



## **3Q15 Conference Call Transcript – Q&A – SULAMÉRICA**

### **Operator**

We will now start the Q&A session. Our first question comes from Mr. Gabriel Gusan (Bradesco)

### **Gabriel Gusan (Bradesco)**

Good morning. I have a question about the health segment. We saw that you had a great quarter, with strong net adds in SMEs and all of the lines. I would like to understand a little more about this dynamics, given that the market is suffering. We saw the ANS figures already demonstrating a decline in beneficiaries. I would like to understand a little better if it is pricing that is better or maybe Amil and Bradesco are passing along strong price readjustments. Does it have something to do with the Unimed's losing space or with Unimed Paulista? What kind of color can you add? Thank you.

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

Good morning, Gabriel. Thank you for the question. I think that the market has maintained its pricing rationality in a way that has been consolidated in the last two to three years and we see the market as a whole moving in the direction to have sustainable robust pricing. There has been some turbulence with some market players, but nothing that we haven't seen in the past. We know that there has been some consolidation over the last several years and this movement has been intensifying recently. Obviously, within this intensification of the consolidation movement, those who are better positioned in pricing and availability, regions and network access, will benefit. Therefore, what I think it is a natural driver of this rational market pricing and a consolidation movement that is intensifying and the fact that you would have a transition of members of operators that maybe would be in difficulties. A good part of the market is benefitting, while another part of the market, obviously, is going to have its operations discontinued or have an intervention.

### **Gabriel Gusan (Bradesco)**

Great, thank you.

### **Operator**

Our next question comes from Gustavo Schroden (Bank Of America)

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

Good morning people, thank you for the opportunity. I have a question that is a little broader with respect the Company and its earnings.

The Company reported R\$172 million in recurring net income but there is an effect, which in principle, here, I think that should have been highlighted, the lower effective tax rate. If we were to calculate approximately how much you could have in terms of an effect income tax rate, considering that the social contribution perhaps this number would be closer to R\$150 million, and this would be below consensus. My question is, in your vision, is the market overestimating the improvement that the Company is reporting within its earnings potential. Do you think it's viable for the Company to continue deliver results in line with the market looking forward?

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

Good morning Gustavo. Your question is opportune, but at the same time it is reasonably complex. There were specific positive effects from the tax credit adjustments, as you know, which are already being reflected in the expenses for September and has affected the tax rate from the first of September. We cannot speak about tendencies or future perspectives, but indeed the Company is going to be exposed to a higher tax rate. This is going required, as has been required in all of the sectors affected by the tax rate adjustment, a review of operations such that to the extent it is possible and having space in the markets that each one operates, the necessary adjustments are made to the pricing policies which already consider this new taxation environment. I don't know if I responded exactly to your question, and if not, I am going to ask that you be a little more specific.

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

You partially responded, but my question is that we understand and believe that within the affected companies models, probably, the higher tax rates to which you have been exposed have already been calculated. But perhaps the market understands that there could be a greater offset for this effect coming from the operations. To offset this rate increase looking forward, perhaps the combined ratio already could be below 100% in 2016, for us to continue to see strong earnings growth. Therefore, it was more this point that I would like to explore.

Do you think it is possible to have an improvement in this regard with a combined ratio below 100% to offset the increase in the tax rate looking forward? In other words, is there space to improve the operational side and maintain the pace of earnings growth that has been presented now and that we see also in the consensus? This was the point that I would like to explore.

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

I think that your point, when you ask if it is possible, the response has to come also with a time horizon. It is not possible to expect, or for the market to expect, that the Company would have an acute impact in the first instance and could already reprice to offset this, nor would we stay frozen waiting for the expense to hit, in other words. However, we are aware of the social contribution tax and of the necessity for this to be reflected in pricing. We also know that this is going to be incorporated into the price readjustment cycles that we are going to be passing along in the next quarters. Remember that every day we have policies being renewed and to the extent that there is space in the market or different cost trends, we are yes, aware of the tax burden, created by this new calculation.

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

That's great. Going further, are there still thoughts within the Company to maybe search for another model that could reduce the pressure from this tax burden. Have there been any studies?

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

This is an interesting theme that was brought forward by certain market agents, even for public debate. I think it is reasonable. We have been looking at this since the news was released about the law and the expected tax rate. However, the response is a little more complex and less obvious than it seems. This depends on tax aspects that go to the granularity of the municipal level. We may have other types of exposure and the conclusion that is not necessarily very obvious as it seems. What I can guarantee you is that Company is very consistent in the evaluation of these issues and we would not be mobilizing portfolios for any structure if it was not very certain and with the conviction that these benefits would be sustainable or justify this movement in the medium to long-term. You have to remember that this tax rate has a final date which is set forth in the law, and it will be effective for three years. Such measures have to take into consideration this horizon, and our activities need to take into consideration this horizon.

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

That's great, perfect. I appreciate your responses.

**Operator**

Our next question, Carlos Macedo (Goldman Sachs)

## **Carlos Macedo (Goldman Sachs)**

Good morning Gabriel, good morning Arthur, Good morning everyone and thank you for responding to the questions. The first question refers to the cycle which we are seeing. Historically there has been a relatively good correlation between economic growth and the group portfolio loss ratio. It's clear that there has been a change to the mix, there have been a series of factors and, principally, the efforts that have been made to reduce frequency and prevent plan use and everything else. It has helped a lot these last quarters. Looking forward, do you believe that the greater portion of these efforts have already had an effect or still can we see this mitigating the effect of an economic contraction in the loss ratio.

The second question is more specific. We have seen an increase an increase in the individual portfolio loss ratio, which was above 100%. I would like to understand if this was recurring and what happened and how we should think about the loss ratio for this portfolio looking forward?

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

Hello Macedo and thank you for the question. What we are observing in the group portfolio, I think that, the macro numbers speak for themselves, they are very clear as far as what is happening in the macro dynamics. However, the portfolio has shown to be very resilient. I think there are a great many factors to be considered together. Remember that the group portfolio has been able to be able expand both in affinity and corporate plans. The SME portfolio has been very dynamic. The manner in which the portfolio is being structured provides, and even more so in ASO, the possibility to migrate from one modality to another, to maintain clients within the company, this is the first aspect.

The other is to be sustainable in portfolio growth, I think that it is important to remember that we launched a portfolio in July of this year now with many options for new clients, more pricing options, more reimbursement options, more comfort options, more network options, and more dynamism in the commercial area, in new regions, places, and in niches that have not yet been explored. This is contributing to a product mix for us which has contributed to our dynamic which is very different from the macrodynamic of the country. I think that the numbers speak to this. The portfolio growth of 7% YTD, relative to last year, I think that this gives you a clear idea.

I think that the maintenance of this portfolio is a result of the operational work being done. The claims contention and health management mechanisms being put in place are all maturing well. Obviously, claims management initiatives mature faster. Negotiations within the network, the procedure packaging process, direct purchases, and medical second opinions has been developing very quickly. For 2015, we have been able to

achieve the same level of procedure packaging that we are able to do during the first years in which we began, and we have been able to achieve the same velocity which is very interesting and a process that is very simple to do and has more rapid results which is different from more complex processes such as direct purchasing of drugs and materials, that is much more structured and challenging to put in place. Even so with these more complex processes, all of these together are extremely dynamic. The quantity of hospitals, procedures, and specialties included in direct purchases are growing and we are observing results.

In terms of health management, the acceleration has been very significant in terms of deadlines and deadlines for operational returns which have been diverse. There are initiatives which have deliverables in the short and long-term, and clients have the perception that significant work is being done. We have been able to negotiate price readjustments or try to maintain the contract to benefit and maintain client satisfaction in the end. As a result, the claims management projects, health management projects and new portfolio, that was previously mentioned, the situation of some players in the market has growth the portfolio.

With respect to the second question, the individual loss ratio, we have observed two effects. There were relevant accounting adjustments whereby we have reallocated claims and reduced premiums within the individual portfolio which as a result led to a higher loss ratio. The second point was that there was a large number of projects in this portfolio which will have results. The portfolio has contributed to the gross operating margin. Historically, we haven't been concerned with the type of one-off that we have had this quarter. Work is being done, is being planned, and it is within what we would have imagined.

### **Carlos Macedo (Goldman Sachs)**

Ok, thank you. Going back to the first question: in the group portfolio, I remember that you have mentioned on other occasions, the objective of the loss ratio when you price the contract, it is clear that to the average applied is close to 80%, is this what is being considered? We are seeing 78%, 79% on average. Should 80% be maintained or given the market environment do you expect a pricing situation that is more favorable to the company?

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

Macedo, each portfolio and contract has a specific dynamic. You have, obviously, a pricing target in the pricing target in the corporate portfolio as a whole, in the gross margin of the operation that has to be generated, larger contracts may lead to a higher loss ratio, and the smaller contracts, have higher maintenance costs, and require a lower loss ratio. The mix is what we expect from gross margin. It is not possible to affirm that 90% or

75% is a predefined target. In the last two years, we have changed our pricing models significantly through the inclusion of many more variables. This makes it possible for us to have more accuracy in what we expect to earn for each one of the contracts that we put on the street. More than this, I think that we have a rich synergy between the business units and the commercial area, which has brought about greater understanding about the pricing objectives and drivers. The commercial area has brought about in a very clear way the force of our distribution network which has been drivers of our products and allow for correct pricing. This has functioned very well. We have begun in one or two regions this more complete model and its already being reflected throughout Brazil for practically one year now.

### **Operator**

Our next question, Francisco Kops (Banco Safra)

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

Good morning everyone. I have two questions also: the first is for Mauricio is about moral hazard. In the previous cycles, each time that unemployment has increased, we have observed that the loss ratio has also increased, the frequency of plan utilization tends to increase. In the past, unemployment increased and we observed that the loss ratio also increased, given increased plan utilization tendencies. We are heading for a poor economic cycle in 2016 with high unemployment. My question is: until what point the price readjustments take into consideration the increase in plan utilization for the coming year. In truth, the idea is to try and understand until what point SulAmérica is protected or not with respect to the increase in plan utilization expected for next year. Afterwards, I will ask my second question. Thank you.

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

I think that two things happen in this dynamics of group health contract price readjustments. When we had a strong crisis in 2008, we had strong incremental additional plan utilization which was very strong and one-off for the time. The way that the contracts were structured at the time and the technology that the healthcare operators had at the time were very different. From then until now, we have learned a lot both from the side of the operator and from the contracted clients. I think that the beneficiaries in that moment did not have a clear understanding that they would be able to continue more permanently on the plan, given the law, We have been in a crisis for the last two or three halves and we have observed strong plan utilization but we have already found that there is a more defensive movement on behalf of the companies that changed some contractual structures or changed to an extent the way to lay off or fire its employees that brings a little more rationality to plan utilization.

From the perspective of the healthcare operator, we also learned a lot. Today we have many more models which work and are able to serve the beneficiaries in the way that they need, but also is able to give a little more protection during moments of crisis. I think that these two factors together bring more stability in plan utilization, for at least the last two to three halves. We have not observed a more significant trend than observed in previous periods. What will we see this looking forward? No one knows or can read the future of the macro environment. The second opinion mechanism, the sub-networks, medical boards, and all of these processes bring greater rationality in plan utilization, such that that tendency is less common today than was previously observed and this is the result of greater maturity within the market and the incorporation of operating technology.

**Francisco Kops (Banco Safra)**

I understand and just to confirm, in this adjustment are you are taking more account of a medical inflation forecast and not necessarily incorporating a possible increase in plan frequency. Is that right Mauricio?

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

Medical Inflation (VCMH) has been relatively stable in the recent months. We have not seen VCMH growth compared to previous periods. As the price readjustment policy is based on the past VCMH levels projected forward, and the past figures have not changed, I do not see the application of a readjustment now being very substantial relative to what we have seen in the past, or in other words, what we have this quarter is a maintenance of the pace that we have observed in the past, without any significant changes.

**Francisco Kops (Banco Safra)**

Perfect. I have a second quick question for Arthur, specifically to do with the earnings. This increase that you had in tax expenses, I think that it was well-explained given the larger payment of JCP to the subsidiaries. But my question is, if we look at the last year, the large payment of interest on shareholders' equity (JCP) from the subsidiaries was made in 4Q14. How should I imagine this year, Arthur? Should the fourth quarter be strong or actually did the recognition of this positive effect for the fourth quarter already occur this third quarter?

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

Francisco it is difficult to speak about the fourth quarter now, the point that you highlighted, when you compare the third quarter of last year we did not have the same impact, because the interest on shareholders' equity (JCP) that we declared this quarter was larger than what was declared in 3Q14.

What we are going to pay in 4Q15 depends on the performance of the Company and the space that we would have to pay or declare JCP from the subsidiaries and from the holding. I cannot pass along any more than this. It is obvious that we are always looking to this as a necessary management tool.

**Francisco Kops (Banco Safra)**

So this is totally related to the Company's payment of Interest on Shareholders' Equity (JCP), this line?

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

This line, the impact that you saw in the increase in the tax line was the consequence of the JCP declaration by the subsidiaries as you mentioned. So, it was only this, there was no other behavior. Even, perhaps, to an extent, part of this increase is the result of an improvement in the operations. Remember that the direct tax calculation base for PIS/COFINS is the premium less claims, simplifying this approach. Therefore, to the extent that we have an improvement in margins, you have, consequently, a higher tax base for this calculation.

**Francisco Kops (Banco Safra)**

Perfect, thank you Arthur.

**Operator**

Our next question, Gustavo Lobo (BTG)

**Gustavo Lôbo (BTG Pactual)**

Hi, good morning everyone. I have two questions also. The first is about the auto segment. Your performance was very strong this quarter. I am not only speaking about the loss ratio because a good portion of the players have been reporting an improvement in the loss ratio. The highlight was the auto premium growth rate. Was there some change to your strategy for the quarter to explain this, or you have been reaping the fruit of a strategy that was already implemented for some time now? If you could comment a bit about this and after I have one more question, thank you.

**Eduardo Dal Ri (Vice President of Auto and Other Property & Casualty)**

Gustavo, good morning. This is Eduardo speaking. You have a point and in your own question there was some of the response. He have observed a maturation from a series of measures such as improvements to pricing and the search for new niches, both in vehicles and in vehicle categories. This does not, necessarily signify price reductions, but basically means that we

are taking advantage what we have already been able to observe and those opportunities that the brokers have been quoting but were unable to close with us. This began last February and we have perceived it over the last three quarters. We are growing our production and the result is maturing each month and in the third quarter we have observed growth of 23.8%, or 16.5% year-to-date, that we highlight to the market.

**Gustavo Lôbo (BTG Pactual)**

Perfect, that's clear. My second question is a little more general and is relative to 2016. It is clear that 2015 will be an excellent year for SulAmérica in terms of results. Looking forward, we continue with the Company's growth in terms of the top line, reserves, that are going to benefit from investment income also, and I imagine that very probably, the average interest rates (Selic) should be lower in 2016 relative to 2015. The doubt we have is related to the loss ratio, do you see much space to improve compared to the strong base we have had this year?

The second point is that is this improvement going to be sufficient to offset an increase in the effective tax rate that you are going to have next year and if there is much more to do?

**Gabriel Portella (CEO)**

Hi Gustavo, it is Gabriel speaking. I think that you should end up doing our budget for 2016, but it makes me happy to know that all of these points you are making we discuss all of the time. It is our obligation and our nature to always look forward, for excellence, and therefore, as an insurance company, we are following these aspects and in each of our business lines, focusing on cost discipline, in our investments, measures to address the loss ratio, new sales and pricing, such that we can continue to develop, grow, and improve the profitability that we have been demonstrating over the last years. The story of this quarter is not only the story of a quarter, it is the result of an effort on many activities that have been done and are being improved over the years. When we look forward, we have a challenging economic scenario that continues to be challenging. I say that increases the degree of difficulty but it is nothing that we are not prepared and focused on to maintain our trajectory. This is our target and objective and when you mentioned offsetting taxes, improvements to the loss ratio, the high Selic, everything is being considered so that we can continue to demonstrate sustainable performance.

**Gustavo Lôbo (BTG Pactual)**

Ok, thank you.