

Q1 2014 Earnings Call

Company Participants

- Arthur Farne d'Amoed Neto, Executive Vice President - Control and Investor Relations
- Gabriel Portella Fagundes Filho, Chief Executive Officer
- Marcelo Mello, Vice President - Investments
- Mauricio Lopes, Vice President - Health and Dental

Other Participants

- Eduardo Nishio, Analyst
- Francisco Kops, Analyst
- Gustavo Lobo, Analyst
- Rafael Frade, Analyst
- Unidentified Participant

Presentation

Operator

Good morning and thank you for waiting, and welcome to Sul America's first quarter of 2014 earnings conference call. We have with us today, Mr. Gabriel Portella, CEO of the Company and the Vice Presidents of the Company. We would like to inform you that this event is being recorded and that all participants will be in a listen-only mode, and then, we will start our Q&A section and further instructions will be given. (Operator Instructions).

There will be a replay specifically for this call for one week. Today's live webcast audio and slide show may be accessed through the Company's Investor Relations website at www.SulAmerica.com.br/ir, by clicking on the banner Broadcast 1Q14. The webcast presentation is also available to download on the Webcast platform.

Before proceeding, we would like to mention that forward-looking statements are based on the belief and assumptions of Sul America'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 may also affect the future results of Sul America and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I would turn the conference over to Mr. Gabriel Portella, Sul America's CEO who will start the presentation. Mr. Portella, you may begin the conference.

Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Good morning and thank you for participating on this call, where we will present our first quarter results. We have present at this call almost all the Company's VPs. We would like to highlight on some points which I consider relevant. We maintained our pace of growth in the first quarter, achieving a total consolidated revenue about BRL4 billion, demonstrating our growth capacity in several lines and enjoying the versatility of our multi-line model. We grew our plant portfolio in Health and Dental and we continue to consistently increase our Auto fleet.

We presented in Health, in Health we have shown a loss ratio lower than the previous quarter. The Auto's loss ratio showed a slight increase impacted by the increase of theft in the month of January. We continued to show average productivity. We had an increase combined with each ratio. Auto had a slight increase impacted by the increased theft and stabilized in subsequent market. We continue to increase our productivity measures regarding admin expenses over premium. We had an improvement of the combined ratio of 0.7 percentage points. We had a performance of 106.6% of CDI in the management of our investment portfolio, delivering 157 million in the quarter.

And finally the highlight and regard volumes points we had a net income of 80.7 million, more than 240% above the income of the same period in the formal year, continuing our trend towards sound results.

In a still challenging economic environment, we are (inaudible) with these results. Now, I would like to Arthur Farne, Vice President of Control and IR to comment on the details. And then, as usual, we will be ready to receive your questions and comments. Thank you.

Arthur Farne d'Amoed Neto

Thank you, Gabriel. So, we will start now on slide two, which gives us the consolidated revenue of the Company. And you can see the revenue and other activities of the Company. We have had a growth of revenues in the first quarter and the growth from the third quarter and we will (inaudible).

The other activities we have had important growth in pension plans and health plans last year the activities, a little bit of volatility in our channels, we had a more stable flow in this quarter and health plan administration and services rates coming from asset management rates and the collection from capitalization now incorporated into the company. This was consolidated as from May this activity and would be compared to the last quarter of last year, we can see that this is quite considerable. The Company comes (inaudible) 4 billion with all these results, a growth of 14% vis-a-vis or year-on-year.

On slide number three, we have more details on total revenue. We can see here that we have total revenues of almost 4 billion. We have a diversified space of revenues in the Company, which (inaudible) effective introducing capitalization.

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Slide four, we show the consolidated results. The insurance premiums year-on-year, the loss ratio has improved slightly and the Company has grown 11% in insurance premiums and the administrative expenses incorporated the expenses of all segments including capitalization. We haven't done -- we didn't have the capitalization expenses before.

We can see these points here on slide five of the combined ratio, an important result, this financial result, 43% improvement. It was natural that we should see with an improved, with a growth of the premiums and an improvement in income 42%, a return of 15% of Health and Dental.

Now, the business units. Health and Dental, a drop in the, loss in the segment of Health and Dental grew 14.7% in the quarter's premiums because of the growth of the number of insured members and annual adjustments. The loss ratio improved 0.4 points. The gross margins were maintenance of the margin and at the top of the chart on the right, we have an increase of almost 3% in the portfolio of members, a slight drop as compared to the fourth quarter of 2013. That we can comment this later where we have had this drop and we can talk about this in questions-and-answers. Maybe, if you can talk about it.

Now, Auto, the next slide, a growth of 4.5% and we can see some doubts being raised in the report, why this growth less than the previous year. And also we can come back to this in the Q&A. We are comfortable with this number. And loss ratio is slightly worse than the same period in the previous quarter. And also with -- the gross margin has dropped because of this. The insurance fleet has grown almost 7% when we compare this to the same period in the previous year. And it is flat regarding what we have produced in the fourth quarter of 2013.

Other Property and Casualty, more or less the same trend, stable regarding premiums, better in any other measures regarding loss ratio, not only because of the reconstruction of the portfolio mix, but also because of the policy of substitution, which has led to better results and a gross margin, which is slightly better. The portfolio shows a greater portfolio of max insured, of insurance, which in, on their own are not so important. And insured also the risk appetite of the Company vis-a-vis these segments.

Now, on slide eight, we have Life and Personal Accidents, a slight drop in insurance premiums, but a growth regarding the fourth quarter of 2013 showing that we have this portfolio today, we have a very much more stable operating structure in line with our objectives. After some year of important investments in this consolidation and this new operating structure, loss ratio also more regular levels. This is more in line with what we expect from this portfolio and a slight volatility in 2013 compared to this quarter. The gross margin is better and the portfolio is very spread out of one group risks, pension plans, here we have a growth of these contributions for third quarter had already suffered, because of the volatility. And PGBL -- VGBL is going more contributing in the financial demonstrations for the growing slow of admin expenses.

Now, the Capitalization, collections almost 30% more. Today, we have all the distribution base of Sul America. This is present in our almost 70 subsidiaries and all our insurance brokers are familiar with these products. And this is growing in line with collections. The

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results are in line with the collections, but there were some events which occurred regarding asset management. This is stable. We started off the quarter as -- we finished the quarter as we started. Proprietary, more or less the same as third-party. The assets allocations, a slight repositioning regarding the environment. And lower down on the slide, we see the contribution of this result to the consolidated figures and increase regarding the first quarter, slight drop compared to the last quarter. So, (inaudible) first quarter and the behaviors of the revenue of normal admin revenues.

Admin expenses on slide 12, an increase of 9.5% and all the undergrowth of the base collective bargaining averaging, which had been predicted for this period. The administrative expenses ratio increases a little bit, which has as a base the (inaudible) retained premium, slightly better -- I'm sorry, it's very difficult to hear him.

The combined and operating ratios, an improvement 2 points because of the greater financials. And the financial income, on slide 14, on the other part of the slide, we have three parts with the investment strategy, we will not have pension plans, which contribute to the consolidated results of the Company. And what we think is a (inaudible) due to the low exposure to equity. So, fixed income securities and assets phase II inflation. So this slide closes the start of the presentation. So, now we are open to questions. Thank you.

Questions And Answers

Operator

So, now we will start our questions and answers. (Operator Instructions). Our first question comes from Mr. Eduardo Nishio from the Banco Plural. You may proceed, sir.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Good morning, and thank you for this opportunity. I have two questions. Regarding the premiums, we have seen you have finished the quarter at a level of almost 11% of growth regarding premiums compared to last year, there has been acceleration, last year, it was 15%. So, I want to know what the prospects are for this year, how much do you think you will be able to grow? Regarding also the increase of prices in healthcare by middle of the year, I want to know by for the whole year. So, do you think you will be growing about 15% like last year. That's the first question. And I'll ask the second.

A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Well, Gabriel, thank you for your question. This is Gabriel speaking. There are some effects of the slowdown as you had said and also remain conservative growth level like in the Auto segment. Last year, the growth was high and also we are repositioning some products. So, if isn't grown more it was because of the strategy of repositioning like in life, which had a direct result on the results.

Health has grown more for the corporate segment, small and medium sized companies and continuing with the speed of growth as you have said. We maintain a growth of two-digits, which is the prospect that we hope to keep for this year. There will be no

slowdown. There will be a continuation of the growth in the Health segment, which strategically are of greater interest to the Company. So two-digit growth for 2014.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Now, well, would you say that you have a variation or is there some difficulty of -- because of maybe higher competition for charging more?

A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Regarding the growth for the beginning of the year, it's important to say that last year we had a growth of premiums of 28.7, a consequence of a policy announcement middle of 2012. So, when we entered 2013, those prices of January and February 2012 had a very stronger adjustment, which we had forecast earlier, we had predicted earlier. And this year, obviously, you once -- you have declared your budget cannot make more significant increases in the same portfolio, if you've already made them. This year we have our strategy has been to protect our results.

The end of last year, there was some movement of some companies in the sense of they became more aggressive. And the beginning of the quarter, in February more or less this began to give way a little bit. So, our movements at that time was to protect our results, protect that portfolio that has been adjusted to the previous year. And we will see that these growth rates were also driven time, because of the different amount quarter of '13 as compared to '12. This does not concern us, does not worry us. This is within our plans and what is of interest now is to protect our portfolio to have a good profitability and there has been a slight increase of the loss ratio, because of the increased frequency of that, but now this is stabilized.

Now, we are increasing securities, so this will drop. And again, also the methodology, an adjustment of the methodology of the -- and there is 1%, which is a consequence of this adjustment. So it should stabilize throughout the year. So, this, in the Auto, things will stabilize.

Q - Eduardo Nishio {BIO 15333200 <GO>}

My second question has to do with the debentures. The operation was canceled. So, now, this is over. Could to give us more details, could you talk about these segments of interest, which you had as an objective with the issuance of the debenture. And what you're going to do now since it can't pulled?

A - Arthur Farne d'Amoed Neto

This is Arthur speaking. Well, we are making a new issuance, rating the same 500 million, same for those activities. We have in mind maintaining the adequate level of liquidity for the Company to take the opportunities of acquisition present for the (inaudible).

Q - Eduardo Nishio {BIO 15333200 <GO>}

No, I haven't seen that yet. And could you tell us what is your segments of the interest, is it Health, Auto or any segment?

A - Arthur Farne d'Amoed Neto

Yes, all segments in which we are active. I know that's a very generic answer, but that's what I could tell you. So, we will invest in whatever we are already in our portfolio as a whole.

Operator

Our next question comes from Rafael from Banco Bradesco. You may proceed, sir.

Q - Rafael Frade {BIO 16621076 <GO>}

Good morning. My question is for Mauricio. I'd like to know about loss ratio of Health. You may remember last year, part of this loss ratio, if I'm not mistaken, was assigned to some payment that should have been made in December and they happened in the first quarter of 2013. So, 2013, you had still some expenses of the fourth quarter. And so, in fact, when we look at the loss ratio on recurring basis, that should be going up year-on-year.

So, what you see behind this and what you expect regarding this loss ratio, the performance of this in Health, particularly? In this year, are you making adjustments that are perhaps higher than the adjustments made last year? And do you think that this will be enough to bring the loss ratio down to lower levels?

A - Mauricio Lopes {BIO 21675846 <GO>}

This is Mauricio speaking. Thank for your question. I think there are two issues [ph] the first question is the calendar effect of last year. We do have completed -- I think, last year we closed the quarter on a Wednesday -- yes, we did have some external factors. So, some things were transferred to 2014. This year has been less.

And regarding the loss ratio, our loss is always the same, we are having adjustment, which is very robust in keeping with the market. We have already discussed this. The adjustment is a short-term solution, long-term we spend on health management and loss ratio management. For the Health, we've at medium-term. This will allow us to have a better profitability and better service to our client.

Now, the health does not give you a short-term result. It has to be consistent long-term. And I think we are coming to this situation very soon. And managing claims, we want to be the best-in-class and we have been managing our health, turning up our health and qualifying our network and standing up and this has been to improve our traction as a whole. Adding the two things, the growth of the adjustment and management of the health as a whole, we continue to be very optimistic with our product. And we think that we have an opportunity for better profitability intact.

Operator

And Mauricio, regarding the calendar effects, last year you were at a typical situation of the loss ratio, and the second quarter was above the first quarter, the first quarter. And

will there be something similar this year?

A - Mauricio Lopes {BIO 21675846 <GO>}

Don't you know, generally we don't predict the future. But, even if we could, we don't yet have everything close, we haven't closed the month of May yet. So I can't give you an answer. Now, what I can tell you is that we have closed a lot of work on our portfolio, we have worked very hard more than we did in 2013 on this. So, we are putting a lot on the table to be able to control this loss ratio.

Q - Rafael Frade {BIO 16621076 <GO>}

Thank you very much, Mauricio.

Operator

Our next question comes from Mr. Francisco from the Banco Safra.

Q - Francisco Kops {BIO 17215088 <GO>}

Good morning. I have two questions. One is about Health. I think, this is the second quarter, where we have been more insurance holders. For three years, we have seen this dynamics of medical inflation and the transfer of the industry prices, which is high. But, at least in the past we saw those two, but even still there has been a growth although those number of insurance holders has been higher, but now it seems to be dropping. So do you think this is something more specific for Sul America or because they were looking for more profitability or do you think it's something more structural, or do you think we have greater stability now or a drop in the number of insured parties?

A - Mauricio Lopes {BIO 21675846 <GO>}

Thank you, Francisco. This is Mauricio. Well, what we think is that we will continue this structural question of the market is homogeneous and we have been fighting for profitability based on to our new adjustment. If everything if everybody goes up in the same direction, everybody in their own dynamics and specificity, we, in fact, have been lower. But, as unemployment continue to be low, retention of labor by companies continues to be very important. And also the unions also make things more difficult and our product seems a little bit more premium, which entered the union negotiations.

So, we don't see the reduction of insurance holders of that things. We have had an adjustment, because of the renegotiation of contracts at the end of last year, the big one. And it did affect some portfolios. But, in the two portfolios, where we have more volume of growth, they continue to grow the dental and another which I couldn't understand. And also the question of the reduction of contracts is just because underwriting and the beneficiaries continued the same.

So, I think if we have the questions of adjustments, retention high and circumstantial events and we will continue to have a relevant number. I am confident in the growth of the portfolio, what just happened was the loss of the contract at the end of the year, last year.

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So, you think it's a circumstantial event, but nevertheless, the industry as we had a third subsequent year of high adjustment, and also the retention of employees perhaps, there will be a stability. Yes, we do not see the penetration of health insurance, the reduction of health insurance penetrating the market. We are now, we now on the fourth-generation, so, I think it'll continue to grow. And we continue to grow the dynamics of the market and we continue to believe that the bargaining power of workers together with employers will be for health benefits and which is one of the more desired things in the country. So we don't see a risk of slowdown. Our beneficiary, and something circumstantial might happen, but it's irrelevant.

Q - Francisco Kops {BIO 17215088 <GO>}

And the second question, Capitalization is already quite relevant in you revenue 13% of this quarter. I'd like to know a little bit about what is the question of distribution is acquiring through the brokers well, what about the distribution of the banks focusing a lot on this segment. So why there has been such a strong increase of expenses here?

A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

This is Gabriel. Well, there was an expansion of the channel of this activity. There was a specific channel for all subsidiaries in these brokers and this is a program, which actually integrated the capitalization of the savings bond. We had to map out the training, et cetera. And we have noticing month-after-month is the growth of the basis of brokers and channels pressure those products, which are more characteristic.

So, the potential that we had and we still have and the other products, which have also a great potential and have a good performance, there the company talks about capitalization of savings bond and we expand the basis, the competitions have changed, there are more competitors now coming into the market, which is also always exciting. But, that's our life and the product also begin to become more attractive as a cross-sell product in the Company was combinations with other products.

So, the main channels are the ones that we operate normally and the (inaudible) and showing the capacity within independent channel can become -- we can become the fourth largest company in this -- while with an increase this quarter, the net result was (inaudible) growth. Just an adjustment of the portfolio of capitalizations, which have a gap of one month. Well, there won't be this adjustment won't happen again.

Q - Francisco Kops {BIO 17215088 <GO>}

Thank you.

Operator

Our next question comes from Mr. Gustavo from Merrill Lynch.

Q - Unidentified Participant

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Good morning, Gabriel. Thank you for the opportunity. If we go back to the first quarter of 2013 and compare that with the loss ratio, we will see that in Health, is practically the same level. The Auto has gone up as expected, because your competitor also showed these numbers. So, the impression we have is that in spite of splendid growth and price adjustment, that business has not enough for you to manage to reduce the loss ratio. So, if we take with cost of acquisition, and the ratio went from 10.6 in the first quarter '13 to 11.3 in the first quarter '14.

So, my question is, during this calculation here considering this improvement of the financial result, you put that the average of the term monthly 15.3. What can we expect from now on?

It seems that this loss ratio in Health seems to come to say there is a seasonality during the year. But, now the Auto segment as well now higher acquisition cost. So, could you talk about this? Do you expect an improvement of these indicators and is this something that we should expect? Thank you.

A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Well, I think that the average that we are publishing represent more than we expect for the year, and for the whole year of 2013. The question of the marketing cost in Health is virtually the same. So, in fact, it's a question of classification expenses, what we have is the possibility of doing what we do with classifying expenses. The end result will not be altered. And we had the amortized parts of the cost of the policies, which was classified as a reducing element or an element of reduction. So, I'll ask Mauricio to comment.

A - Mauricio Lopes {BIO 21675846 <GO>}

Good morning. I think what we find regarding last year is a moment of stability downwards and not a growth loss ratio. We have a question of price and also the management of loss ratio in Health. What we have is that all in spite of the readjustments being stronger than last year, we have the variation, natural variation, the VCNH [ph] has varied, the medical hospital cost variation. We have predictions for the medical hospital cost variation this year and we have predicted some idea this year.

So the question which you ask me for we don't think that frequency will grow indefinitely, so we might be correcting the loss index of ratio. We believe that frequency is not something that goes up indefinitely. I'm sorry; the sound is very, very bad.

Q - Gustavo Lobo {BIO 18719996 <GO>}

Mr. Gustavo from BTG Pactual. Good morning. I would like to go back in little bit to the Capitalization just to understand a little bit more about the seasonality of this product. And then, I would like to say not only what you have is operating results of capitalization, but what is the property, we have a very strong fourth quarter and now a drop in the first quarter and if we compare this with the level of the second and third quarters, there was a drop as well. So, I'd like to know the increase of equity income. So, could you tell us what is happening? What about the seasonality of this product.

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A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Well, Mr. Gustavo, you must understand now this quarter, in the fourth quarter there was a reduction of this line. We said that there was a sale of an asset of a piece of land. And there won't be any more relevant impact on the assets. And this will not recur.

Q - Gustavo Lobo {BIO 18719996 <GO>}

And the second question about the expenses, you had a good level with quarter you couldn't compare the segments because you didn't have capitalization before. Looking forward, is this a recurring level if the expense level drop structurally comparing with your premiums level or do you expect more during the year?

A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

No, I think that this level that we have published now for the first quarter will continue. And I think this is what we expect.

Operator

(Operator Instruction). Our next question comes from Mr. Francisco. So we are collecting some questions. Francisco from Safra.

Q - Francisco Kops {BIO 17215088 <GO>}

Thank you for accepting one more question. This will be quick. Your performance was good this quarter. I'd like to know what we can expect for the rest of the year, your allocation of investments in CDI and pre-tax. Is that the same as in the first quarter? What can we expect in financial results?

A - Marcelo Mello {BIO 21963995 <GO>}

This is Marcelo Mello. This portfolio of PCA, the idea is to maintain it. The portfolio is smaller than PCA is larger. We will continue and it will continue to be favored by the increase of information and we do not expect a significant change of this portfolio since this is doing well.

Q - Francisco Kops {BIO 17215088 <GO>}

Do you not benefit from the mark-to-market of the price of the security, it's the interest rates, right?

A - Marcelo Mello {BIO 21963995 <GO>}

So that they are being 12.5 (inaudible) but the variation doesn't impact the result. The variation of the mark-to-market, no but you do have an impact of the increased inflation.

Q - Francisco Kops {BIO 17215088 <GO>}

Thank you.

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Operator

(Operator Instructions). As there are no more questions, I would like to ask Mr. Gabriel Portella, CEO of Sul America for his final remarks.

A - Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Thank you very much. I'd like to take this opportunity -- we have a large number of executives and members of the Board listening to this call. So, thank you all for your commitment and loyalty. And we are at your disposal after the call. Thank you very much, and have a good day.

Operator

So, Sul America's call is now closed. Thank you very much, and have a good day.

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