Felipe Salomao - Brasil Plural – Analyst

My question is more theoretical. Over the last three to four years, the result of the second quarter usually is the weaker seasonal result for the year maybe considering factors that are lagging behind due to the adverse scenarios or maturity of agreements and when we consider the announced transfer to the third quarter and also due to seasonal reasons. Now this year, you had significant results considering quarter-on-quarter and year-to-date figures. So what changed this year vis-a-vis the last two or three years?

Well, there is a rupture in the trend for results. I'm asking you this because economic indicators in Brazil by and large are not doing very well. Job generation has a slowdown and also the same applies to economic growth. And you managed to have good results despite the adverse scenarios. So what changed this quarter vis-a-vis the previous years? And then I have a second question to ask. Thank you.

Gabriel Portella - SUL AMERICA SA – CEO

In reality, this is a positive math job. This quarter last year we had a competition of many factors and we don't have a silver bullet or a single explanation. Claims control measures were made for Health for instance, and maybe Mauricio can give you more detail than that. The good underwriting practice that Carlos Alberto can also give more details for Auto, the measures that were not taken actually now, but last year. So when you look at the quarter, please take into account that we had a positive balance of a series of efforts that were made, not only now, but over time.

So there is not a single explanation. That's why I'll give the floor to Carlos Alberto and perhaps he can start by addressing the positive effect of Auto this year, and later on Mauricio can also make comments about Health this quarter. Carlos Alberto?

Carlos Alberto Trindade - SUL AMERICA SA - VP - Auto & Property

Let us briefly address the results for Automobiles. Results for Auto, as Gabriel mentioned before, these results stems from several measures and also from a strategy that developed about a year ago in terms of portfolio positioning involving a large series of actions related to pricing and also with regards to improvements in operation.

We also were strongly engaged to control cost related to service to customers and particularly lawsuits and claims and also several changes in the commercial strategy that were implemented with Matias. And there was a very significant impact not only on risk quality and better and mostly to build prices, but also increasing capillarity and the number of quotation, so with a mounted expansion in our production capacity.

And this combination all together led to those results. So as Gabriel mentioned in the beginning, the results achieved now do not come from a short-term move, but rather it has been well thought of for quite a long time now. I understand there won't be any changes in our plans for the future. We always consider our capacity to generate results at the front line and not growing at any cost as a strategy. So we want to stick to this line of result generation and also trying to find room and also work on strategies, but the winning strategy so we can increase our portfolio size and also our ability to deliver. Since you have a lot of homework to do, obviously I'm not going to talk about that now because that would give hint to our competitors.

But we have many projects underway right now. Our strategy is very well set and we understand that we will still bring far more productive things into the markets. And maybe you have this question in mind or many of you may have this question about market in mind. I understand the Market is already conditioned. We had a new price level not only due to previous results, which were very poor, but also considering the policy cost, whatever was concluded and the up tick by new prices.

So all this have been absorbed and you could see a market environment that is very healthy nowadays. But the industry is concerned to deliver operating results since all the interest rates moves have shown how volatile the process may be and how it can add to our activity, not as a driver only.

I believe that's the market's perception regardless of the interest rate growth that we are beginning to see. I believe things have begun more mature. I'm not saying that the processes will disappear cost wise but I believe they will be milder. And obviously for those who would like to venture, there is a price to pay in the future because in our business while getting in this cyclic standard is what keeps the high cost and we are not willing to go on that route. Now, I'll give the floor to Mauricio to talk about Health.

Mauricio Lopes - SUL AMERICA SA - VP - Health Dental

Felipe, thank you for your question. Following what Gabriel said there is not a silver bullet this quarter or a substantial rationale vis-a-vis previous quarter. But this is a calendar effect that we explained in the first quarter which is an increase in loss ratio due to a transfer of the last strong -- the first quarter of 2015 in our network also combined to a strong action delivered on premiums and control our portfolio on loss ratios.

So there is a series of projects that have been used over the last couple of years and they are reaping fruit now, some of them faster, others slower. These are related to materials or Health management or Pensions. So we have a broad menu where they are delivering over time and there gradually have been more return than we expected from some of them. So be it in a medical management or loss ratio and adjustment, we had good results this quarter combined with a calendar effect of the previous quarter which you saw that was an outliner.

I still would like to make another challenge to answer a pretty big question. A comment for the quarter as a whole, to some extent it validates the multi-line model adopted by Sul America. With the portfolios not related among themselves, we have different behaviors and contribution at different quarters.

What we see now is very good performance in the Auto portfolio, not only premium volume wise but also a reduction in loss ratio contributing to the operating margin and net income. This quarter, our Health loss ratio behavior was improved compared to what we typically expected for this quarter. So that's a comment I'd like to make and I wanted to make about the multi-line strategy adopted by the Company.

Felipe Salomao - Brasil Plural – Analyst

Perfect. Thank you very much for so detailed explanation. Now, the last question is very brief. Historically, the second quarter seems to be seasonally stronger compared to the first quarter only due to the renewal of Health agreement. Is this expected to happen in the third and fourth quarter, becoming better and better, or any reason why this would be flattened or does it make sense to assume what happened in previous years will happen again in terms of seasonality and improved result? Thank you.

Gabriel Portella - SUL AMERICA SA – CEO

There is no reason not to believe that the second half of the year will not bring the same volumes we had before. We are aware of seasonality. This is positive. We had the adjustment and we keep on having strong new sales, we keep on selling well. So there are many opportunities in-house. There is no reason whatsoever not to believe that the second half of the year will be as strong as it has been so far.

Felipe Salomao - Brasil Plural – Analyst

Perfect. Thank you very much.

Gabriel Portella - SUL AMERICA SA – CEO

You're welcome.

Victor Schabbel - Credit Suisse – Analyst

Thank you for taking my question. Actually my question is related to the re-composition of the margins and the management's effort to protect the Company's profitability in a more challenging scenario. I know that obviously there are many efforts to be taken down the road. But is there any room for administrative expenses in the percentage of earning premium or an important component of the combined ratio? Any room for this index getting down over the quarter, the third quarter, considering the efforts that you are implementing right now in terms of cost control and obviously another composition for margins? I'd like to know if there is room for that or the bulk of whatever could have been captured has already been captured. Thank you.

Arthur Farme - SUL AMERICA SA - CFO, IRO

Thank you for your question. I will expect anything in the short timeframe, I think the Company has been improving the index. Now, you will have investments that we need to make to support our investments and performance. As to customer's position, they should optimize G&A as a whole. We'll have actions underway that will drive to improve index. I'd like to remind you that two key portfolios still have scale issues to be improved. They are a burden to administrative expenses, but they contribute more to retain premium and consequently things will be improved if we move or change these compounded effects. Expense wise, this quarter we already include SulaCap expenses. SulaCap is well integrated to our expenses.

In other words, the lower index would be higher. Secondly, we have no expectations in terms of earned gains from redesigned processes or changes in operating system in a short timeframe and is expected to have within the next two or three years from the moment, we can reap the benefits of these projects. So that's a growth index. Obviously, it is a heavy weight in the combined ratio as we showed it. But in the short run, I would say it will be stable or slightly going down with an outlook for improvement down the road.

Victor Schabbel - Credit Suisse – Analyst

Perfect. That was a very clear explanation. If I may, just another question. We've been seeing that Dental has been helped to increase volume despite our more challenging performance not only at Sul America but also in other carriers in other segments as well. If possible, could you give more details about the room for this additional performance in the quarter? Dental a year ago accounted for 30% of the corporate SME portfolio and now we have almost 40% or 38%. Any target in mind for cross-selling for instance? Have you been following that up because certainly there is no room for that? So I'd like to have a better understanding about this potential. Thank you.

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

There is a lot of room for improvement. We've been checking the growth in the Dental portfolio both on new sales and in-house in this portfolio. We've been really making efforts in achieving Health as we're cross-selling both for new sales and also for those who are already in the portfolio.

So the new adjustment negotiations, particularly in a complex environment, as we have said in the previous conference call, for Health this allows to have Dental combined. So we are in the negotiation package. So there is no reason not to believe that we are very close to our full potential. There are many more products, more life insurance and more revenues to earn. Now for Caucasian and Asians, well we have about 50% of our Caucasian volume and these Caucasians already improved all the potential, all the tools required to sell Dental insurance together with Health to our customers, and we've been very successful in this arena, not to mention the Dental growth which alone already has a market. If it were a standalone, it will grow anyway. And now combined to Health, there is an even bigger potential. In our adjustment conditions, there is a lot of compliance for the Dental. So later on possibly we can sell even more Dental claims.

Victor Schabbel - Credit Suisse – Analyst

Thank you, Mauricio. Thank you for your explanation.

Gustavo Lobo - BTG Pactual – Analyst

In the first quarter is that your Health result was very poor. Even considering the calendar effect, it will remain weak. So possibly it will take a very strong adjustment in the new cycle. Now we are ready almost getting into August and I guess more negotiations already took place. So what about new the adjustments and what about your customer response?

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

Gustavo, thank you for your question. Mauricio speaking again. The thought is good. I think the main argument behind is good. Response if we can break that down to some components, the brand remains a proven brand. The level of service is still very strong and customers acknowledge this.

In a full employment environment or better retention of Company's employees, we believe that the Sul America brand still makes a very good differentiator and we can see that in the low churning rate that we can see with adjustments. Now, the second driver to our favor is that the Market at large has a very high large ratio behavior in the previous quarter as you can see data disclosed by EMS in the first quarter vis-a-vis 2012. And this environment of lower loss ratio in the market at large leaves all players to have the right sustainability measures. So our peers "also have a more defensive approach" and the customers are more oriented to renewing the policy and to remain with us a preferred driver in today's environment and considering how we struggle to retain beneficiaries exchanging. I'm sure it brings a lot of questions between employers and employees. So they are more persistent to stick to the Health benefits they currently have.

Gustavo Lobo - BTG Pactual - Analyst
Thank you.

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

And the supply are more comfortable.

Gustavo Lobo - BTG Pactual – Analyst

Okay. What about the order of magnitude of adjustment? Last year adjustment was very strong. And apparently that would take -- also take a strong adjustment or even greater this year. How about that?

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

Adjustment remains strong as in the previous cycle. I guess the right response is the amount last year to the market as a whole was not enough to handle the market's loss ratio. So the market's position right now is stronger then. There is no sign to show that it will get worse or better than the previous year because we're very much in line with whatever happened already.

Gustavo Lobo - BTG Pactual – Analyst

Thank you.

Henrique Navarro - Santander – Analyst

Many of my questions are already answered. Now one final question, competition. The market was trying to manage it's position, and if it would be more aggressive or not. How do you feel competition not only for insurance but also competitor? Any change in the scenario?

Gabriel Portella - SUL AMERICA SA – CEO

Enrique, this is Gabriel speaking. Are you referring to any specific line or at large?

Henrique Navarro - Santander – Analyst

More specifically for the Auto segment. It would be more interesting to see that.

Gabriel Portella - SUL AMERICA SA – CEO

It is really cold in Sao Paulo, that's why I have a cough. The temperature was better today. Anyway I see that they are closing the cycle or the operating cycle in a very positive manner. Nothing severe has happened. Now the growth in the Auto segment has been also strong over the period. But nothing considered to be an outlier. So they are benefiting from the synergy. And price wise, I can tell you that the policy at least under my perception, the policy is very much in line with the brand's policy now showing a very healthy manner. We're not trying just to grow out of cost or price. So we're working on all those structures without causing any major impairment in the markets. I'd like to ask Matias to add on to my comments. But there is not a greater perception of big moves of the Company groups or conglomerates. It is business as usual.

Matias Avila - SUL AMERICA SA - Commercial VP

Matias speaking. What we see in the Auto market, if you can see there's a market growth by the whole life factor mentioned in the policy card and also development of the cost required for loss ratio, particularly index series. Now, I'd like to mention we've been trying to address with a lot of technology in front of the risk. This of Auto, as if they were one by one, and also observing the profile at risk, and also regionalization very carefully. And as a result to our broad base and 30,000 brokers, we had very significant information. And this allows Sul America to have a very Strong performance vis-a-vis the market and our brokers. As for competitors, we haven't seen any problem or specific problem with any of them, and everybody has been extremely careful in order to protect assets, to protect portfolios.

And as a result the market remains competitive, but not so volatile. So there has been a maintenance in portfolio and also growth at Company's levels that are adapted to the Company's behavior. And by the way, that's why the growth market is very much in line with our actions. And in previous months, we had high sales, believe it or not, in an industry that is still under development with very strong sales due to tax (IPI) cuts. That's a continuous trend. The market is developing, and like Arthur explained, we conducted a plan last year. We repositioned the Company, and now we're reaping the fruit. Now the Company's strategy is very much connected item by item, risk by risk, to each one of our partners, so we can really be competitive and have an extremely profitable portfolio.

Henrique Navarro - Santander – Analyst

Thank you.

Operator

Pedro Zabeu, Banco Fator.

Pedro Zabeu - Banco Fator – Analyst

First of all, congratulation for your result. I have two questions. One of them regards Auto and the other Health. Let me start with Health. Of all the indicators, which indicator was more positively affected by the measures you've taken lately? Was it the control of procedures or perhaps possible outliers payment retention increase or any drop in the usage of plans? So where do you think it really made sense? Which indicator in your opinion led to the surprising reduction you found or you had in the loss ratios quarter on quarter?

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

Pedro, Mauricio speaking again. Thank you for your question. Well, it's been seen and working heavily on when it comes to our revenue breakdown where we are being very consistent. As you said before, the main driver in-house is adding core management and wealth. On losses we have been spending a lot of our efforts in the bulk of our expenses be it by doing direct sales or working on specific sub-networks of compensation measures or lines of alternative products. So we've been very much engaged in recent years.

In 2012, we did intensify our direct sales efforts very efficiently and we're reaping good results now in 2013, and the outlook is to improve by year end vis-a-vis the previous year. We also had some systems that really changed the quality of information in order to negotiate with our accredited network. In the past, our packet shares were more flexible. The format had one information and it was easier for the provider to have or include another kind of expense inside the medical bill.

And now as we arrange our database and now that we have our personnel trained and under the same formats, particularly if there is a no renegotiations, our package is more closed and more specific and far more controlled. With that -- so we are in many hospitals particularly in São Paulo and Rio and also moving to the north east and possibly Brasilia and we are lowering the number of losses.

If I could give you a more straightforward answer, it is that the bulk of our actions are our claims control combined with a long-term effort in Health management. Health management programs are thriving. We have more than 30,000 lives enrolled in our wellness programs with a very positive return. So these are the main factors.

Pedro Zabeu - Banco Fator – Analyst

Thank you. And about the Auto market. What do you envisage? Our perception is that price adjustments, particularly last year, for the second half of the year and also the first half of the year was very strong when it comes to Automotive policy renewal. However, now loss ratio after the Strong reduction is flat and stable in the market at-large, not only for you but also some of your peers. This change in competition that happened in 2011 was also related to the high Selic rate. How would you compare this with the last result and to what extend can it affect loss ratio and also the competitive environment down the road?

Carlos Alberto Trindade - SUL AMERICA SA - VP - Auto & Property
Pedro, as I said before, we have the cycle and teeth. There is a relation Selic as you can see, but my conception now is that the level of Selic, even though it shows the direction for about 9% or 9.5%, the market still looks at this movement as something that perhaps would not happen on a long-term basis considering adjustment over next year.

Therefore, we don't see a need by the market to lower prices due to the Selic rate. You're right to say that when the rate is very strong. Thankfully there is some pressure in order to low prices in an attempt to gain market share. However, whenever that happens, the market as a whole destroys those values because it goes beyond whatever is expected or possible in this kind of move when it impairs value.

And Selic rate also has its own project moves and that recovery can be very painful. But I can see is that today the market is more mature. It eventually understood that it's not because we have 1.5 or 2 that we can just go down and take market share and therefore maintain the results because -- and also profitability moves does not lie on Selic rate alone, but the results of the fact. And the fact are medical costs, the value of cars for instance and there is another binding factor with Selic and also return risks.

So if you move in that phase of lower prices owing to the Selic rate and considering the comeback of ITI, then it affects your whole portfolio immediately and you were not pricing for that purpose. So it is not a move that is so simple today when it's back to the Selic rate. Obviously it does have an impact. Those who are not so intensive might take the risk.

So the cost today has not been low, particularly all the stories in the past of those who jump off the backpack. And I think the market is more mature today and understands that there are too many variables into the Auto operations leading to more stability. So considering all these growth in terms of price adjustment, the inclusion of policy cost et cetera, our renewal ratio is very good.

And by the way, this even included an in-house growth, as an in-house growth. So we understand the market is stable. The market is healthy and we managed to add a lot of value in our process. And as a result, our renewal rates are even greater. We're very bullish for the future market and particularly when it comes to Sul America because we've been managing to move forward in so many fronts and so many new things taking place.

So I don't believe this to be short time frame, but a long time frame as to very promising for Auto.

Pedro Zabeu - Banco Fator – Analyst

Thank you once again and congratulations for the good result.

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

Thank you.

Carlos Macedo - Goldman Sachs – Analyst

I've just one question regarding individual Health. In addition to seasonality in the second quarter and if you consider our loss ratio of the last 12 months with the specific portfolio, it has been maintained about 90% since the second quarter of 2012 starting from '82 and '83. So I believe part of the reason why it has been at this level above 90% has to do with your initiative to refrain an increase in loss ratios. But could we work perhaps because with the same indicator in the future, in other words, any perspective to have a significant improvement or at least partial improvement in the loss ratio at individual health or does 90% have a level that we'll be maintaining considering the peculiarities of this segment.

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

Thank you, Macedo. This is Mauricio Lopes. Couple of important points to address. Everything that we do in terms of loss management and control and health management is in our portfolio so that we can have synergy in the operation and therefore it can have out agents checking through our concept. The health management programs more specifically or prevention of some diseases or help prevention while we concentrated more effort in the individual portfolio because it needed more programs a couple of years before. So we had more results in this area, in the individual portfolio when it comes to lower or to loss ratios.

Another important point to bear in mind is the rate of portfolio that has been coming down gradually, 6% or 7% over recent years with no significant changes. Now we do see some oxygen with the inclusion of the new dependants or new children that are born, but for the portfolio as a whole that has been a reduction.

Now, we just had recent news of 9.04% price readjustment for individual plans issued after the Law 9,656/98. Please bear in mind that 80% of our portfolio is called prepayment. So we are still trying to see within our processes, an authorization of processes. And once we come to a figure, we can better expect what future behavior of the portfolio payment wise has to Life which only relies on ourselves.
We've been focusing a lot of efforts to have a better performance in this portfolio. We can see the loss ratio for Life in this portfolio, but we don't have an idea of frequency. But loss in Life are going down medically. I believe this stems from an effort to lower the frequency in your initiative thus completing the dynamic appraisal and taking to account the impact vis-a-vis inflation.

Would you say or do you expect, in other words, do you think it might present a more consistent improvement in loss ratio. The portfolio is stable. There is no impact of internal or external factors that might have a negative impact in our loss ratio in this portfolio. I believe all players want to have the portfolio working in one form or another. So any potential adjustment that's might bring more premium in the portfolio associated to all the set of initiatives being carried out up to now, we have no reason to believe why this portfolio wouldn't have a very asymmetric behavior compared to the previous year within our portfolio. Well, it does have an inclusion of beneficiaries over time and a gradual drop in this portfolio, about 7%. So we have a seasonal effect.

Carlos Macedo - Goldman Sachs – Analyst

Right, that's exactly my question. Is this scenario of better loss ratio or stable loss ratio considering the initiatives that is made basically offset a premium increase that was not enough or not the desired?

Mauricio Lopes - SUL AMERICA SA - VP - Health and Dental

We've been heavily investing in loss control. The premiums remain in line and loss control proves to get effective. We'll have a positive outcome.

Carlos Macedo - Goldman Sachs – Analyst

Perfect, thank you.

Jorg Friedmann - Merrill Lynch – Analyst

Thank you and congratulations for the results. I believe most of my questions were already answered. I would just like to address a topic related to the financial results. I wonder if you give us some color about the reasons behind this drop this quarter. Well, volatility is related to equities and future interest rates. Am I right to assume that? As considering these scenarios I wonder if the outlook begins to show some signs of improvement once we have a recover of these factors in July?

Arthur Farme - SUL AMERICA SA - CFO, IRO

Thank you. This is Arthur speaking. Now, this quarter when it comes to equity and also vis-a-vis our results, we do have some market exposure issues and the rates were not positive. In that sense we had these two aspects Contributing to worse and also worse yields compared to what we had before. We had 119 this quarter, 103 so basically a combination of these two elements.
As we said in the beginning, that the Company strategy start by protecting its liabilities (ALM). We can see that only one of the equation is being focused here when we talk about the financial result. Now considering our margin exposure and the equity market, well, I had Marcelo Mello next to me as portfolio manager, and I'll ask him for new comments on what is happening in the area.

Marcelo Mello – SulAmérica SA – VP – Asset Management

Jorg, thank you for your question. Now considering the half of the year as a whole a significant fact is reserve portfolio just made up of growth post-fixed securities. And the portfolio performance tends to be alive with higher Selic rates than we had expected positive results. And when you analyze the security portfolio linked to inflation, which is also significant share of the portfolio, around 20% or 25%, you can also expect slightly higher inflation rates for the second half of the year, and perhaps the positive results as well. As Arthur mentioned, with a low equity exposure it's hard to forget anything. But any impact or a rather negative half of the year for the capital market, the impact tends to be milder since percentage wise we have 2% allocation in this portfolio.

So to sum up, we can expect a positive financial result considering a higher Selic rate.
Look just to add to Marcello's comment, even with a yield would not prove to be so higher. The real volume expected will be higher due to the exposure and also the inflation component highlighted my Marcelo.

Jorg Friedmann - Merrill Lynch – Analyst

So what about a flow of results from SulaCap -- okay, okay, got it.

Operator

There are no further questions. I would like to give the floor back to the Company's management for the closing remarks.

Gabriel Portella - SUL AMERICA SA – CEO

Thank you all for joining us. I hope we've answered all your questions. We remain at your service with our Investor Relations team and the officers of the Company to clarify all your questions. Have a great day.

Operator

This concludes Sul America's conference call. Thank you all for joining us today. Have a great day.