

2Q18 Conference Call Transcript – Q&A

Operator

Ladies and gentlemen, we will now begin our Q&A session. Our first question comes from Thiago Kapulskis – BTG Pactual.

Thiago Kapulskis (BTG Pactual)

Good morning everyone. Thanks for the opportunity. I have two questions: the first one is related to Auto, which I think was the highlight in this quarter due to its significant improvement. I would like to better understand this improvement and I would like to know if you can provide more details about the fleet growth, 5% quarter over quarter, which was quite considerable. Where is this coming from? Did you resume operations in regions where you weren't operating due to all recent public safety issues? Is it related to a different strategy that you have been practicing? And I would also like to understand if this number, which was very significant, could be recurrent in the near future, almost 70 thousand new vehicles. I would also like to know a little bit more about the loss ratio, this 800 BPS improvement, almost that, it was very expressive and I would like to know if you see this level of 61%, eventually 60%, as something to be expected for the rest of the year. This is my first question.

My second question is related to Health. If you could give more details about what drove this improvement: if it was in individual plans, group plans, or if it was frequency, maybe looking at the semester as whole, I think this is the most interesting way. Thank you.

Eduardo Dal Ri (Vice President of Auto and Massified)

Thiago, I'm going to begin with the Auto segment. This is Eduardo. You kept track of what we talked about the segment throughout last year. We are overcoming a crisis in the Auto segment, especially at SulAmérica, but the market also suffered a lot, mainly in the first semester of last year and regarding what's happening now... Well, I will separate this topic in two, first I will talk about growth and then about loss ratio. Speaking of growth, we are maturing investments that we have been made in pricing and this explains part of the growth and part of the loss ratio improvement that I will talk about later on, besides investments we made in distribution. Now, we are more efficient in distribution, we are able to distribute in regions with better risks, which we couldn't access so efficiently. In part, this came from our commercial capabilities and also from our better pricing accuracy, related to all these investments in underwriting tools. This growth is significant, but it's also helped by the poor performance in the same quarter of the last year. Last year, compared to the same quarter in 2016, we had a decrease of around 13%, so we are, in part, recovering this portfolio. Distributors are our partners, who suffered when we had to recover margins, but wait for the moment to bring the client back, and this is exactly what's happening now. We have seen costumers that had been ours in a certain moment and are coming back now, so, we have this period of greater growth, which is related the decrease in the portfolio in the year before. I think that's it in relation to growth. Speaking of the loss ratio, we are seeing the maturation of the investments done in the operation, I could mention CFR (closed file review) initiatives, sourcing, better claims management capabilities. This becomes evident in the average claims and in an improved underwriting. We have changed our pricing tools, we now use much more the predictive capabilities of our models and this becomes quite evident in the loss ratio. The roll-out of this project began in July 2017 with policy renewals and, during the year, it was extended to new sales. We already have a large part of our portfolio running by these new pricing models, and this explains the considerable decrease in loss ratio, a result of this investment which began well before this year. So, everything is well planned and, thanks to these assertive investments, we are reaping this loss ratio.

Maurício Lopes (Vice President of Health and Dental)

Thiago, it's Mauricio, I'll answer your question on Health, thank you for the question. We can see a decrease in the loss ratio in all portfolios, without exceptions, from portfolios which we don't sell anymore, as is the case for individual plans, to portfolio with more active sales, as in the case of SME plans. All of them presented a consistent decrease in the loss ratio.

Thiago Kapulskis (BTG Pactual)

Great, thank you for the answers.

Operator

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

Gustavo Schroden (Bank of America Merrill Lynch)

Good morning everyone. Thank you for the call. I will also ask two questions: in the first one, I would like to explore the increasing number of members in the Health segment. I think that we are seeing positive numbers in the last quarters, mainly in SME. I would like to understand two things: I imagine this is obviously related to a relative improvement in the economy, which is still struggling, but in better shape than last year. So, in this process of membership growth, I would like to understand in which stage we are in. In other words: does it tend to accelerate from now or is this a level we should work with? My second question is: do you expect that corporate, affinity and also ASO plans reach the growth levels seeing in SME plans? This is my first question.

I have another question related to the Company's product mix. If we look to the performance in Health and Auto, in on hand we see a strong top line growth in Health, as result of this membership growth, but the operational improvement is coming from the Auto segment. If we imagine that the room to improve the health loss ratio may be somewhat limited - the Company did an excellent recent work to bring it down to the 80%-level, but I think it would be hard to imagine a significant improvement in this ratio. On the other hand, Auto is showing consistent loss ratio improvement. Wouldn't it be interesting if the Company increased a little bit more the share of the Auto segment in the composition of its results? In short, I would like to discuss how do you see the mix evolution between Auto and Health and how can we imagine it from now on. Thank you.

Maurício Lopes (Vice President of Health and Dental)

Hi Gustavo, this is Mauricio. Thank you for the question. We have four factors to consider answering your question: the first one is the most relevant, the first and the second one concern the launch of new portfolios in the last two years, which are being widely accepted by the market. When we talk about the launch of a portfolio, it's not only the product design as network and reimbursement, but it's the way we sell it. Do you remember that one year ago, approximately, we changed the sales structure for SME plans? We reduced acquisition costs and improved the contracting process, for both brokers and clients. The entire system was revamped, entry dates were reset and became more flexible, transfers dates also became more flexible, and this enabled sales growth. Now we have a new product launch as well. In June we launched two new products, one is an affinity product and the other one a corporate product. We understand that, in the last few years, we became capable of working with two other levels of product in a profitable way and these products were launched now. One is called Vital and the other is called Extra. They began to be sold about a month ago, let's see how this develops in the coming months. Talking about geography, the sales team has been increasing the number of branches around the country and our team that handles the referred network has

been dedicating time to expand it in locations where we used to have a disadvantage. We expanded the network, changed it, besides changing the compensation model for some providers and it gave us a chance to sell products where we didn't use to before. So, for us, it's like a greenfield. Greenfields in regions which we previously didn't cover and this has been bringing good results. The third most important factor is retention, I believe. When you see a great number of lives still increasing, as Bottas mentioned in the beginning of the presentation, retention is working very well, the after-sales teams are doing a great job in keeping the customer with us, but, more than that, the operation is delivering a product with a great service level and with lots of innovation. The innovation presented in the previous years in terms of claims management, claims distribution, online reimbursement, "house calls", online features, that sort of thing, geographically processed network and all of those things are giving our customer the perception that it's worth keeping the product. This has proven to be right in SME, corporate, affinity, and dental. Finally, the last factor, which I think it's the least important, are the net adds. We presented, once again, as Bottas mentioned, a positive change in net adds for the second consecutive quarter. It's still small, it's important to mention its size. In June we had net adds of only 1,500 lives in the corporate segment, so it's very small in relation to the total number of beneficiaries. In a scenario in which the economy begins to grow again, for sure these contracts will be positively influenced, but we need to wait until it happens. This leads to your second question: if we should imagine different growth rates for the portfolios over time. I think that, depending on the economy, the corporate portfolio will be able to grow more than in the past few years, but it depends on how the economy will grow, how fast it will happen and in which cycle of the year it will happen. On our side, what we have is the strong commitment to maintain the existing contracts, waiting for economic growth. We will maintain our contracts not only with a strong underwriting, but also with innovation and great customer service. I think that this idea has always been the Company's drive. How can we do that? By managing claims in an effective way, but constantly highlighting to the customer their importance, how easy it is to use the product, the level of service, and so forth. With that said, I concluded my answer and will hand over to Gabriel who is going to answer the second question.

Gabriel Portella (CEO)

Hi Gustavo, I would like to choose the ideal mix for our portfolio, for our Company, but it is important to bear in mind that we are in a competitive market and that it is not so simple to have the ideal profile. The most important thing is to look at each of the segments in which we operate, the growth opportunities in each one of them and how we can help the main channel to sell more in regions that are not well explored, as Mauricio and Eduardo Dal Ri mentioned, without losing our main characteristic which is growing with balance and profitability. What we have been doing in the last years is to explore. We used to have a low penetration in Dental and this portfolio has been growing, currently we have more than one million of insured members. We used to have a pricing problem, so we adjusted our Auto underwriting and are capturing the benefits now, gaining market share but at the same time significantly improving the profitability. So, we look at the profitability of every business line, I could mention all the examples in the Life segment, as well as in Pension, Saving Bonds, in which we are exploring the real estate channel. The mix represents seizing the opportunities, our ability to grow with profitability. There is the proportion issue with Health, when you compare it with any other segment of the Company, it seems like all others are small, but we do have a significant share, not only from insurance premiums, but also from others operating revenues from fee-based portfolios. You must realize that there are more than R\$200 million per quarter in claims receivables, in asset management, in ASO, and much more. So, we are satisfied, but not in terms of the mix, we are satisfied with what the mix represents for our profitability. We are still looking to improve our position in each one of the segments.

Gustavo Schroden (Bank of America Merrill Lynch)

That's great Gabriel, thank you. I just have a follow up on your answer. The cross sell topic that you mentioned is interesting. Do you have a number to provide, in relation to clients that have more than one product, one type of insurance plan? If you could share some information about that, I think that would be great. The cross sell is an interesting issue.

Gabriel Portella (CEO)

I don't remember talking about cross sell, but I think that I intuitively said something about some products that can be combined, and I think we have good examples in the Company. The examples are related not only to the advantages of selling the products together, but also to channel training, allowing us to increase both cross sell and what I like to call 'share of wallet', which is our participation in the insurance brokers revenues and in the several segments. Nowadays Health and Dental are the most classic cases, health plans being sold with dental plans, this happens with auto and homeowners' insurance as well. 11% of our 7 million clients have more than one SulAmérica product, which shows not only the efforts that we have been doing in this front, but also that is possible to promote joint selling within our channel capabilities, considering what the policyholders want to buy, which products they believe can be combined. Life and personal accidents today are just one product, but actually are two different things. Health and Dental are mentioned together, Auto and Homeowners became just one process. So, there is this 11% and I believe we have a lot to do, but it depends not only on the channel capabilities to distribute, but also on the clients' willingness to buy this product with cross selling. We still have a lot to grow.

Gustavo Schroden (Bank of America Merrill Lynch)

Great, thank you very much for the answer.

Operator

Our next question comes from Rafael Frade – Bradesco.

Rafael Frade (Bradesco)

Good morning everyone. I would like to know, if you could comment, about the pricing scenario in the Health segment. The price readjustment calendar is very concentrated, beginning now in the third quarter. For SME plans, which are contracts up to 30 lives, there was a small deceleration compared to the readjustments from the past few years, but still at high levels. As we are in the beginning of the price readjustment cycle, is it possible to have more details on the process? Thank You.

Maurício Lopes (Vice President of Health and Dental)

Rafael, this is Maurício. Thank you for the question. You are right, we are seeing a deceleration, stronger in some portfolios, in others, not so much. I think that we are, maybe, in one of the last cycles with high price readjustments, even though this year was already lower than last year and also lower than the year before, so it's been decreasing. According to our calculations, there is a correlation between general inflation and medical inflation (VCMH), the VCMH has a considerable time lag and we're reaching the end of this lag. So, in the next months we should see, at least the market has been working a lot, a consistent decrease in the VCMH for the next cycles, this is what we price in our readjustments and they've proved to be right in the last two cycles, at least this downward trend. Let's see how it develops.

Rafael Frade (Bradesco)

Great. Thank you.

Operator

Our next question comes from Eduardo Nishio – Banco Plural.

Eduardo Nishio (Banco Plural)

Good morning to all, thank you for the presentation. I have a question related to the strategy in the Health segment. My question is related to what we are seeing in the market, the development of some competitors targeting the popular segment, the bottom of the pyramid. We saw some IPOs coming out with valuations well above SulAmérica's market cap. I would like to know from you what is the Company's perspective in relation to this segment, and if you intend to join it. I think Amil has just launched a brand, Next, to fight these new entrants. I would like to know if you think, since you are at the top of the pyramid, doing very well, we can see the evolution of the Company, the operational improvements, technology, etc, you're consolidating in the top of the pyramid... I would like to know if you have any ambition in the bottom of the pyramid. Thank You.

Maurício Lopes (Vice President of Health and Dental)

Hi Nishio, this is Mauricio. Thank you for the question. The Company has a thesis and we've been chasing it for a while. Our thesis, without discussing if it's right or not, as each one has its own market thesis, is that the verticalization process is more efficient if it is virtual and this is what we have been pursuing over the last few years, as we have been managing to induce risk sharing with providers and alignment, on behalf of the beneficiary. This thesis has pros and cons so, for example, as I was saying, we have been able to expand to different regions in the last months. This expansion does not need assets, we go there, we build the network, we train the brokers, we also negotiate and work in a productive way in these regions from the commercial standpoint and, consequently, from the results point of view. We have been pursuing this, and what we have found with our through our experience is that these claims and health management initiatives allow us to have more lower-end products, lower than what we had until now. So, we launched these two new products last month, and we are very confident that they will be profitable. If this is a fact, and we are just in the beginning of the health management induction process and in the beginning of the risk sharing process, it could, in theory, open avenues to work with more lower-end products. But we will only discover that over time, just as I imagine other companies are also testing the frontiers to their products. If you have a low average ticket, you launch a little more expensive product and see what happens, if you have the service level to serve your customer and so on. So, what I think is important as a concept is that everyone has a thesis. Our thesis is proving to be positive in the way it has been designed, a portfolio that was not profitable with basic products became profitable and we are testing a lower-end product in some regions. Where this process will take us, we will discover together over the next few years. Thank you.

Eduardo Nishio (Banco Plural)

Thank you. Is this thesis only related to geographical expansion or is it also related to product remodeling? How do you match a product, which in theory is more premium, to regions in which you are competing with a lower ticket plan and even with the National Health System (SUS)?

Maurício Lopes (Vice President of Health and Dental)

This has to do with network, health management and claims management. Claims management is more connected to the referred network while health management pays attention to the patient as a whole. Just by putting these two pieces together we can have a complete product. If you look at our history, you will see that we spent a lot of energy in the last few years managing claims. This homework is done. In my opinion, today, if you look at claims management, it is quite mature, around 80% of the energy we spent in claims management, today, is roll-out and only the remaining 20% in innovation. But since just a year from now, a little more than that, just to give you an example. So, drugs and materials' direct-purchase, artificial intelligence for reimbursement, all that is claims management and being rolled-out smoothly, also the processes for previous authorization, done in a very innovative manner, which is really good. Now, the Company is focusing efforts in health management, for more than one year now, it's a more complex field, but if it brings the results as claims managements did, in line with what we believe, it will complete the care coordination of the patient. And by doing that, it's not being vertical or not that will make a difference in terms of the quality of assistance, the quality perceived by the patient, but how you coordinate care. So, it is not only a matter of network, not only a matter of geography, it is a matter of having a complete strategy for patient care coordination, in which we have been spending 80% of the our efforts in new projects. Just to give you a number, we have fourteen ongoing projects linked to care coordination, all in agile methodology. There is a huge number of people involved in these projects and it seems that they will bring very good results for all of us in the next cycles, health management as whole. This is our goal; we are working in the operational, business, commercial and strategy fronts to achieve that.

Eduardo Nishio (Banco Plural)

Perfect. Thank you very much.

Operator

Our next question comes from Lucas Lopes – Credit Suisse.

Lucas Lopes (Credit Suisse)

Good morning everyone, thank you for the question. I would like to ask two questions related to the Auto segment. I would like to talk about two variables: price and cost. In terms of price, we saw acceleration, considering premiums over average fleet, there has been a significant acceleration in the second quarter last year, and it remained at a high level of average price variation, year over year, between 20% and 30% until now, this was in the third quarter last year. So, I think it is possible to imagine, that now, we will have one more quarter of average premium variation year over year and then stability. In other words, the question is: is the cycle of high price readjustments close to the end or, actually, this average ticket variation does not mean that much in terms of price? In relation to claims, something interesting that you always mentioned is that what has impacted the most, more important than the level of theft and robbery itself, is the surprise or disappointment related to theft and robbery figures. If you can anticipate that theft and robbery will be high, you already capture this in the price and the loss ratio comes aligned. This year, the levels of theft and robbery are stable or improving in the main regions, so my question is: did you have a positive surprise comparing to your budget estimates or not?

Eduardo Dal Ri (Vice President of Auto and Massified)

Well, let's go, this is Eduardo. Lucas, thank you for the question. Regarding the price readjustment cycle, we have been facing a considerable change in the portfolio mix. We are

changing a little the mix of regions, as a result of our distribution capabilities and a better understanding of the regional prices and regions. We have been reaching regions that were less covered by us. So, we have been growing at higher rates in the countryside without neglecting the metropolitan areas. For this reason it is difficult to track the average premium evolution as I am continually changing my portfolio mix, the mix is also varying in relation to the categories. We have a lower number of trucks and more individuals' vehicles, as the countryside demands vehicles with smaller insured amounts. For these reasons, it's difficult to measure the portfolio's health through the average premium, since at the moment the portfolio is changing frequently. Obviously, it is an important ratio, but at the moment, we have been analyzing the average premium in a segmented way, looking at each region, looking at each category, to see this evolution.

Lucas Lopes (Credit Suisse)

What about robbery and theft, how is it evolving?

Eduardo Dal Ri (Vice President of Auto and Massified)

Well, naturally our figures for theft and robbery have been better for two reasons: we are doing a better risk selection, we had a very binary risk selection, in other words, we did not accept some regions or a certain vehicle because it was too much influenced, for example, by the theft and robbery variable. With our new pricing tool, now we have a multivariate acceptance. We began to observe a selection of variables, rather than refuse based on a specific location or type of vehicle, I started to mix variables and this enables us to be more assertive. A set of variables revealed some bad risks in which the robbery index achieves 6% per year. So, instead of selecting by city, where there are good costumers, I was able to better select the risks to decline, for example. This helped us a lot since last year, besides the tailwind of lower levels of theft and robbery. The theft and robbery level in this quarter was impacted by the truckers' strike and by the World Cup, which explains the lower theft and robbery frequency that the market and SulAmérica have also benefited from. But our trend, looking at theft and robbery figures over the months, was benefited by theft and robbery not because of an improvement in public safety, but due to our better risk selection.

Lucas Lopes (Credit Suisse)

It's clear, Eduardo. Thank you very much for the answers.

Operator

Our next question comes from Domingos Falavina – JP Morgan.

Domingos Falavina (JP Morgan)

Thank you for the opportunity. My question is related to a section in the earnings release. The passage mentions that you presented a lower loss ratio because of new underwriting tools. It suggests that you have changed the auto risk underwriting system. I would like to understand what exactly happened, what are the implications, because there were significant improvements.

Eduardo Dal Ri (Vice President of Auto and Massified)

Domingos, could you please repeat your question?

Domingos Falavina (JP Morgan)

Ok, I'm sorry. My question is: the explanation for the improvement in the Auto loss ratio, mainly in the English document, is related to the introduction of a new technological underwriting system, new underwriting tools. I would like to understand what exactly changed, if have you changed the whole underwriting system. Why is it better? I would like to understand the improvement in more details.

Eduardo Dal Ri (Vice President of Auto and Massified)

We have been doing this investment for a while, and now, I am talking, for the first time, about the results this investment is bringing. When I talk about investment in underwriting, actually we did an investment in a new pricing mechanism which I can breakdown in two parts: the first one is the building of mathematical models, now we can build these models much better, using a better price segmentation, but, fundamentally, this project is about translating the statistical models to price. In the past, it was possible to build statistical models, this is the most trivial part of the process despite its sophistication, but there was often a frustration of not being able to turn it into a more assertive price – a higher or a lower price depending on the risk. Sometimes I could only price using the average or the lower range, we had less possibilities to use what we learned from the models. I don't know if my explanations were clear, but basically, this new pricing system uses the statistical models, that are, mainly in Auto, very predominant in setting the price to define more assertive sales, the price that is practiced by our broker. This system provides better underwriting because I can mix variables instead of, as I explained before, choose based on only one variable, for example, removing a specific vehicle from a determined city. I can make a multivariate acceptance, in other words, I can choose a specific vehicle in a specific city to decline. In the previous model, I was only able to do it for the entire city, but actually I found out that I could underwrite risks for a certain vehicle model in a certain city, so, I continue underwriting certain policies for vehicles in a city where theft and robbery levels are not that good, because I'm able to find good niches to continue operating there.

Domingos Falavina (JP Morgan)

Pretty clear, excellent. Let me ask another question. Do you believe that this new model had more of a positive impact in the loss ratio, i.e. a better price distribution between vehicles with an overall average that does not change too much, or also a contribution to a higher premium growth? In other words, were you able to reduce prices in some locations, but, on average, prices increased more than decreased?

Eduardo Dal Ri (Vice President of Auto and Massified)

Look, at the moment both are strong because, actually, the pricing project is taking advantage of the adverse scenario faced last year. As I said before, now we can absorb a client that we could not before because we weren't able to have a price adequate to its risk, or sometimes the price was too high. This typically happens when you are not able to set the ideal price. Sometimes it was a mistake because you're conservative, and you ended up losing the client and, in the same way, it could be a too low price that would lead to a higher loss ratio. So, at the moment, we are experiencing both trends but, in the future, as the system enables us to choose the better strategy, for example, to face a public security crisis, I will respond to theft and robbery deterioration faster than before. This will inevitably mean that I will often have to raise prices more than the market and this may impact production a little. So how is this new system delivering results? At the moment, the new system is delivering results on both fronts: top line, helping our commercial distribution capacity, and bottom line (loss ratio more specifically). But, at some point, there will be a choice, between top line and more operational efficiency. Or, in the event of a crisis, it will respond with faster price increases, sacrificing top line.

Domingos Falavina (JP Morgan)

Thank you, it's pretty clear. Congratulations for the improvement.

Guilherme Nahuz (Executive Superintendent of Investor Relations)

We have got a question from the webcast, from Pedro Gonzaga, Pacífico Gestão de Recursos. I am going to read the question.

“Was the Health loss ratio benefited by special events in this quarter, like the truckers’ strike or the World Cup? If so, what would it have been without these impacts?”

Maurício Lopes (Vice President of Health and Dental)

This is Mauricio. Thank you for the question. Regarding the truckers’ strike, it was statistically irrelevant, we did not find anything that really impacted the loss ratio, either in the reported or incurred. Obviously, there are claims yet to be incurred, according to accrual, and we will continue looking into that but it does not seem to be relevant. As for the World Cup, there were some impacts, but they are small and do not materially change the results. Just to remember, this event happened in the end of June and in the beginning of July, there just two games in July, so we are going to observe how it will develop in the next months, but it’s a small impact, nothing noteworthy. Even though it is a good theory, and we were also expecting some reduction in claims, it was not significant.

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