

Q2 2011 Earnings Call

Company Participants

- Arthur Farne, Corporate VP and IR Officer
- Sergio Borriello, CFO

Other Participants

- Carlos Macedo, Analyst
- Guilherme Assis, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time, we would like to welcome everyone to the SulAmerica 2Q '11 earnings conference call. Today with us, we have Mr. Arthur Farne, Corporate Vice President and Investor Relations Officer and Mr. Sergio Borriello, CFO. We would like to inform you that this event is being recorded and all participants will be in listen only mode during the Company's presentation. After SulAmerica's remarks are completed, there will be a question and answer session. At that time, further instructions will be given. (Operator Instructions)

There will be a replay facility for this call for one week. Today's live webcast, both audio and slideshow, may be accessed through the Company's Investor Relations website at www.sulamerica.com.br/ir by clicking on the banner webcast 2Q '11. The following presentation is also available to download on the webcast platform.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of SulAmerica's management and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of SulAmerica and could cause results to differ materially from those expressed in such forward-looking statements.

Now I will turn the conference over to Mr. Arthur Farne, Corporate Vice President and Investor Relations Officer, who will start the presentation. Mr. Farne, you may begin the conference.

Arthur Farne {BIO 1845065 <GO>}

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Thank you. I would like to begin by thanking everyone for attending our conference call for the Second Quarter of 2011. I'm pleased to be here with my colleague Sergio Borriello, CFO of the Company. And following the presentation, we'll be ready to take your questions.

We're going to begin with slide two, where we as usual, we provide highlights of the main figures and performance indicators of SulAmerica in this quarter. Those figures are presented on a recurring basis, which means, in this case, that we have excluded some effects of some premiums that we have issued for individual health policyholders, leaving the State of Bahia and going back -- dating back to 2005.

Our total insurance premiums grew by 16% in the quarter over Second Quarter of 2010, ending with a total of BRL2.3b. The main highlights here are maybe the premiums of 19.5% in the health insurance segment and of 10.2% in health insurance, both multiplied which together would account with something like 8% -- 9% of SulAmerica's total premiums.

Other property and casualty insurance, life and personal accident, they have also contributed to our performance in this quarter with an improvement of -- with an increase in premiums of 7.2% in the case of P&C, and 8.3% in the case of life and personal accident, respectively.

In the Second Quarter, the share -- total loss ratio was 78.2% and our combined ratio was 103.9%.

Investment income in the quarter, excluding those assets linked to pension and life, came to almost BRL132 million with a yield of almost 103% of the CDI Brazilian base rate. In the first half, so for the six months it's -- for the first six months of 2011, the yields for the (inaudible) was 107% of the CDI, which is a good result considering the fact that this is basically a fixed income net portfolio.

It's also important to mention that in this quarter we had an increase of provisions for the life insurance portfolio with a negative impact on our net income which ended the quarter totaling BRL30m. We're going to go over this issue in more details in slides 8 and 14 ahead.

Moving on to slide three, we show here the many events that have influenced the Company's results in the quarter and some of the subsequent events following the close of the quarter.

The main highlights in this case are a coinsurance agreement we have entered with Caixa Seguros in the automobile insurance segment. The fact that we have under the revaluation process, a dental plan, a dental plan operator with something like 140,000 members which is being fully integrated in our dental portfolio.

The fact also that the Board of Directors of SulAmerica has approved the distribution of quarterly dividends, following a new dividend policy; in this case relating to 2Q '11. In fact has been previously approved in the amount of BRL0.036 per units, with a total of about BRL10 million repaid on August 18.

Also the fact that we have increased -- broadened our network with branches and offices in our C.A.S.A.s. And in the case of our new offices and branches, we will have a total of 54 units in the whole of Brazil. And we count now with 30 of those automobile service centers in the main cities of Brazil. With this strategy, we aim to expand our services and improve the quality of the service that we provide our customers and brokers, and that's in this slide.

Moving on to slide four, here we have our private portfolio with a -- you see that the health insurance segment is accounting for about two-thirds of the Company's total payments in the first six months of 2011.

Premiums, as earlier announced, represented 23.8%, which means that both lashed together would account for 90% of our revenues. The portfolio composition has been somewhat stable over the last quarters and we've seen all of those lines growing on a sustainable basis over the next quarters.

Now we're going to move to slide five to address the information on the healthcare and dental. Our premiums here, at the end of the Second Quarter, were BRL1.5b, of which 75% or BRL1.1 billion corresponded to Group health insurance; a portfolio which has grown 23% over Q2 2010. This increase in premiums in the Group health portfolio is explained by the increase of almost 32% in our membership base and also to increase in premiums, the rate adjustments that we have applied to our policies upon their anniversaries.

It's also worth to note here that we had also a positive effect on our portfolio. And that partly was held at our ASO business and is now written as health insurance following the decision of this large policyholder.

Still on the Group health, premiums related to SMEs -- small and mid-sized enterprise segments -- went up 37%. Also in line with the growth of insured members and the rate adjustments applied to that portfolio. The segment has shown a very good expansion -- a very good potential for further expansion and is among the Company's growth pillars in this -- in our health segment.

Synergies also achieved through the incorporation of dental plan are reflected in our Second Quarter dental operational results. With the incorporation of 141,000 members coming from dental plan, our portfolio increased by 60% over Q2 2010, almost doubling when we compare within this period. So premiums for dental BRL17 million with an increase of 86% over last year.

In the (overall) health segment, although the number of policyholders has decreased by almost 7%, payments went up 9.9%, due to price adjustment that we authorized to apply following what has been the rate adjustment approved by NMS, the national healthcare

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agency. In fact, these in 2011, the rates were (769) for policies issued after 1999, effective May this year and 735 for policies for those called pre-logged policies. Those in that case being effective July 1st.

The loss ratio we had in the health has shown an improvement of 270 basis relative to the Second Quarter of 2010 due to a reduction in frequency utilization and also to the (combinations) we have been able to achieve in negotiating our contracts with healthcare providers.

To wrap up this slide here I'd like to mention the fact that we have reached 2.3 million members in all of our healthcare portfolio by the end of June, of which 9% are some type of Group policy. And if you look at the breakdown, we see that 88% of our contracts are Group plans, including SMEs and ASO plans, which is consistent with our strategy and focus in Group businesses.

As we move now to slide six, the auto insurance segment, I'd like to call your attention to the fact that industry data for the first five months of this year, the latest available, has shown that the industry in automobile has grown by 7.3% over 2010. In the same period SulAmerica has increased in automobile 21.2% and has gained 120 basis in market share to 10.7% at the end of May this year.

In the Second Quarter of 2011 our fleet -- the volume of our portfolio has increased 21.5% to total 1,500 vehicles covered by SulAmerica.

We have reported premiums of BRL548 million with a 10.2% increase over Q2 2010.

The decrease of 630 basis in our loss ratio was partially due to a higher frequency of claims in Q2 '11, which due to rains that have affected -- that have reached the States of Pernambuco and Alagoas in April and also to the fact that we have improved some of our internal processes, then accelerate in the recognition of some reserves. So this is a one-off effect in losses.

As we move now to slide seven, I'd like to comment on the performance of other property and casualty insurance segments, which -- in which case, premiums have grown 10.2% over Q2 2010 mainly in marine, homeowners, comprehensive, other bundled products, engineering and other small lines that combined have grown 18%.

Loss ratio in the segment was 58.2% and that was a factor that in fact where we have deals for provision for reinsurance coming from an event affecting a policyholder we had in this quarter. So SulAmerica continues to adopt a very selective policy in double underwriting in these segments, favoring more mass institutional products.

Slide eight, we're going to address the performance of our life and personal accident insurance, in which case we have ended the quarter with 2.2 million members covered by our policies.

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Premiums have increased 8.3% up, to reach BRL120 million in the quarter. These as a result with higher average premiums and somehow offset the fact that we had a reduction of 1.6% in portfolio volume. Here it's also important to notice the fact that we have developed a migration program, starting in 2006, which was based on our actuarial studies. Quite to which we have migrated a part of the portfolio to new policies.

And recently in 2010, both in the First Quarter and the Second Quarter, we have revisited our estimates in -- related to a provision for judicial claims in this line and which has led the Company to increase this provision by BRL76.5 million this quarter alone, which with a reduction of BRL43.7 million in net income for this quarter. So we -- in the beginning of the presentation, we had mentioned the fact that part of the decrease we had in our net income was related to the increase in net provision that I just referred to here.

If that provision had not been increased the way we did, premiums would have grown 4.6% in this last segment compared to Q2 2010. And the loss ratio that we have posted of 145.1% would have been 43.4%, so much, much better. And in a following presentation we're going to cover the impact of that income in that case.

Now moving on to slide nine, we see here information regarding our pension and VGBL. And together pension contributions totaled BRL120 million with reserves of about BRL3 billion ahead at the end of June. VGBL reserves had reached BRL680 million in industry reserves.

Moving on to slide 10, it refers to our investment management unit. And the volume of assets under management by SulAmerica Investimentos at the end of June had reached BRL17.3b. In the Second Quarter of 2010, the income from this operation pre-tax, was BRL6m, 11.1% better than Q2 2010. The growth, or the improvement in this -- the income from the assets under management operation was explained by not only the higher amount of volumes under management, but also the fact that we have a more diversified portfolio, yielding higher management fees.

Slide 11 refers to our administrative expenses, with G&A, total G&A increasing in absolute terms 1.1%. But the ratio to retained premiums improving 130 bps compared to Q2 2010. So this improvement which being -- we have been achieving over the last quarters is partly due to the fact that we have fees from red line services, insurance services to a third party.

On slide 12, the combined ratio was 103.9% as we just -- we had mentioned in the beginning, negatively impacted in this case by the provision we have increased in our (life statements).

Slide 13 addresses our investment portfolio. The upper side -- the upper half of the slide refers to investments excluding life and pensions -- the life and pensions portfolio and, in this case, totals BRL4.6b. And you'll see on the left side it's basically allocated into -- I meant, I'm sorry, on the right side -- basically allocated to fixed income investments. The yield in that case was one of 102.(5)% of the base rate in this quarter. And it has been up 106.5% for the first six months.

The bottom half includes not only our GMC automobile portfolio, but also our life and pensions portfolio, with a total BRL7.8 billion at the end of the year, so total return in that case was BRL147.6m, with an increase of 43% over Q2 2010.

Slide 14 is the next slide. As we come to the end of the presentation, we see here our net earnings this quarter of BRL30 million with a decrease, as compared to Q2 2010. If we were to exclude the effects of the net provision for life we had just mentioned, we have reached BRL71.3 million with a 43.3% growth compared to Q2 2010.

Our return on equity was 4.2% this quarter annualized and that is also affected by this provision we just referred to.

Well this is basically what we would like to share with you about our Q2 results. And Sergio and I will be ready to take your questions. Thank you.

Questions And Answers

Operator

Thank you. We will now begin the question and answer session. (Operator Instructions)
Our first question comes from Carlos Macedo of Goldman Sachs. Please go ahead.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good afternoon, gentlemen. Thank you for taking the questions. I have a couple of questions actually. The first one is related to the loss ratios in Group health. They increased again on a sequential basis this quarter their -- and on an annual basis as well. I was wondering if you can give us some guidance with respect to that for the remainder of the year. Are we likely to see the same kind of improvement in the second half of this year as we saw in the second half of last year when the ratios declined significantly? If you could provide us some guidance for that, it would be great. It would help us try to understand how that line is going to behave.

The second question is related to something you said, Arthur, which was the services you're rendering, and I think it's Banco do Brasil. If you could give us -- and I know there is an impact on cost, as well as an impact on revenues. I was wondering if you could basically size that for us. The last contract that you signed with them, if I'm not mistaken, runs probably for another three months. What should we expect once those -- that contract is concluded? What impact would that have on your expenses, revenues and all together the bottom line? Thanks.

A - Arthur Farne {BIO 1845065 <GO>}

Well thank you, Carlos for your questions. On the Group health, I guess if we were not -- we may not be able to present the same total improvement we had shown in last year when I compare second half to the first half, especially because we had not a better Second Quarter this year than we had last year. So we are coming from a much better position in terms of the loss ratio in that segment.

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There is a seasonal impact, as you know, which usually leads to Second Quarter being the worst quarter in the year. So we do expect an improvement in Q3 and Q4 this year. We would not like to give forward any figure precisely right now. But we do work --- we've been addressing the issue here both in pricing and in terms of cost controls that would lead to a loss ratio improvement in this year. So our major guidance is that we should be posting this year our loss ratio in health somewhat like 100% basis points --100 basis points better than the last year, full year against full year. And I guess this is what we had for our priority.

Q - Carlos Macedo {BIO 15158925 <GO>}

No. I was just going to say, that's going to be based on not only the seasonal improvement in the Second Quarter, but also is it something with frequency or really just the cost?

A - Arthur Farme {BIO 1845065 <GO>}

Frequency is one of the other things in our -- among our cost control measures. But also we are reviewing the way we handle contracts with service providers. Of course, we have just begun the rate adjustment season for not only the individual health but also the Group health segment. And in that case, they did have a more significant impact in the loss ratio.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. And the second question about the revenues from rendering the services to a third party, revenues and expenses.

A - Arthur Farme {BIO 1845065 <GO>}

Okay. Do you have a comment on that?

A - Sergio Borriello {BIO 16041269 <GO>}

I think you remember that we have communicated to the market the last April we have renewed our contract with Brazil Credit Plus up to November 15th. So up to November 15th our contract will be at 100% covering the services to Brazil Credit Plus.

In terms of the revenues and expenses, we are disclosing these numbers and in derivatives, which you call expense recovery. And there is no reason to say that in 2011 we would be posting the same level that we are posting up to this year.

Next year probably, due to the way have we settled the contract with them, we are just managing their claims, meaning that we'll decrease it during the year and we are just managing their claims. Our revenues will decrease through the 2012, up to the number of 2012 when we really finish the whole services to Brazil banks.

Q - Carlos Macedo {BIO 15158925 <GO>}

But the expenses will decline as well, right?

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A - Sergio Borriello {BIO 16041269 <GO>}

Expenses will decline much in line with the expense recovery of where you have next year, meaning eliminating the services, we are eliminating the cost as we have to provide the services to.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you.

Operator

Our next question, and pardon the pronunciation, comes from Guilherme Assis from Raymond James. Please go ahead.

Q - Guilherme Assis {BIO 16143141 <GO>}

Hi. Good afternoon, everyone. My question is regarding the increase in the member base of the health insurance. I'd like to understand how the market is looking like. I think it was a good growth. And what were the measures taken by SulAmerica in order to achieve such a good growth in the quarter?

A - Arthur Farne {BIO 1845065 <GO>}

Thank you, Guilherme for your question. This is Arthur speaking. Well leaving aside here the migration within the portfolios, we have been able to increase all of the portfolios I guess very successfully; not only PME -- SME, sorry, which is growing very fast, as you have seen over the last quarters, also the larger policies. We have seen not only a number of new policyholders coming to our portfolio, but also the number of members within those portfolios, the final, let's say, recurring employment in Brazil. So both -- those are feature Group segments. The larger portfolio and the SME segments, we have been achieving a very good growth in terms of membership in those portfolios.

We've been doing that in all Brazil, so expanding our portfolio. Of course we also have the benefit of 140,000 members of dental coming from dental plan. So a segment which we have been addressing and trying to explore more synergies and cross-selling opportunities which will also lead to a larger number of members in our portfolio.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thanks for answers. If I may have just a follow up. It's regarding the revenue decline for the -- managing claims in the Banco do Brasil agreement. How much do you expect of revenue to decline next year because of that?

A - Sergio Borriello {BIO 16041269 <GO>}

Oh, probably next year, we will have like 50% of the revenues booked this year. So it's a good number in terms of the estimation, 2012, compared to 2011. But again, it's not a net effect. It's just a decrease on the line, expense recovery, because we will have some

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decreases on the personal and third-party services, and etc. expense. The net of these two lines, in my mind, is not material for next year.

A - Arthur Farme {BIO 1845065 <GO>}

Guilherme, maybe you can refer to the explanatory notes 22.2, which provides details on those lines. And I see there that we had about BRL60 million in the first six months of expense recovery, so for the first six months of 2011. So you notice that we had, say, a larger amount in Q2 than in Q1, exactly because that's when we recorded the new contract -- expansion of the contracts, which as Sergio mentioned goes up to the end of this year.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Great. Thank you.

Operator

(Operator Instructions) I'm sorry. No further questions at this time, so I'd like to turn the conference back over to Mr. Arthur Farme for any closing remarks.

A - Arthur Farme {BIO 1845065 <GO>}

Well thank you. Thank you for those attending. The conference is available here through our website in our IR area. Also, we'll be glad to take your questions. Thank you.

Operator

Thank you. The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines.

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