

3Q18 Conference Call Transcript – Q&A

Operator

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

Eduardo Rosman (BTG Pactual)

Good morning everyone, congratulations on the very strong result. I have two questions: first, I would like to understand this seasonality. I know the insurance business has a very strong seasonality. I remember that the first quarter was not so good and I think the share price dropped considerably on the day after the disclosure of the results, and you were very clear that the snapshot didn't look so great, but the trend was still very good. I think that this statement was confirmed in the second and third quarters. So, I would like to understand if the picture in the third quarter was too strong or if you believe the trend still is, in fact, improving so you could maintain this profitability over future quarters. The second question is: is it possible to give us an update on the health regulation environment? I know there is a public hearing related to the change of the solvency margin mode and there is also a project in the Lower House to link medical compensation to readjustments in plans, there are new technical provisions, IBNR, etc. So, if you could update us with what is being discussed in terms of regulation in the health segment, it would help a lot. Thank you.

Gabriel Portella (CEO)

Thiago, as you didn't specify the segment or the business line, I will give you an overview about Health and Auto, as I think that you are talking about these main segments. I think that you very appropriately mentioned the seasonality, it's a characteristic of the insurance business and all of its business lines, but in the case of the first quarter, we explained it and you confirmed, that those figures didn't represent a trend, we did see some factors impacting but we are going to follow our regular trajectory. When we look at the performance in the quarter, later I will let Mauricio speak about Health and Dal Ri about Auto, but the variables are all positive, which doesn't mean this is the new normal, it means that we have to bear in mind the seasonality in the quarter. Usually, this is one of the strongest quarters, when we consolidate a big volume of readjustments, which in the case of Health begins in the second semester. We have been capturing good results in Auto and in everything that we have been investing in terms of improving the underwriting. Now I will hand over to Mauricio but, without a doubt confirming what you said, recovery was the main trend and it's been confirmed. This quarter has positive aspects, typical characteristics of the quarter, but we are always preparing for the challenges ahead. So, I will let Mauricio and Dal Ri speak a little bit more about the effects in each one of the business lines.

Mauricio Lopes (Vice President of Health and Dental)

Hi Thiago, talking about Health, I will answer your first question related to seasonality following up on what Gabriel was saying. After that, Eduardo will talk about seasonality and then I'll return to talk about the second question, which is about the regulatory environment, otherwise my answer will be too long. What we have been noticing is that, in fact, the third quarter is the one in which most of the price readjustments are concentrated, when the after-sales team does the renewal of the biggest contracts of the Company, notably the individual and affinity portfolios. Today, the SME portfolio is almost uniform, almost evenly distributed throughout the year, and

we have large contracts in June, July and August for the corporate portfolio. So, what we are seeing here is: we got a very good volume of readjustments that were very adherent to what we needed, in line with what we had been doing in the previous years, in terms of keeping the portfolio sustainable, and the retention cells are working very well. Just to give you a number, SME's retention is almost at 88%, Corporate is around 95% and, more important than that, the NPS (net promoter score) that we are measuring for a number of activities, in a recurring way for a while now, in retention cells for SME, for example, floats above 60 points, so in addition to our ability to retain well, the process of retention is being very good for all costumers. In addition to the high retention level, the sales team has been doing well, sales are up by almost 17% over the same period of 2017 in terms of lives; we're adding lives and mouths in Health and Dental. In parallel, the portfolio is showing organic growth for three quarters in a row, with no commission payment in this case, it's very good, in the main portfolios. In other words, we're seeing positive movements in the contracts, when hires are greater than lay-offs, and this has been very satisfying, it obviously helps a little bit in the loss ratio, there's a time for the beneficiary's ID card to arrive, to get to know the network, to go to the first doctor, etc. But more important than anything, I'm discussing two structural factors: in other words, we can do an excellent retention work, sales, customer satisfaction and service level, but, in parallel, we can see the medical inflation and the loss ratio decreasing in a very good way in all portfolios, including the individual portfolio which was a concern in the past. This adjustment, this decrease in the medical inflation, comes both from a greater frequency control related to all initiatives carried out by several teams - products, operations, control, care coordination, etc. – as well as to network adjustments, hospital network, labs and doctors, in line with what we expected, what we planned in the beginning of the year and this has been very satisfying. We are doing a well-structured partnership with the network, the provider teams around the country have done long-term agreements with labs and hospital networks, doctors network, no more short-terms agreements, price readjustments are smaller, the packaging of procedures is faster, we're dealing with risks more efficiently, with more robust and structured packages. This, obviously, is translated into better loss ratio, so I think this is what you have seen in the last few years as a whole. So, I will stop here and I am going to turn it over to Eduardo.

Gabriel Portella (CEO)

Eduardo, before turning over to Eduardo Dal Ri, I apologize, we confused you with Thiago. So, Eduardo, Dal Ri will answer your question now and my apologies.

Eduardo Dal Ri (Vice President of Auto and Massified)

Eduardo, this is Eduardo speaking. I am going to talk about Auto. The seasonality is less meaningful throughout the year. As might be expected, the second semester is always better in terms of loss ratio than the first one, at least when we look at historical figures, not only ours, but also for the market as a whole. It also happens in the Auto segment, I could emphasize all the investment that SulAmérica has made, the market improved and SulAmérica improved more because, first of all, we came out of a crisis that was somewhat more intensive than the one experienced by the market and now our loss ratio is a little bit lower than the market's, but the market has also improved this year, the market loss ratio improved almost in 400 BPS, this is a result of more stable and rational market in terms of price, when we compare the relationship between costs and risks. Additionally, SulAmérica had a better quarter than the market because we are somehow maturing the investments that we've been talking about in the past calls. They go from a pricing system in which we invested a lot to improve not only risk acceptance, but also to improve the definition of the price, by better understanding risks and its changes and, of course, we are recovering the vehicles we had lost last year when we worked with prices which were already more adequate to the risk level while the market was more aggressive. We didn't want to be aggressive as well because we needed to improve our results and this year, this customer, this broker that went to another company naturally returned to us, submitting quotations and bringing back customers. As we now that know our customers better,

we can make better choices in terms of which customers to take back and retain, and this helped us a lot. In addition to all of this and still speaking of production, which invariably affects our results a lot, we've launched a new quote system, in which the broker makes all the interactions and submits the calculations and this, added to a greater effectiveness of our sales team, the sales team is working closer with the whole network, allowed us to increase considerably the numbers of quotations submitted to SulAmérica. This has also increased our capacity to choose our customers, enabling us to not only improve, but also to choose our customers better and increase premiums at the same time. So, basically, I have tried to give an overview not only of the seasonality of the loss ratio, which I think is quite different from Health, the seasonality is not related to the period of the year, it goes beyond it, the market was operating with a higher loss ratio and now is recovering and for SulAmérica is not different, we're actually improving more, and I also covered the production issue. So, I hope I've answered your question and now we go back to Mauricio who will answer the legal one.

Ricardo Bottas (Vice President of Control and Investor Relations)

Maurício, just a second. Rosman, since you asked a more general question about seasonality and in my presentation I briefly presented one component that explains the deviation seen in G&A expenses, even though the index is under control, the absolute increase is related to the taxes on interest on capital. I made a point to clarify the net effect to make it clear that it was immaterial, so, the interest on capital paid in the subsidiaries in the second and third quarters does not materially impact the regular seasonality, considering that the most relevant impact occurs in the fourth quarter, with the distribution of interest on capital by the holding company, OK? Mauricio.

Mauricio Lopes (Vice President of Health and Dental)

Hi Eduardo, in terms of regulation, I think that we've got to break it down. At the federal level, the "blocão" issue you mentioned, I think nobody can really anticipate or predict what is going to happen in the Congress in the upcoming months. There is going to be a new Congress composition, there are a number of bills in the Senate and in the Lower House, several topics being discussed at the same time, besides new agendas that will be brought to our attention. I don't have a clear vision of what may happen from now until the end of the year, what I know for sure is that there are many topics competing for the attention of the Congress, therefore I don't have great expectations in the short term. In the second level, which is the Executive and the agencies, we can see that there are some topics being discussed; they are not at decision level yet. There are some proposals to be discussed: work groups, readjustment, contracting process and relationships among providers, IBNR, compliance. All regulatory issues have begun a cycle of discussions and I really don't know when this cycle will end. What I can say is that we have been participating in all forums, represented by Fenasaúde, our association, technically discussing all topics, some of them seem to be more promising than others, but this depends of the point of view. If it's something which is going to increase the requirement for capital, it might be good for SulAmérica because it's going to concentrate the market faster, however that won't be something good for other company. So it's difficult to have a sectorial view about these regulatory issues because the market is very heterogeneous and we have a representation by Fenasaúde which is a federation, so, of course, there are also specific issues in its agenda, like others federations. So, I would pay attention to the movements being made now, but I reinforce this point. We've been part of these discussions. These topics are still being discussed, so aren't close to a decision yet.

Eduardo Rosman (BTG Pactual)

Perfect, it's pretty clear. I would like to thank you all for the very well detailed answers. Thank you.

Operator

Our next question comes from Lucas Lopes – Credit Suisse.

Lucas Lopes (Credit Suisse)

Good morning everyone. I have two questions. The first one is about Health, I would like to know, if you could elaborate, on the Company's initiatives in the mid-ticket segment. We know that the Company has a combined ratio similar to vertical players, with a higher loss ratio and less G&A allocated to your non-vertical structure and I would like to know if it's possible, I think you have been studying the possibility to reduce the average ticket and operate not only in the premium segment, but to compete with Intermédica, Hapvida and join one of the segments that grows the most in the market. And my second question is related to Auto. We have seen a deceleration in premiums, not only in market figures but also in the Company's results and talking to people in this industry, I get the impression that auto insurance prices have been going down, that would be the trend of this second semester. So, I would like to know if you have been observing the same trend, if there is more competition in the second half of the year and if you think that this more competitive landscape will make it more difficult to present insurance fleet growth. Thank you.

Eduardo Dal Ri (Vice President of Auto and Massified)

Hi Lucas, I will begin and then Mauricio will take over. About the competitive landscape, you are right, September data just came out and it shows a decrease in premiums in this month. Today, the market as whole is growing 3.6%, one of the worst prints, but when we talk about price war, and I have been in the market long enough to know that it happens all the time, there is always someone behaving like that, now it's not different... I don't believe there is a generalized war, I think that there are less premiums, there are less customers in the market and this is natural, this is why the companies are making more investments to seduce this customers, not only through product and services, but by having the best offer, the best cost benefit relationship to attract customers. We have suffered a lot in the Auto segment, we lost new vehicles. The sales of new vehicles has dropped a lot since 2013, we began to see positive figures in 2017 and this year will also be positive, but it's still insufficient to recover the insurable fleet, the amount of vehicles aged between zero and ten years old, with the percentage of insured vehicles varying according to the age. So, what I believe is happening now, yes, you are right, players are fighting with price in the market, this is natural, there are at least 20 insurance companies fighting for the same customer, but there is also a lower volume of premiums in the market, because the fleet is aging, there are some customers leaving the market, at least temporally, until the fleet resumes to grow. This reinforce what I said before, our necessity to make investments, to continue to improve our measurement of risk and to work to attract more customers, not only through our brand, but with the whole proposal we can offer. Just a detail about September, we saw a decrease in the month due to the lower number of business days, there were 19 business days, so probably we will see an increase in October and the 3.6% figure will probably go up. I expect the market will grow a little bit more than this 3.6%, but it's going to be a challenge, not only to increase average premiums, but to increase the insurance market as a whole, this is going to be a task for all of us. So, if you are satisfied with my answer, now I hand over to Mauricio.

Mauricio Lopes (Vice President of Health and Dental)

Well, Lucas, for the mid-ticket segment, SulAmérica does not believe that only reducing the network will reduce the loss ratio enough to allow us to enter the mid-ticket segment, as we also don't believe that increasing the network is enough to make the customer like the product better, at the level of a premium product. It's more than that, on the one hand is the service level and on the other hand is an effective control of the loss ratio. It's not just to scale the network up and down, by just changing the network you can't change the capacity to perform in another segment. Why am I doing this introduction? Because we started a journey some years ago, trying to go into the mid-ticket segment, without losing the capacity to be a product with a higher

average ticket with customer satisfaction, so the Company has an obsession with the NPS related to all services it may launch, everything is measured, everything is analyzed, trying to have the satisfaction associated with a higher ticket and, at the same time, be able to have a lower ticket, with control and without losing the satisfaction. So, we put into place several claims management projects, health management projects and the Company has a set of initiatives, in several fronts, with more than 150 people involved, at the moment, to develop a number of functionalities that can provide frequency management capacity and the capacity to steer the clients, with quality, to the providers that we consider more efficient. We've been working for a while and this is what we call coordinated care. This care coordination is already with almost 100 thousand lives under management and it's showing excellent results, not only in terms of satisfaction... The care coordination NPS is around 85, which is very high and at the same time it's showing a better-than-expected control of average claims, so this is making it viable to work in the mid-ticket segment more efficiently. We've launched two small pilots with two products, Vital and Extra, and now we need to observe how they are going to perform in the medium term, but there is also an extension of our national footprint being addressed between the team dealing with the providers and the commercial team, in order to give us more coverage in some regions of Brazil, where we previously didn't have coverage and which could be faster avenues to grow with the mid-ticket products. So, it's a journey, we've already started, results are good, we still didn't get to the level we want but we've started the process and you need to follow this up with us for a few more quarters.

Lucas Lopes (Credit Suisse)

That's right, Eduardo and Mauricio. Thank you for the answers.

Operador

Our next question comes from Rafael Frade – Bradesco.

Rafael Frade (Bradesco)

Good morning everyone. I would like to go back to Rosman's question and maybe put it differently. As he said, considering seasonality and the importance of the fourth quarter to the result as a whole, there were some situations in which we had a weaker third quarter and a very strong fourth quarter very strong, or vice versa. I would like to discuss how we can imagine this. I mean, we had a very good third quarter, but could it eventually be an anticipation from the fourth quarter? How should we think about this continuous evolution for the fourth quarter? And the second question is related to... as you presented a profitability that was around 16% in the cumulative of the last twelve months, I think, considering historical figures, SulAmérica has a profitability of around 15%. Looking forward to 2019, it's not really guidance, but a discussion about a possible a reduction in the tax rate, perhaps there will be an increase in interest rate, so can we think about a profitability of around 17%, 18%? How do you see the possibility to continue to increase the profitability? Thank you.

Ricardo Bottas (Vice President of Control and Investor Relations)

Frade, this is Bottas. I will try to answer your two questions together because they are somehow related. There is a component of your question that talks about an eventual anticipation in the third quarter. Except for what I talked about interest on capital, I also mentioned the figures, they are completely immaterial because the holding company has not yet declared interest on capital, which would be an anticipation in terms of what we did last year. This component, which has a net impact of R\$7 million in the first nine months of the year, benefited the first nine months of 2018 because last year it happened only in the fourth quarter. This is the only material effect in the third quarter. Speaking of operational issues, the number of the third quarter represents what was accrued in the third quarter. As to the fourth quarter, it is not an expectation, the seasonality of the fourth quarter is a given, in particular related to the health loss ratio behavior, mostly health, which is historically lower in December. Also as you already helped me to answer your question, as we don't provide guidance, what we do to try to illustrate

is the behavior of this seasonality and that's why we talked about the ROE in the last twelve months, it was exactly to capture the profitability of the last nine months, but also seasonality effects, there are other effects that may affect the fourth quarter but we need to wait. The market, as already explained by my colleagues in the operation, we can see in the high-frequency data from ANS and SUSEP, there is no expectation of a reversal in the current trend, but we can't give you any guidance for the fourth quarter, much less for 2019. For 2019, there are some components that still carry some risk in its premises. For example, the change in the tax rate, as today we may have a scenario in which it remains the same and another in which there is a relevant impact on profitability. In the same way, there are issues that are related to capital as denominator of the equation, which are related to regulation and are not under our control, but we look for the combination that can give us a better profitability. We'll keep seeking the best performance in terms of results and capital optimization, we look for this combination, but we can't tell you if we are going to change levels, if it's going to be the x, y or z. OK?

Rafael Frade (Bradesco)

OK. Bottas, if you allow me, just in terms of seasonality... Actually, there is one factor that I would like to understand if had an impact or not, which is the closing of the quarter. September ended on a weekend and we know that one or two days sometimes make a big difference in the loss ratio. What I would like to understand, anticipating the fourth quarter, actually is if there were some claims that will only be accounted in the fourth quarter because of the calendar effect. I would like to understand if it's relevant or not.

Mauricio Lopes (Vice President of Health and Dental)

Hi Frade, This is Mauricio, thank you for the question. No, as far as we can see, everything that we have been monitoring, it's all business as usual, there's nothing in terms of reduction or increase in deliveries per working day in this cycle. I don't know how it's going to be in the end of December, but in the end of this cycle there wasn't a holiday, so we didn't see any atypical movement.

Rafael Frade (Bradesco)

Perfect, Mauricio, thank you.

Operator

Our next question comes from Guilherme Palhares – BTG Pactual.

Rodrigo Gastim (BTG Pactual)

Hi everyone, actually this is Rodrigo Gastim. I have two questions, the first one is related to the premium segment. We heard from some health insurance operators, even from some service providers, that there's been a stronger pressure in terms of downgrades of healthcare plans over the last few months, it came even with a lag, it was a little lower in 2015, 2016, but from 2017 until now it's been stronger. I would like to hear from you how this is actually happening, this downgrade movement. Which products did you develop in the past few months and quarters to cater to this demand for downgrades? Do you see a reversal of this trend at the moment, with some improvement, some reduction in this downgrading movement? This is my first question about the premium segment. The second question concerns the JV with Healthways. I would like to understand how much this constant improvement in the loss ratio over the past few quarters is related to this initiative, how much of this improvement is coming from this partnership with Healthways and the better big data analysis that you have been doing together. What is the percentage of your client base that joined this program which proactively feeds the system with information and that allows you to eventually engage in interesting preventive programs? So, if you could talk about the evolution of this partnership with Healthways it will help a lot. Thank you everyone.

Mauricio Lopes (Vice President of Health and Dental)

Hi Rodrigo, welcome to our call. Let me tell you what we have been doing for the premium segment, this equation is difficult to analyze in the way that you have mentioned, because it's indeed a fact that there have been some downgrading and upgrading in the portfolios, and we repeated this a number of times over the past quarters, it's not the first time. On the other side, the portfolio has been growing consistently, so even though we might have some downgrades in parts of contracts, we have also been absorbing other chunks, from other contracts or even the same contracts that have premium population. So, for us, it would be difficult to say if the downgrades are relevant or not. We can see our premium share increasing, it didn't decrease, exactly the opposite, it has increased, because we have contracts in which we had hypothetically, the middle of the pyramid and now we have the top of the pyramid, or contracts that we did not have, but when this customer see the number of functionalities, online reimbursement, house calls, digital membership ID, mapped referred network, the premium customers get more attracted to our product. So, it is difficult to separate these things, we can't tell you if the premium market, as a whole, is shrinking or not. In our case, it hasn't, it's been growing. Speaking of Sharecare, which is the current name of Healthways, remembering that Healthways was sold a few years ago to Sharecare, a company which has a number of large investors like Sony Channel Entertainment, Discovery Channel, Oprah Winfrey, Dr. Oz, it is a much larger company and we have 49% of Sharecare Brasil, we are not controllers, actually we are clients of the company. We've had an excellent result in the clinical programs and we have almost 90 thousand lives in clinical programs here, from wellbeing coaching, which is the simplest program, to more complex ones such as complex heart conditions, epidemics, diabetes, and this is generating very good results in terms of claims. For each BRL invested, the returns are around 2.5x, up to 4.5x depending on the program. In the beginning of the year, we launched the new digital platform, which is the engagement platform for wellbeing, we are seeing the first results, people are downloading, and we've been tracking the performance, but more important than the platform and clinical programs, and I go back to coordinate care, is this journey. For many years we used to have a number of actions which were stand-alone initiatives, so there was a stand-alone program for chronic patients, a stand-alone program for complex cases being managed by people in the operation, a stand-alone program for the direct purchase of materials and so forth. What the Company has done in the past eighteen months, which is this new cycle, was to being to build a common platform to connect all initiatives and this connection generates synergies and this is what we call coordinated care, this is what we have been doing at the moment. So, if the program for chronic patients was already powerful on its own, there is a chance it becomes even more powerful when connected with the provider's network, with doctor level I, doctor level II, with other programs. So, this has generated much more synergies, we changed the focus of the programs to the patients.

Rodrigo Gastim (BTG Pactual)

Excellent, Mauricio, it's pretty clear. Thank you for the answer.

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