



3Q14 Conference Call Transcript – Q&A – SULAMÉRICA

Operator

Thank you. We'll now start the Q&A session. (Operator Instructions) Our first question comes from Mr. Gustavo Schrodén from Bank of America, Please you may go on.

Gustavo Schrodén, BAML

Good morning, everyone. Thank you for giving me this opportunity. I have two questions. The first is regarding the combined and loss ratios. Despite the price increases you recently implemented in the middle of the year, like you usually do, and considering that these price adjustments have been among the highest relative to recent years, the loss ratio in the health segment as well as for the company overall is still above or higher when we make the annual comparison, whereas in comparison to the previous quarter, the ratio of course improves.

My question is as follows, is there any expectation from now on or in the future, that you will be able to reduce the loss ratio for the health segment and for the Company? When we compare year-over-year, is there a possibility for improvements in terms of price increases, or maybe an improvement coming from the frequency of plan utilization which has also been very high for some time? The combined ratio has also been above near 100%. So, do you foresee at any point in 2015, a reduction in the combined ratio to below 100%? That's my first question, then I'll ask the second one

Arthur Farne d'Amoed Neto

Hello, this is Arthur. In general, we are not satisfied with the combined ratio at this level. This is in part due to the medical loss ratio, since acquisition costs area not at elevated levels. The current levels can be attributed more to the health segment, and to an extent, the auto segment. The combined ratio will improve to the extent that the heath environment improves. This is not a situation that is exclusive to SulAmérica, it is characteristic of the industry, with elevated levels of plan utilization being observed. There will come a time when the measures we have been taking have an effect. Aside from increasing prices, we have been taking a series of actions during the recent years – we have positioned ourselves as a leader in well-being and health management, which ultimately improves the situation. In the

Company, we have been investing in technology, systems and models which will improve loss ratio levels. We entered into agreements to purchase materials and drugs for use at hospitals. We've entered into the supply chain to reduce our exposure to prices in this segment. So, I'll ask Mauricio to comment specifically about how they are working in the portfolios, which he follows.

Mauricio Lopes

Hello, this is Mauricio. What we are finding, in line with what we commented on the last call, is that although the ratios are higher than expected, client retention levels have not lowered substantially. One contract or another has left the portfolio, but we have relevant levels of new sales that have offset this reduction in contracts and have contributed to premiums levels during the period. Until now this year, we have sold 250,000 lives, which is a good figure added to our portfolio

In terms of the frequency of plan usage, there is a structural issue that we are aware of, however the various actions that we have implemented, particularly since the middle of the year, have begun to generate results and this is quite exciting. It's a long and challenging process, it takes time to develop, for example, direct purchases of materials to be used at hospitals, direct supply of oral chemotherapy, which are provided directly to insured members as well as mechanisms of relationships within the network that are more sustainable for the involved parties.

We're developing various initiatives – despite the structural issues that are complex -- we are implementing the necessary and sustainable tools for health, claims, and pricing management. So, we continue to work in a dynamic way to try to implement these changes in the short and medium term.

Now, I'll pass the floor to Beto, to comment.

Carlos Alberto Trinidad

Hi, Gustavo. Speaking about the auto segment a bit - I think what we saw during the last nine months was a decreasing loss ratio due to the cycle of prices that the industry has been experiencing. The auto segment is cyclic in terms of prices. This year we also have experienced an increase in the levels of robbery and theft. These two factors impacted that market a bit, especially in the first half of the year where we had very high levels of robberies and theft, which diminished in the second quarter and to an extent in the third quarter. However, we are still not even close to the levels observed in 2013 or in 2012, which were much better in terms of loss ratios.

In the auto segment, we have also observed a declining price movement in the second half of the year already being observed in some companies. And also, there is a downward price movement, specifically in the truck insurance segment. It is our position not to follow these downward pricing movements. We want to preserve the value and results of the company and avoid negative impacts in 2015. Our actions today will be reflected in 2015. We want to protect our portfolio and the Company's results.

This is a typical dynamic in the auto segment and those who are too aggressive will pay the price and eventual costs in the future. Anyhow, the fluctuation in our loss ratio is not that relevant for the quarter and we have been able to maintain a good gross margin. Our challenge is therefore stay at our traditional levels, which are attractive to us.

As for P&C, I think that we should also talk about the loss ratio as well, because we have been able to be well-positioned in the portfolio through a good strategy with massified products and in the marine portfolio. So, we have been operating at a loss ratio of 55% with a gross margin above 20%. This is where we want to be. We want to improve the loss ratio more and more, we are going towards that and the massified portfolio is very relevant for this objective.

And it's important to show that this fluctuation of these ratios also has to do with the seasonality of each portfolio in transportation. When it rains more, you have more accidents with equipment and with farming equipment you also have more problems when there is a drought. Each portfolio has its own dynamics that cause fluctuations, but we believe the range is very positive and we are going to continue improving.

And finally, in the life segment, as we are talking about the loss ratio – we have stabilized in the range of 40% to 50%. And again, our expectation is that, as of now, and looking forward, the portfolio will demonstrate growth due to the repositioning for the portfolio initiated in October of last year, achieving gross margins of 20%. So, I think loss ratios are doing well considering the auto segment has been impacted by market pressures since June.

Gustavo Schroden

Okay. I think this was a lot of information, but trying to be a bit more objective, do you believe that at some point in 2015 we will see the Company's loss ratio overall, on an year-over-year basis, decrease to lower levels – or do you think that there is a structural problem especially in the health segment that will continue to pressure loss ratios and we are going to continue to be 1 to 2 percentage points above the year before?

Arthur Farne d'Amoed Neto

Gustavo, this is Arthur. It is a bit difficult to give you guidance for 2015. What I can say is the following. The actions that we have implemented are aimed at decreasing the loss ratio. As Beto commented, the company is not deteriorating its pricing policy. Looking towards the future, this means that we expect 2015 to behave in line with our expectations for the loss ratio. As Mauricio mentioned, as far as actions taken in the health segment, we have been working to reduce loss ratios. Again, we do not price contracts to have investment income offset operational losses; this is not something that we want. So, the idea is to have a reasonable loss ratio in auto, in health, with good investment income reflected in the operating ratio because of management's actions and strategies.

Gustavo Schroden

Okay. Thank you very much. I am going to the second question. I would like to talk about your savings bonds product in SulaCap. Savings bonds collections grew 16% year-over-year. If you look at the previous quarter, growth has decreased. What would you consider a reasonable level of growth for savings bonds collections from here on, given the fact that the segment has reached a certain maturity? And also, in SulaCap, what has been your main distribution channel for the products?

Arthur Farne d'Amoed Neto

Well, this is Arthur again. It's very hard to give you guidance in terms of growth levels in savings bonds. First, these figures observed still do not capture the full potential of this company; this is something that I can tell you. The other VPs can comment on the channels that we have been using for the distribution of these products.

Matias Ávila

Hi, Gustavo - this is Matias speaking. We have been using the whole distribution network of the company. We have 89 branches and 20 commercial managers throughout Brazil. SulAmérica is a multi-line company with 30,000 brokers, 28,000 assets which really enable us to transfer these benefits to the savings bonds segment, especially with the rental guarantee products. As for the incentive and popular product lines, we have been used distribution network of the Company for these products. As a result, we have been growing a lot.

Sergio Diuana

To complement what has been mentioned, it's important to understand that the growth in Savings Bonds collections has been quite significant. SulAmérica has grown by 24% -- 24.5% according to SUSEP considering the year-to-date data until August, whereas the market grew by 5%. So, this demonstrates the force of the strength of sales at SulAmérica.

Having said that, revenue from the savings bonds segment already accounts for 13% of the total revenues of SulAmérica. So, today, this is an important segment. Let's not also forget that the acquisition happened in April last year and the physical movement at the end of June, so we're talking about little more than a year. So, there is still a lot to be done and to achieve.

Gustavo Schroden

I think it's interesting. I have a concern about competition in comparison with the other players which have a bank assurance model and perhaps a higher acquisition model or potential. Perhaps they could offer other things in terms of savings bonds. That's why I would like to understand what you are doing in terms of distribution channels to face the competition from bank assurance models.

Arthur Farne d'Amoed Neto

You have a point. I think, we are positioned with a system of products in a differentiated way in terms of our distribution channels. We have created the rental guarantee, have innovated, and SulAmérica has an important innovative spirit. We know that within the traditional bank assurance model, we are not going to compete. The potential market is very large and there is much for us to explore – Mathias spoke about our branches, we still have a lot more to work on, on the SulAmérica structure.

Matias Ávila

We have diversified structure with specialized products. It's also important to remind you that the traditional products are not closed to the company, this for us is an opportunity through the financial channels through which we have specialized selling agreements. This for us is an opportunity to enter those markets as well.

Gustavo Schroden

Thank you very much. It's very clear. Thank you for your answers.

Operator

The next question is from Francisco Kops from Safra.

Francisco Kops, Safra

Good morning, Gabriel and Arthur. Actually my question is about health and automobile. We see differences both in health, the growth in the premiums come from prices, where in automobile comes from the fleet. So, I would like to understand, in health, what was the difficulty to grow the number of lives. It's been the third consecutive year of high price readjustments. Is the company having a hard time to pass along price readjustments or is that much more to do with economic issues in terms of employment rates, etc.? In terms of the auto segment, what has been the difficulty to pass along price increases, is it a function of the competitive environment? Would you comment on that please?

Mauricio Lopes

Good morning. In terms of health, we do not see a sales dynamic that is decreasing, we see sales dynamic that is changing; we see a change in that. We've been able to sell to SMEs (small and medium-sized companies) quite well over the last year. In terms of the profitability of the portfolio, even though we have been passing along price readjustments, the levels of churn have been much lower than we imagined. So what we see is not a decrease in sales, but a difference in the portfolio mix, a change in the portfolio which has been more significant in the last two to three years. We are betting on what we have been working on - we believe that with these new tools that are being developed will provide us with a better path to profitability. We will be able to manage prices and claims more effectively and efficiently.

We've been speaking a lot about our plans for the health segment. These programs are being put into operation quickly and we expect that in the near future we are able to show you some results. We don't have this preventative culture in Brazil, many of these specific health management tools, we had to import from abroad, because we don't have them here in Brazil. So we are now implementing these tools in partnership with Healthways, the results of which should be consistently reflected in the loss levels as well as the volume of sales and maintenance levels in the future.

Ok, I now pass the line to Beto to comment on the Auto segment.

Carlos Alberto Trinidad

Okay. In terms of your question about the ability to repass prices in the auto segment, when you look at the overall segment figures, you don't have the perception of what is happening within the various portfolios. You have new cars, you have used cars, pick-up trucks, light trucks, heavy trucks, so what we can see here and I did mention previously the issue of trucks, one company in the market was extremely aggressive with pricing in trucks, and as a result, decreased our growth in this segment, however, this does not mean that we lost the capacity to pass along our prices in the car insurance portfolio, for example.

Insurance for cars and average premiums have grown for cars and there is another phenomenon that must be considered, which is the drop in sales for new cars but as a result there has been a strong growth in used car sales. In the newspapers you can read about a 20% year-over-year increase in used car sales. So, there is a migration because of economic issues. So, consumers of new cars are going to used cars. This also has an impact in our portfolio. Used cars also impact in our loss ratio, because you have a car with a lower values and partial losses with prices of new parts and rapidly you arrive at a total loss and ends up impacting the loss ratio. When you consider a one percentage point higher loss ratio for the period, you have a dynamic that is completely different. So, we have been able to pass along prices in the categories in which we have been focused on.

It is also interesting to mention that in terms of prices what really supports our volumes is the level of quotations passed being received by our sales channels. Sometimes the market thinks that we are not being able to pass on our prices, but in fact we are passing along prices in the segments where we perceive opportunities and maintaining pricing in the more aggressive segments.

Francisco Kops

Okay. So in the auto segment, it's much more of an effect of mix and your strategy. In the health segment, there are lots of new sales but you also have a lot of churn. So this is what I understood in summary of what you said. Is that correct?

Mauricio Lopes

We do not have more churn, we have the same levels of churn that we had in the past. If you look back to the last four to five quarters, we have been able to maintain large volumes of sales on average, we increase one line, and diminish the other, but we are more or less stable for some time now. You also have to take into consideration that we have had a reduction in our individual portfolio, which today accounts for less than 8% of lives and less than 18% in terms of premiums. The volumes and churn have been

maintained although our individual portfolio has declined. We do not have an acceleration of churn, it is a maintenance of churn.

Francisco Kops

Okay. It is clear now. Thank you very much.

Operator

Our next question comes from Gustavo Lobo from BTG Pactual. Please Gustavo, you may go on.

Gustavo Lobo, BTG Pactual

Good morning. I have two questions. Administrative expenses, as you have mentioned in the nine months comparison, you have the consolidation of SulaCap in 2013. Looking forward, what can we expect in terms of administrative expenses for the fourth quarter and 2015. Where do you see room for more efficiency?

Arthur Farne d'Amoed Neto

Gustavo, this is Arthur. So again, we have a hard time talking about the future, but what I can say right now is that the company has developed a procedure for controlling administrative expenses, optimizing everything that is possible. For example at SulAmérica, we had 5,000 employees and out of those 130 were brought from the structure of SulaCap. So the levels thus far have been adequate and for the future now on you can think of things that you expect the adjustments for labor costs and contract renewals contracts as a whole. There are no expected relevant impacts that will affect the level of our administrative expenses.

Gustavo Lobo

So, possibly current levels will continue and be maintained in nominal terms, but to the extent that the company grows its premiums, there is space for the dilution of the administrative expenses as the results grow or will administrative expenses remain at the same level in terms of the ratio in line with the Company's growth?

Arthur Farne d'Amoed Neto

I think it's more like the last point, as the company grows and the expenses will grow – the administrative expenses from the non-insurance lines end up not benefitting the ratio. We have also made other investments in IT, so there are also expenses from the amortization of these investments.

Gustavo Lobo

Okay. This is clear. Thank you and for my second question. What we have seen over the recent years, is a high concentration of earnings in the fourth quarter with premiums. Is there anything that the company can do to make these results smoother over the medium and long run? Is there anything that could be done to avoid this concentration at the end of the year?

Arthur Farne d'Amoed Neto

Well, yes, there is. We focus not only on the technical aspects relating to the processes that lead to this volatility at the end of the year, but also on the diversification of the source of our earnings. The savings bonds and asset management segments contribute to the income and are less affected by the volatility we have today.

So the behavior of net income is still impacted by the loss ratio held and the frequency of plan utilization etc., but the diversification of the company and its different portfolios will contribute to a leveling off and a lower dependency on the fourth quarter. In the nine months, we are in a comparatively better condition than we were last year.

Gustavo Lobo

Thank you, that's clear.

Operator

(Operator Instructions) There are no further questions. I'll go back to Mr. Portella for his final comments.

Arthur Farne d'Amoed Neto

Well, there is a final question from an analyst. I do not know if he is still in line. Yuri Fernandes from JPMorgan.

Operator

You can proceed with your question. Once again we are opening the line for Mr. Yuri.

Yuri Fernandes, JP Morgan

Good morning, Arthur and Gabriel. I just would like to ask a question about the medical loss ratio in your individual portfolio. Year-over-year, we see that the group portfolio is a bit worse even though you had higher readjustments and in the individual you have basically the same. Would there be an effect for the next quarter that has not been reflected in this quarter but could be better reflected in the fourth quarter. Does the

individual portfolio have a higher concentration of contract renewals and for this reason the result was more positive?

Mauricio Lopes

You were correct in your second argument. The individual portfolio mainly dates back to before 1999 and has a concentration of contract maturities in July every year due to the Real Plan. So you have a concentration of contract renewals and therefore you have more relevant growth this quarter. Let's remember that this individual portfolio accounts for less than 8% of our portfolio, but it is where our pricing has major changes in this quarter. As for the group portfolio, the difference has to do with the inclusion of new lives, changes in the mix of the product, and therefore a change in loss ratio. We see that whenever we lose a major contract which is what happened this quarter, it ends up impacting the loss ratio for the quarter, especially when you have any kind of loss in the middle of the quarter. So therefore, we can see some effect on the overall group loss ratio.

Yuri Fernandes

Okay. Thank you very much.

Operator

As there are no further questions, I get back to Mr. Portella for his final considerations

Gabriel Portella Fagundes Filho

Well, thank you very much. I finally would just like to extend the invitation to be part of SulAmérica Analyst Day on November 25th. This is going to be an event with a very innovative format. Access the Investor Relations website and be part of this event. Have a good day.

Operator

SulAmérica's conference call is now closed. We thank you for your participation and wish you a good day.