



## **1Q15 Conference Call Transcript – Q&A – SULAMÉRICA**

### **Operator**

We will now start the Q&A session. Our first question comes from Mr. Gustavo from Bank Of America. Mr. Gustavo, please you may go on.

### **Gustavo Schroden (Bank of America Merrill Lynch)**

Good morning everyone, thank you for the opportunity. I am going to ask two questions. The first refers to price readjustments in the health segment. I know that it's still early and that you will begin to discuss this further after June, but I would like to know how the conversations are going? What are you observing with the other players? What kind of color can you already provide us with and can we expect the same level of price re-adjustments that were observed over the last two years, principally based on the level of inflation that we have been observing? Would you please share with us what you have observed and your perspective for the year in the healthcare segment?

### **Maurício Lopes (Vice President of Health and Dental)**

Hello Gustavo, how are you? Thank you for your question.

We begin this portfolio re-pricing about three years ago, and not only us, but the whole market. This has accelerated a little more than two years ago and the accelerated rhythm has been maintained from the past year. We understand that we are continuing this re-pricing trend over time and it is being reformulated as the time passes and we don't have a definitive number that we are targeting, and each one of the portfolios have demonstrated a distinct behavior. The corporate, affinity, SME, and dental portfolios, each one behaves differently, and we are re-pricing accordingly. What I can tell you is that we have continued this price readjustment movement, and we continue interpreting that there is still space for clients to absorb price adjustments, which are necessary. Over the recent years we have needed to make these adjustments due to medical inflation, and notably due to elevated plan utilization. In parallel, we are continuously accelerating health and claims management activities. Our efforts are being directed towards the point that if we can quickly put into place these activities to control claims, as have been completed over the last two years, to structure for health management over the long-term, we would have

lower potential re-adjustments over the following periods. This macro-level work has been conducted by our teams over the last three years.

**Gustavo Schroden (Bank of America Merrill Lynch)**

This is very clear, but I would like to understand, on the one hand, do you think there has been this movement together with the other players at the same levels? I imagine that the VCMH (medical inflation) is pressuring all of the players and would like to understand if there is a movement together and therefore, this would further facilitate satisfactory price re-adjustments this year. Have you seen the other players behaving similarly?

**Maurício Lopes (Vice President of Health and Dental)**

Moving together, no. Each portfolio has a dynamic, behavior, composition, region and each player behaves in accordance with the profitability of their portfolio. Imagine that there are players with alternatives and strategies that are distinct. Our strategy is very clear, we want to make a return on the portfolio, as has done over the past three years. What we have that is similar, is the dynamic of some macro market conditions that affect all players in a unified manner, as has been observed with the hospital network, the growth in medical exams which took place over the recent years. These more macro factors have conditioned a good part of the market to behave similarly, but each portfolio behaves a certain way and each player responds in a certain way to gain profit or grow.

**Gustavo Schroden (Bank of America Merrill Lynch)**

Thats great, it was very clear.

My second question is more related to the auto segment, which was a very positive highlight for the quarter, both in premiums growth and mainly in loss ratio performance. You have accelerated premium growth, especially in the last month, reaching 10% year-over-year and an improvement of 3.0 p.p. in the auto segment loss ratio. How sustainable is this favorable environment for the auto segment throughout the year? Do you think it is a cycle that is really here to stay in 2015? Can we expect this good performance in the auto segment throughout the year? I would like it if you could discuss this a little with us, it would be interesting.

**Carlos Alberto Trindade (Vice President of Auto, Other Property and Casualty, Life and Private Pension)**

Hello Gustavo.

First I would like to tell you that when you look at March, 10%, you have to remember always that for the year, February and March compared to last year, there was indeed the *Carnaval* effect from one month to the next, so you must look at the number of business days for the quarter to have a

clearer understanding of our development, but anyway, we performed well, both in growth and in claims, a result of the work we've been doing over time. I already have been mentioning since last year about our positioning with respect to pricing discipline and the underwriting policy that we have here at the Company.

We have also been able to expand the fleet, much of which has been a result of our efforts together with the pricing strategy that we have been able to pass along when the sales occur, and this is arriving much faster through a series of specific actions, which I won't detail here. This has been conducted through the expansion of distribution capacity that ends up having an effect on the increase in the fleet. Last year's pricing to today, naturally has been affected by labor and auto parts costs, etc., which has been affecting the price, therefore we have to pass along these adjustments which are natural. Our competitiveness is good and our growth I attribute to an expansion in our distribution capacity and our actions which arrive quickly and have had an impact when sales occur.

Is this sustainable during the year? We saw a decline in new car sales, but at the same time, we saw an increase of business in the used car space, therefore, this movement could lead the Company to be more focused in this segment or in another and through this, we bring better results, but I believe it will continue. We are not going to forget that almost three million new vehicles are being licensed per year, an impact that is very important for the insured portfolios itself in Brazil and this volume will continue, which is a relevant figure. If not three million vehicles, it could be two million nine hundred thousand vehicles, aside from the trend that is being observed with used cars. Therefore, I see the maintenance of this process, certainly not at levels which we have had at 18%, 20% growth, but the market will maintain its performance as it has been until now, with the occasional bumps along the way in terms of volumes.

**Gustavo Schroden (Bank of America Merrill Lynch)**

That's ok, a great point. What percentage of the fleet consists of new vehicles and what percentage consists of used vehicles?

**Carlos Alberto Trindade (Vice President of Auto, Other Property and Casualty, Life and Private Pension)**

We don't make this information available, which has to do with the competitive environment, this separation of our portfolio – what is new and what is used, what are passenger vehicles, and what are trucks, etc. This information we keep internally, but what I can tell you is that this question of new vehicles has not affected us with any relevance. Let's remember that you have new popular vehicles with more elevated prices, also this differentiation ends up providing varying results between the different

companies.

**Gustavo Schroden (Bank of America Merrill Lynch)**

This is great, it was very clear, many thanks.

**Operator**

The next question comes from Mr. Gabriel from Bradesco. Mr. Gabriel, you may go on.

**Gabriel Gusan (Bradesco)**

Hi, good morning everyone. I have two questions. Firstly, I would like to ask for some help in my understanding of the health segment, one is a piece of qualitative information, looking at the quarter, how much of the improvement is due to a calendar effect and how much a result of your structural initiatives? The second is about savings bond segment sales, do you have any perspective about when you are going to normalize these sales? Thank you.

**Mauricio Lopes (Vice President of Health and Dental)**

Good morning, Gabriel.

With respect to the calendar effect, there wasn't any calendar effect at all. It was a normal, standard quarter and there was absolutely not this calendar effect at all.

**André Lauzana (Vice President of Savings Bonds)**

Good morning, Gabriel.

The Company is re-evaluating the way in which we can return to operate in the popular products segment, shortly we will have a more defined position, as to when we will return to operate in this segment. This is a subject that is still being evaluated internally.

**Gabriel Gusan (Bradesco)**

Perfect, thank you.

**Operator**

The next question comes from Mr. Gustavo Lobo, do BTG Pactual. Mr. Gustavo you may continue.

**Gustavo Lobo (BTG Pactual)**

Hello, good morning to everyone. I have two questions and the first one is a follow-up.

With respect to auto, we have observed that interest rates have risen, robbery and theft has fallen significantly and one thing that surprised everyone positively was that the segment performance was very favorable in the first quarter. We imagine that to an extent, this applies to a large number of players in the auto segment. My question is, does competition continue to be well-behaved? Would you observe the comfort of another player reduce pricing to operate at a slightly higher loss ratio relative to last year, especially considering that the Selic is a little higher, or to reduce, given that the level of robbery and theft is at a level which is significantly below the previous year? How exactly have you been seeing this competitive dynamic? Then I have another question.

**Carlos Alberto Trindade (Vice President of Auto, Other Property and Casualty, Life and Private Pension)**

Competition in this segment has always existed, it is very intense, and it will always exist. What we have observed, which has been different, prices have not come down, and actually, the market has adjusted, even considering that levels of theft have fallen relative to the first quarter of last year, however, it is still at levels above the best we have observed. Also, the majority of companies are suffering a little from pricing movements last year and this also has contributed to price increases. And, for example, theft in Rio de Janeiro has increased a little and even with the improvements in São Paulo, other regions have not necessarily achieved the same level of performance, and I don't see any movement, as observed in the past, in which interest rates are rising, and therefore the prices are going to fall to capture market share. This does not appear to be the observed market behavior. I believe that today's market is doing their analysis very well and knows that an acceleration in interest rates also requires that you allocate more capital, as you have to pay higher costs, and therefore the market has not demonstrated any signals of lower prices due to these reasons.

**Gustavo Lobo (BTG Pactual)**

Perfect, it's clear.

My second question is about efficiency and you have had excellent performance in the first quarter. My question is, what is the correct way for us to look at your general and administrative expenses, is it to compare them to inflation, as a real gain or compare them with premiums growth, because the Company grows its expenses. My doubt comes exactly from your non-insurance business growth. Arthur himself commented that it was an unfair comparison, comparing non-insurance expenses to insurance premiums and we see that the fall in the G&A ratio now in the first quarter. How can we see this ratio looking forward, is there still significant space for

improvement or are we already at a level which should see continue over the future quarters?

**Arthur Farme (Vice President of Control and Investor Relations)**

Gustavo, thank you.

A large part of the expenses have some type of indexation, such as salaries, such as the Company's contracts, they have an indexation component and inflation would be a good proxy. The point that I was highlighting is that we have been making investments and the Company has been spending CAPEX on infrastructure projects, consultancies, software to improve the quality of our operations and as I already highlighted, this is already being reflected in our operational improvement that we are observing in the loss ratio in other aspects and maintaining an operational improvement. The challenge of lowering this ratio of expenses relative to revenue is that, it reflects the Company's objective to improve the quality of operations. I am not able to say that 8.5% is the bottom; we want to believe that it's not, but we have improved this ratio significantly over the recent years. It fell from 10% to 8.5% and obviously we have been able to grow with the same installed capacity.

Simplifying a little the response, there is a component of indexation, yes, while we negotiate better with our suppliers, there is also a trade-off between growth and necessary investments. I believe that this is being reflected here.

Another point you mentioned, is that the combined ratio of the Company would be better if we were to exclude the total general and administrative expenses not related to insurance. However, it's difficult for us to highlight this at this time because we have a consolidated vision. We know that yes, savings bonds, asset management, and private pension expenses, whose denominator is not reflected in the ratio, negatively and homogeneously affects the ratio in this comparison and the time series. It's not anything that you could explain as being as being one-off.

**Gustavo Lobo (BTG Pactual)**

Perfect, maybe it was only a one-off movement from the moment that savings bonds were consolidated, after this, it stays reasonably stable.

**Arthur Farme (Vice President of Control and Investor Relations)**

Gustavo, only to correct one point. The savings bonds segment cannot be consolidated as insurance revenue. Savings Bonds are treated as a financial activity, it is already being highlighted after the insurance margins in our structure and we would have to conduct a managerial analysis to exclude the savings bonds expenses in this respect.

Once again, depending on the vision, we are observing an important gain from operational efficiency. This is the message that we would like to communicate. If this relationship could be improved, we would like it, yes, but as I previously mentioned there is a trade-off and the Company wants to maintain its level of investments that have been positively reflected in operational indicators.

### **Operator**

The next question comes from Mr. Francisco Kops, from Banco Safra. Mr. Francisco you may continue.

### **Francisco Kops (Banco Safra)**

Good morning everyone.

The first question is for Maurício. I would like to understand a little about your vision about the macro scenario. One thing that I liked was your result and that you continue, despite the strong price readjustments, to grow your insured member base, even with the increase in unemployment, weak job creation, and anyway, employee bargaining power seems to be losing a little bit within the companies. Is it possible to imagine that we should see a reduction in the number of beneficiaries, some mix effect within SulAmérica's portfolio? If you could comment a little about this and then I have another question for Arthur.

### **Mauricio Lopes (Vice President of Health and Dental)**

We are not able to see this movement in our portfolio, however, remembering that this cycle has observed a reduction in labor contingencies or an increase in unemployment, which began in September of last year. There is a delay in the portfolios, because individuals have the right to continue on their plans for additional periods, if we look at those who are retired or layed off, etc. There are still benefit packages related to layoffs that can be negotiated and can continue with these beneficiaries for further periods in these portfolios. Therefore, we are not able to observe to a relevant extent all of these in our numbers, actually, we have grown the portfolio with respect to new sales and in some portfolios and in others there has been relevant maintenance. But, what I think that it is more important for us here, independently from this movement - it is important to look at what we are doing internally to try and mitigate potential risks. The first question is that we have portfolios which have been constructed in all of the segments, through significant commercial efforts, even with a unemployment movements in the group portfolio, we have strong SME and affinity portfolios, with elevated commercial efforts, because it is a very traditional portfolio and therefore we are able to absorb those who are exiting the group portfolio and entering into the SME or affinity portfolios at SulAmérica. Therefore, to the same extent that group contracts reduce

costs migrating from pre-payment related risks to post-payment, the post-payment portfolio makes it possible to continue with the same clients internally. I believe that the second point that we have worked on significantly is the question of retention and also underwriting. Since 2013, SulAmérica has structured an area specifically dedicated to retention of small and medium-sized companies, it was developed in 2013, matured in 2014 and in 2015 is working very well. We were able to increase retention levels that we had in this retail portfolio, through a restructuring with a long-term focus, looking more at the underwriting and the ways in which we need to retain our clients.

When the sales are occurring, the same thing applies, SulAmérica in 2013 and 2014 made many adjustments in the acceptance rules, making it possible for certain types of clients to enter the portfolio, which previously didn't have access, closing the doors to others, and contributing to the profitability of the portfolio. In summary, as a response to the question about unemployment, we have restructured the segments, we have areas focused on client retention, we have made adjustments to our underwriting, and further achieved a claims per capita that could be replicated in the price per capita relative to our peers, that can derive benefits from our portfolio, or in other words, if any player is increasing its price higher than us, we can have a greater retention in our portfolio, with the acquisition of a portfolio that is larger than we are seeing with our competitors. For now, the subject is not worrying us, we are watching the subject, and obviously, for now we are not seeing the same relevance that we are observing in other industries.

**Francisco Kops (Banco Safra)**

The fact that SulAmérica has a large scale compared to the rest of the competitors, I imagine that this provides competitive advantages when it comes time to re-pricing in the portfolio.

**Mauricio Lopes (Vice President of Health and Dental)**

You are referring to the network of service providers?

**Francisco Kops (Banco Safra)**

Yes. Since you have greater scale, you can dilute your fixed costs and own loss ratio, you do not need to have price re-adjustments that are as significant as with smaller players.

**Mauricio Lopes (Vice President of Health and Dental)**

That makes sense. I think that the question of scale is relevant in the whole health market and it's not going to be different here. but I believe that even more relevant than the bargaining power is the size that makes it possible to invest in a quality and level of service that we are able to achieve

through a greater perception of value from our client. various examples apply, from the question of pre-approval that we commented during previous calls already for five years now, the operational area at SulAmérica previously conducted pre-authorizations for specific procedures through a general practitioner, and it's no longer like this. Today the authorization for an oncological procedure is provided by an oncologist, who already is part of the approval process. Dermatology is conducted by a dermatologist, etc. Therefore, this type of greater refinement only comes from scale, that we have invested in significantly to improve client service levels aside from just bargaining power.

**Francisco Kops (Banco Safra)**

That's great Maurício, thank you.

My question to Arthur is follow-up about G&A. I do understand that you have been a bit more conservative in your response, but, the decline in the G&A ratio has been very significant, especially after we look at the growth in your revenue, especially in health, it is basically pricing, which does not necessarily imply the need for greater or more significant structure. However, I imagine that this operational gain should continue while you are passing along strong price re-adjustments. Do you imagine that the G&A will continue to decline?

**Arthur Farme (Vice President of Control and Investor Relations)**

I would like it, obviously, if you were to be correct. Imagine G&A that is continuously declining. I believe that yes, part of the investments that we have been making, they are exactly considering the operational leverage that we have, the capacity to produce more with the same structure. I believe that this has been happening over the recent years. If we were to look at this series over the last 10 years, the Company has had some years with R\$ 7 billion in revenue and today the Company generates almost R\$ 15 billion, in recurring terms, with the same 5,000 employees, just to give you an example of what is at hand.

Further, we are maintaining a structure that is more or less stable, which has been able, through this vision for example, to gain market share, and incorporate new portfolios. The purchase of the savings bonds business has changed this profile. We have a diversification today with a source of results from asset management, savings bonds, private pension, and health operations. In the diversification of the business mix, the investments in our infrastructure have explained this. I don't want to give the impression that the Company wants to be conservative in its response, on the contrary, but at the same time I cannot promise that we will continue to have gains, at this magnitude in the ratio. We are working for this, we are investing in this, and it's not just a mere indexation to inflation that our expenses, as I

already mentioned. We are maintaining an important component of our expenses relative to the amortization of investments that we are making in IT infrastructure, infrastructure in general and in operational improvements that demand eventually the work of consultants, this all, again, is reflected in our indicators.

### **Operator**

The next question comes from Mr. Fernando Leitão, from Hoya Corretora. Mr. Fernando please continue.

### **Fernando Leitão (Hoya Corretora)**

Good morning, thank you for the call, my first question was already answered, it was to do with employment and up to what point it could affect the portfolio. The second question, I must apologize, because I am indeed new to the sector. However, I would like to understand a little bit about the accounting mechanisms for technical reserves, from the moment in which the regulator solicits through its parameters an increase in technical reserves, and from there how does it work, how is this capital allocated? Thank you.

### **Arthur Farme (Vice President of Control and Investor Relations)**

Thank you. To an extent, no one is new to this market. It is a complex market and your question is very welcome. This is a theme that I believe afterwards deserves a call from our investor relations area so that we can further develop the fundamental technical concepts that make up this accounting. But, the reserves are constituted, above all, as part of the revenue that the Company receives. The mechanism, through which this revenue is deferred, reflects the constitution and provisioning of what has been unearned, using the jargon of the segment, assets and liabilities. For example, our liabilities represent a future obligation through the purchase of assets from our revenue that the Company has written and maintains as technical reserves. Remember that the activity of the insurance segment demands, also, aside from technical provisioning related to reserves, a provision for solvency margins that the supplementary reserves regulated in health and property and casualty demand, but perhaps this is a question that would be better illustrated if we could look at this with you in more detail, looking at the dynamic of our financial statements.

### **Operator**

As there are no further questions, I return to Mr. Gabriel Portella, for your final considerations.

### **Gabriel Portella (CEO)**

Thank you everyone for your participation. One more time, I would like to

thank all of our collaborators, insurance brokers, business partners and other stakeholders for their contribution to yet another excellent quarter. Thank you.

**Operator**

The conference call for SulAmérica's results has been completed. Thank you and a good day to everyone.