is clear. My next question is about Auto insurance, as Arthur mentioned, it has short cycles and we've seen some sights of improvement. In terms of loss ratio it sounds like things will be adjusted in the short term for the whole industry but my question regards growth because part of the adjustment is to restrict sales in high risk levels places so I would like to know how are you seen the growth trend of the whole industry in the short term. Thank you.

Eduardo Dal Ri (Vice President of Automobile and Massified)

Thank you Gustavo, this is Eduardo. In terms of growth we will naturally follow the evolution of the economy and Brazil's recovery, paying more attention to the automobile industry, more specifically in terms of new licensing that will be a fundamental drive to the recovery of the market. It is important to remember that when we talk about earned premiums, part of its recovery will come from this improvement of the economy and part will come from the adjustments the market is making in average premiums. So there will be a combination between economic recovery – and we cannot tell when it is going to pick up but it is worth remembering that regarding on the recovery of vehicle sales we already arrived at the worse level, Brazil lost almost 50% of its annual production of vehicles or licensing, that is what we are most interested which is the domestic market, so Brazil has all this restrained demand then between short and medium term we will see that recovery before any other sign – and before the recovery of the economy is the increase in prices that market wants and need to do. So this combination will answer your question regarding the growth, in the short

term it will be driven by the market price increase and secondly the growth in industry.

Gustavo Lobo (JP Morgan)

It is clear, thank you.

Operator

Our next question comes from Gustavo Schroden – Bank of America Merrill Lynch.

Gustavo Schroden (Bank of America Merrill Lynch)

Good morning guys, thanks for the opportunity. I'll ask you two questions. I wanted to understand, you commented at the beginning of the presentation about consolidation, how this process of consolidation is happening and how it relates with these figures for membership numbers that we see, mainly corporate and SME, since year-on-year corporate has fallen by 6% and we see stability quarter-on-quarter and SME shows the same stability trend. I wanted to understand how the consolidation process is going and how it relates with this stability, and even decrease in some cases, in health members. And my second question, I just wanted to go back a little bit to the price issue, you're in the re-pricing process and one of them has already come out - and I totally agree that, I don't think it's valid to compare companies pricing because we are talking about different structures, strategies and models, but specifically thinking about SulAmérica – do you think you can repeat what has happened in the last three, four years, that is a repricing that has been, in my point of view, stable, maybe with 100 bps or 150 bps drop from year to year, but which have been enough. Do you think we can expect another year of repricing, let's call it solid, right, that is, enough to help in the loss ratio? Thank you

Maurício Lopes (Vice President of Health and Dental)

Hi, Gustavo, it's Maurício. Thank you. The issue of consolidation, and I think Arthur has explored a bit the point in his speech, it's happening because of a set of external movements - a good part of them completely exogenous to the actions of the operators - and this is a game of scale. Given that there is a lot of negative homogeneity, given that you have a recessive environment, the pool of customers in the market is shrinking or you have a slightly stronger regulation with health plan operators who didn't compose reserves over the year needing to address that. In the last few years, if you don't have enough scale to keep a sustainable operation and to invest in innovation, the world gets a bit more complex. I always note the work that the area of operations did, for example, on prior authorizations of procedures. 10 years ago, or less than that, this area was formed by general practitioners and today it only has medical specialists: the doctor

who makes the authorization of an oncology procedure is an oncologist; the one who makes the authorization of an orthopedics procedure is an orthopedic surgeon. This can only be achieved with scale. Obviously smaller operators will not be able to have sufficient scale to reach this level of specialization, which in this case makes a pre-authorization process more specific, more adequate for both the patient and the requesting physician as well as for the operator at the same time, it's a win, win, win situation. So I think consolidation has been happening, it's happening regardless of what we want to do, in an organic way. Not all operators are losing members, I think some of them are, but several operators are gaining members, we are not the only ones, there are others gaining members, which means the market has opportunities coexisting with difficulties for some. I do not see a process changing that, I think the macroeconomic scenario and regulation will continue to impact operators in the next cycles, at least I think it's a market consensus. In the matter of pricing, if in fact we see a drop in inflation as we are seeing overall, and as there is a lag in all portfolios in relation to general inflation, this will obviously reflect in pricing in the future. We still do not yet know exactly, now we started the discussion on the issue of repricing of two other portfolios, we should conclude the discussion this month, still impacting this quarter, but it's still being discussed. The only one that we have already defined was the RN-309 pool that has already been released, it's the only figure for the moment. Thank you.

Gustavo Schroden (Bank of America Merrill Lynch)

Great. I just wanted to do a follow up on the first question, if I understood, if this migration didn't happen, this consolidation of these minor operators benefiting you and other players, but mainly you here in the case, do you think that the behavior of the number of members would have been worse than what we are seeing, this year-on-year drop and a quarter-on-quarter stability, can I read it this way?

Maurício Lopes (Vice President of Health and Dental)

Your interpretation makes sense, it sounds correct to me.

Gustavo Schroden (Bank of America Merrill Lynch)

Great, thank you.

Operator

Our next question comes from Lucas Lopes – Credit Suisse

Lucas Lopes (Credit Suisse)

Good morning, everyone, I also have two questions. The first one, I wanted to go back to the homogenization of claims throughout the year, I wanted

to understand if and how this change in the payment schedule for the providers changes the loss ratio in the full year. My second question is related to auto. Apart from re-pricing, price increase, etc., is there any other strategy that the Company has pursued to structurally improve the claims levels, or in terms of geographic diversification, but I especially wanted to understand about launching new products, encouraging products with different coverage, etc. Thank you.

Eduardo Dal Ri (Vice President of Auto and Massified)

Lucas, I'll start with auto to give my friend Maurício a breather. It's Eduardo talking. Yes, your question is well placed, very timely. Price is just the backbone of all this, of course, and given the challenges we had in the auto portfolio in the last year and a half, mainly impacted by theft and robbery in Brazil as a whole and more evidently in some capitals, this all drove SulAmérica to react to this scenario and change more than just price. I can highlight some things here for you, for example, the creation of a new product very in touch with the crisis and the current customer situation which is the *Auto Compacto*, a product that has all essential coverage, but with more appropriate price in regions that we are prioritizing. It is not a product sold to all customers, it seeks a better cost benefit for the customer, but keeping the profitability levels we expect. We have worked very hard our costs in the operations, we have been working in several fronts, we have been optimizing processes, from administrative expenses to a stronger position in regulation, in other words, we are getting better every day. I could mention the sourcing project, related to the supply of auto parts, which has been a success and is growing every month, the so-called call closed claims review, i.e. we are learning with previous claims and reprogramming ourselves to be more efficient, so each cycle we become more efficient. We have been acting carefully, driven by the current moment, on frauds, we have raised our bar, our requirements, our attention to this point, we have very strong actions in that regard. We are also looking at those capitals that are insistently suffering from robbery and theft, and we are repositioning ourselves in regions that have a greater stability in this index. I could mention Rio de Janeiro, which is the epicenter of theft and robbery in Brazil, unfortunately we had to reduce our exposure to Rio de Janeiro and expand in other regions, which, despite having a lower average premium, allow for a more stable portfolio which is more appropriate to our targets. Thank you.

Maurício Lopes (Vice-Presidente de Saúde e Odontológico)

Picking up here, Lucas. It's Maurício again. There are two issues on the table here: the first one is the homogenization and the second one is the year's loss ratio in the year over year comparison, you've asked both questions. In relation to the homogenization, we are talking about a great effort being made when it comes to the payment schedule, the work we're

doing is trying to make the payment schedule more homogeneous throughout the year, which means to take a day from this week, add a day to that other week, or take two days from here and add two days there, this will bring balance. The second question is what to expect for the year, we do not give guidance, but I think three factors must be discussed in your reading: how prices/readjustments/retention will be defined for the year, you already have one of these indicators and the other two will come out; the speed of maturation of the actions to control claims, be it of health management or claims management; and sales dynamics, mix of products and regions. The composition of the three factors will give the loss ratio of the year, we are only in the first quarter, which means we cannot, even if we wanted to give guidance, we do not have all the factors that will define the year, there's plenty of water to run under the bridge. The month of July specifically, June and July, are very important month to us, it's when we define relevant readjustments of the portfolio of large corporate contracts, individual plans, which means that next quarter we will already be in better conditions to look at the year's trend, because we will have several of the indicators of retention and price already defined. Now in the first quarter I think it's still too early to try to make any kind of guess about the year given that this huge set of variables is yet to be defined.

Lucas Lopes (Credit Suisse)

It's clear. Thank you, Eduardo and Maurício.

Operator

Our next question comes from Eduardo Nishio – Banco Plural

Eduardo Nishio (Banco Brasil Plural)

Good morning, everyone, thank you for the opportunity. Two questions as well, the first one is related to health, sorry to go back to the point of the smoothing of the loss ratio, I just wanted to understand a bit more how this payment schedule adjustment is done, and if it's the only measure you are taking to do that. At this point I wanted to know if the renegotiations, the contracts, remain mostly in the middle of the year or if there is also a shift of these negotiations with the clients during the year. In relation to auto, I wanted to have an idea of trends in this issue of theft and robbery, if you are still seeing a relevant worsening in this first quarter and if you could break it down by state, in Rio we know there is have a very serious fiscal problem, then Minas is another state that is in serious problems, Rio Grande do Sul, and finally São Paulo, which is the largest auto market in Brazil. I wanted to know how you see this trend, if you cannot shed some light for the year, but for the first quarter, how you are seeing the theft and robbery dynamics. These are the two questions I have. Thank you.

Eduardo Dal Ri (Vice President of Auto and Massified)

Eduardo, this is Eduardo speaking. I will start with auto. We have seen a strong increase in theft and robbery in the last two years, as I said, Rio de Janeiro is the one that suffers the most with theft and robbery, in those two years it has risen more than 60%. People did not feel that much in São Paulo, although in the first quarter they felt it, but when we say that in São Paulo it has increased by 3%-4%, it sounds like a joke compared to Rio de Janeiro, so São Paulo still has stability in this indicator thanks to public policies that have been implemented and which are different in each state. Theft and robbery has also grown mainly in the metropolitan areas of the states you mentioned, I highlight Porto Alegre, Belo Horizonte, there was also increase in Recife, Salvador, among other capitals. What is the trend? We believe that theft and robbery will go along with the recovery of the economy, if the economy recovers, with some delay, theft and robbery can also recover. It is important to say that neither we nor the market are working with this scenario yet, because, as we price next year, I cannot afford to model a recovery in theft and robbery, on the contrary, we are already pricing this worsening we had in the first quarter compared to last year, as well as in comparison to 2015. This issue of robbery and theft is quite serious, we had not yet seen such a rapid increase and the market as a whole, especially SulAmérica, are seeing the trends and still not projecting a possible improvement. This should not be seen with pessimism, on the contrary, as we look at reality, price it, and if the market can do this pricing, of course, the loss ratio can return to the target of each player, so we are not foreseeing improvements despite the fact that, yes, it may happen, but today levels are very high, we hadn't seen this in the last few years, so it might improve, it's true, but we are not working with this scenario.

Eduardo Nishio (Banco Brasil Plural)

OK, thank you very much.

Maurício Lopes (Vice President of Health and Dental)

Talking about the calendar effect, let me spend two minutes of your time to try to explain what the calendar modeling is because I think it's not getting very clear. The way we work, and each operator has its way, is by defining a quarterly calendar sent by the area of operations to all providers and this quarterly calendar tells which are the windows for medical bills to be sent to the insurer. You can send bills in the week from this day until that day, then from this day until this other day, after such day to such day. These batches, once received, are processed and sent to be paid according to this calendar. Two years ago or so, the Company's actuarial areas, in a big effort, tried to model how we could do two things at the same time: the separation of the days within this 365-day rule that we have, if there's a holiday, if there are no holidays, if there's a weekend or not, if it's long month or a short one, etc.; and the second part of the work is to, on each

of those days, look at which are the competencies within them, that is, March 25th, this day will fall on a hypothetical Tuesday, there are 75 competencies on this date and these 75 competencies have working days, non-working days, strong days, weak days, weak Fridays, strong Mondays, more or less weak Sundays, this modeling, it is very complex, takes a long time and it has evolved very fast in the last two years and that is why we are managing to bring this improvement to the calendar, in the homogenization, that is, it is not only talking about what day falls on one period and what day falls on the other, it is to know precisely what you have within that specific day, you can have a week that has 9 days of billings, but these are 9 weak days, not days of relevant bills, so, even though we have a 9-day week, which is not normal, it has a lower volume of claims, on the other hand, you may have 4-day week which has very strong days, days after holidays, days in July which have a strong seasonality, lots of COPD cases, lots of emergency room occurrences, so, there is a shorter week, fewer days of billings, but these are very complex days, very strong days, and it's this whole math that is perhaps bringing this better homogeneity to the calendar. So, it's complex to explain, I apologize for the long and complex explanation, but it's because it's complex to model as well. OK?

Eduardo Nishio (Banco Plural Brasil)

So there is nothing to do with price renegotiation with customers, right?

Maurício Lopes (Vice President of Health and Dental)

The Company's good results are due to three big blocks: underwriting, claims management and health management. There are a lot of areas of the Company working on these issues, from renegotiation with providers, made by a team, to the authorization, made by the another team, audits, contract renegotiations, customer retention, the good result is due this whole work. Intra-trimester homogenization is a calendar effect.

Eduardo Nishio (Banco Plural Brasil)

No, that's perfect. Calendar effect. There is nothing to do with a change in the dates of renegotiation of contracts with customers, right?

Maurício Lopes (Vice President of Health and Dental)

No, the two things are not linked, I cannot tell you if there is one, or two, or three basis points more or less in the quarter on account of a renegotiation, it's everything together.

Eduardo Nishio (Banco Brasil Plural)

Perfect. Thank you very much.

Maurício Lopes (Vice President of Health and Dental)

Thank you.