

4Q16 Conference Call Transcript – Q&A – SULAMÉRICA

Operator

We will now start the Q&A session. Our first question comes from Mr. Marcelo Cintra – Goldman Sachs

Marcelo Cintra (Goldman Sachs)

Good morning everyone, thank you for the question. Actually I have two questions. The first one is related to the administrative expenses, as you put well, it keeps improving, in 2016 we had 50 bps of improvement comparing with 2015, reaching 8.9%, due to obviously your focus in improving efficiency and cost control. My main question is how you see this trend from now on. Is there more room for improvement, other projects or initiatives to be implemented to continue reducing this rate or we should consider as a new level when looking forward? I ask this mainly because of all the improvement you've been delivering. And the next question I'll ask later. Thank you.

Arthur Farne (Vice President of Control and Investor Relations)

Cintra, thank you. This is Arthur speaking. There are some aspects in 2017 that maybe will be helpful. Such as exchange rate that may be more comfortable, the down on the trend of inflation which affects the indexation of part of our contracts, agreements, and others, which affect a large part of our administrative expenses and others. We have expenses of debentures, IT, licenses and investments in software that we have been doing. We will not stop investing in plans and projects that we believe are important and that improve our operational efficiency. We will be more critical perhaps in the choice of these demands, all in favor of preserving the company's profitability, but for sure, a change in the exchange rate or inflation, should point to an improvement in administrative expenses compared to 2016. I cannot anticipate the effect of this in the expenses' rate, but the company's goal is to deliver a better index, as we have been doing in the past years.

Marcelo Cintra (Goldman Sachs)

That is great, thank you. My second question is related to the healthcare loss ratio. Looking to this quarter results, we see a deterioration of the loss ratio comparing to 4Q15 and you commented in the earnings release that this deterioration was mainly due to the higher number of business days in 2016, but the deterioration was around 260 bps, which is quite relevant. I just want to know if this change was only due to the number of business days or if there was another reason, such as a portfolio's deterioration or something like that, just because I thought this worsening was very relevant. And if you could talk about how we should see the health loss ratio

for 2017, if it's fair to consider that it should continue to improve mainly as the economy improves; will the premiums maybe accelerate a little more? How should we see this line? Thank you!

Mauricio Lopes (Vice President of Health and Dental)

Hello Marcelo, this is Mauricio speaking, how are you? Thank you for the question. In the matter of the quarter you have to take two things into account: first, we are trying to change the payment schedule to bring homogeneity to the calendar throughout the year, and this also brings its effects in the quarter. So you always have to be careful not looking just at the quarter alone. And if you look at the trend of the quarters over time, regardless of any occasional fluctuation of any of them, the trend has always been a better result, as a result of all those claim management projects. Some of the established initiatives in health and claims management, as we've talked about in the last calls, are maturing faster than we had imagined, which is enabling us to start new initiatives in parallel with the projects that were running, so we are comfortable with the loss ratio that is being generated, even though in some quarter, due to a calendar effect or maybe due to our attempt to homogenize the loss ratio between the quarters, the loss ratio may seem to have risen, but it has to be contextualized. Regarding 2017, I will not give you any guidance but you know the product, it is pro cyclical, if the macro scenario improves, the trend is that more members remain in the portfolio since that companies will dismiss less and our portfolio is basically corporate portfolio. Regarding the claim management projects, all of them are maturing quickly and we have more projects in the pipeline. I think it's the most I can anticipate you without breaking any rules.

Marcelo Cintra (Goldman Sachs)

It is great, perfect. Thank you. If I can only make one final question, I just want to hear from you about capital. Could you give any idea about SulAmérica's solvency capital? How much additional capital versus required capital does the company have? So we can get a better idea of that number. Thank you.

Arthur Farme (Vice President of Control and Investor Relations)

Cintra, this is Arthur speaking. The level of capital that we have in the operating companies is appropriate. What we have in excess of operating companies is also appropriate for the level of growth that we intend to have this year and the next.

Marcelo Cintra (Goldman Sachs)

It is great. Thank you.

Operator

Our next question comes from Mr. Gustavo Schroden – Bank Of América Merrill Lynch.

Gustavo Schroden (Bank of America Merrill Lynch)

Good morning everyone. I have two questions. The first one is about the consolidation that was mentioned during the call. Could you give us more details about the characteristic of this consolidation that is taking place now? Where is it coming from? What kinds of players are involved and in what regions is this consolidation taking place. Since we do not see any M&A process going on, I think this consolidation could be a portfolio purchase. So could you explain how this consolidation is happening and how this migration of new members is coming to SulAmérica? How do you expect that to be in 2017? My second question is related to Auto insurance segment. We were under the impression that in the past two quarters we had reached the peak of loss ratio; however it was higher than we expected in the fourth quarter. Could you comment on that? We are still far from improving the loss ratio in auto, if you could elaborate on that, I would thank you.

Gabriel Portella (CEO)

Hi Gustavo, good morning. This is Gabriel speaking. Consolidation is not just about acquisition, it is a trend of concentration in players that are more attractive due to several reasons as the quality of product or because their consistency the performance. You know that this consolidation have already been going on for a while in the health and dental market, the best players have been concentrating the greater amount of beneficiaries and I think this is also our characteristic. I will give you two figures: for two consecutive years SulAmérica has an amount of new sales above 500 hundred thousand lives in health and dental segment. This is only one aspect of consolidation and it means that consolidation is also coming to us. On the other side there is also the benefit of amortizing the two years that we had a high level of unemployment, so growing our portfolio despite the level of unemployment the proof that SulAmérica is has been taking advantage of market consolidation opportunities and taking place as one of the biggest players. Opportunity of acquisition may make strategic sense by increasing portfolio but we understand that today this consolidation is much more optimized if we continue in our growth trajectory through quality products, relationship with brokers and claim management. But if there are acquisition opportunities and we have looked at these opportunities, we are willing to make it in any of the segments that we are participating in. Now I will let Eduardo Dal Ri answer your question about auto segment.

Eduardo Dal Ri (Vice President of Automobile and Massified)

Gustavo, it's Eduardo speaking. That's a good point. In fact, 2016 was marked by high price competitiveness in the auto segment, as you've been seen and reported. On the other hand, both the total loss and, mostly, theft and robbery frequencies have been under pressure, as a result of the public safety issues we've been facing in the country's major capitals. These factors kept the loss ratio at high levels for the whole market, as you can see in the SUSEP data. When will it improve? Speaking for SulAmérica, I can say that in the past six months we have been increasing prices to reflect this new risk level. We don't project an improvement in the short-term because of this risk matter, and we've been not only adjusting prices, but also significantly changing our hurdle, increasing the restriction level because there are risks for which price increases are not enough to reach the return levels we seek, so we are giving up the underwriting of some risks. This somehow explains our lower production and the lower insured fleet figures. Of course the auto segment has faced this kind of cycle before, perhaps not as severe as now, basically because the risk level worsened while premiums also suffered given the competitiveness seen the market. We don't know when the market will see reflected in numbers what we and other players have been doing in terms of premiums and other cost factors, we don't know when the market will react, but it's certainly working to mitigate the issues of price competitiveness, mainly in the first semester, which are impacting results now, and when these price hikes will have a positive impact in the loss ratio in 2017.

Gustavo Schroden (Bank of America Merrill Lynch)

It's great, very clear. If I can only make a follow-up question to Gabriel on the issue of consolidation, if I understood your message, it happened, obviously, the economy has been under recession for the past two years, many players weren't able to survive and there was a perhaps natural migration to the solid market leaders like SulAmérica, but, correct me if I'm wrong, if the economy starts to grow again, the tendency is to look for organic growth, or at least preferably organic growth. Is that it, Gabriel?

Gabriel Portella (CEO)

We will continue growing organically, if you break down the two segments, health and dental, the situations are different and we've been taking advantage of the growth in the dental segment, given our strong operation in health and the increased cross-selling between the two portfolios. Answering your question, if there are good opportunities, of course we will look to bring them, but if there aren't, this doesn't change the trend and we will continue our organic growth, which also represents consolidation. Considering the health market scenario, we increase our scale, increase the penetration in other regions, increase the negotiation capacity, well, only positive aspects. So, if there are strategic opportunities to add value, as happened in the previous acquisitions we made, we'll look at them, but

otherwise the trend doesn't change and we will continue growing and consolidating our health and dental operations.

Gustavo Schroden (Bank of America Merrill Lynch)

Great, thank you.

Operator

Our next question comes from Gabriel Gusan – Bradesco.

Gabriel Gusan (Bradesco)

Hi, good morning everyone. I also have two questions; the first one is about the investment income, particularly the "others" line, which was quite strong this quarter. I'd like more details on what happened in this line which was decisive for the investment income result in the quarter. My second question is about the Santander contract, it's public that you got the account, so I would like an estimate on the size of the portfolio, I think they have around 50,000 employees, but that doesn't consider dependents and so forth, so if you could give more details on this portfolio. Thank you.

Gabriel Portella (CEO)

We are talking about 2016, so we don't have new clients implemented yet, we have several of them in the pipeline yet to be implemented, but talking about 2016, there is none we can comment on. The pipeline is big, it's one of the ways consolidation happens, as I answered Gustavo, we've been increasing it, but we don't want to mention specific names at the moment, even though I'd like to talk about a series of them. I will turn the floor over to Arthur to talk about the investment income.

Arthur Farme (Vice President of Control and Investor Relations)

The investment income, other than the result of the proprietary portfolio, includes some other accounts that compose the net result, the returns of judicial and fiscal deposits, not only provisions. In the fourth quarter, in particular, we had the effect of some tax lawsuits that appear in this line, this wasn't the first time, we've seen the impacts resulting from these lawsuits throughout the year in this line.

Gabriel Gusan (Bradesco)

Perfect, thank you.

Operator

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

Gustavo Lôbo (JP Morgan)

Hi, good morning everyone. I have a question slightly more related to the long run. We are in the middle of a cycle of interest rate cuts and it's been stronger than we anticipated a couple of months ago, so the questions are: firstly, if you can compensate this expectation of lower investment income with price increases amidst a still weak economy; secondly, I understand that a structurally lower interest rate also lowers the cost of capital, so the question is if the cost of capital changed in the project evaluations of the company in these last two, three months; and thirdly, what would be a sustainable ROE level for the company, considering this scenario of a single-digit SELIC rate next year. Thank you.

Arthur Farme (Vice President of Control and Investor Relations)

Lôbo, thank you for your remarks, this is Arthur speaking. We don't disclose our discount rate for projects and I can't tell you our expectation for return on equity. What I can say is that our structure, or the process by which we determine the reference rate for any project or initiative, considers the future rate, and this rate still hasn't moved enough to make us change our hurdle in the short term. So we don't see much change in the sense. If we are going to be more or less competitive, that's a different discussion, but the Company's underlying return target looks at this future perspective, from the operations' point of view. Your question has another side to it, which you didn't mention but I will anticipate, asking Marcelo to participate, related to our investment strategy. You mentioned the hurdle rate, we've been answering this question with a perspective of improving operations, that is, the operating result contributing more than it has been doing, administrative expenses are a driver for that, but we have the portfolio management aspect, observing the ALM issues, etc., which I mentioned earlier. There are opportunities on the radar and Marcelo can comment here.

Marcelo Mello (Vice President of Investments, Life and Private Pension)

Lôbo, this is Marcelo speaking. As Arthur mentioned in the beginning, the main driver for allocations are the companies' actuarial liabilities, but we obviously have to make the most of opportunities when doing the allocation, and we should have some opportunities in private credit issuances in 2017. This might help the composition of a portfolio with a more competitive yield and, if we see an opportunity for amounts exceeding the actuarial liabilities, we obviously may analyze alternatives in multimarket or equity allocations. It's also worth highlighting the way the assets are accrued, looking at the investment income, it's easier to understand how a large share of profit or loss of the mark-to-market securities goes straight to the equity. Obviously, as we had a positive yield curve movement with the more positive macro scenario, if we consider this effect which went straight to equity, the financial return would have been

much higher, I would say almost 100 bps higher than the one we presented, so I believe we have some opportunities, always respecting our liabilities, and we will work on those in 2017.

Gustavo Lôbo (JP Morgan)

Perfect, thank you. Just checking if I understood correctly, the accrual of this variation of curve will be reflected in a yield portfolio above of the CDI throughout 2017 for the ex-private pension portfolio, considering no major variation in some line that would change this situation, but we should expect a financial gain in the next two, three, four quarters, is that it?

Marcelo Mello (Vice President of Investments, Life and Private Pension)

No, that's not it. What we meant is that, in 2016, we had a pretty satisfactory result in relation to the CDI if you take into account this issue of asset marking. From now on, in 2017, it will depend a lot on the oscillation of these assets, on the behavior of the future interest rates and obviously on the behavior of inflation, since we have 7% allocated in assets linked to the IPCA (CPI Index).

Arthur Farme (Vice President of Control and Investor Relations)

Lôbo, just to clarify, I think it's worth looking at the equity adjustment movement, where you clearly see the reduction in the adjustment occurred in the period. What Marcelo said is that, if we were to consider this effect and add it to the investment income in the P&L, the yield would have been much higher.

Gustavo Lôbo (JP Morgan)

Understood. So this gain didn't flow through the P&L, it went straight to the equity and now for 2017 everything depends on ALM, the opportunities that will arise and you are working on that.

Arthur Farme (Vice President of Control and Investor Relations)

In short, that's it.

Gustavo Lôbo (JP Morgan)

Perfect, thank you.