Q2 2012 Earnings Call

Company Participants

- Arthur Farme, EVP, IR
- Gabriel Portella, EVP, Health & Dental
- Thomaz Menezes, CEO

Other Participants

- Guilherme Assis, Analyst
- Iago Whately, Analyst
- Roberto Savaris, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. At this time we would like to welcome everyone to the SulAmerica Second Quarter 2012 Earnings Conference Call. Today with us we have Mr. Thomaz Menezes, CEO of the Company, Mr. Arthur Farme, Executive Vice President of Control and Investor Relations, Mr. Gabriel Portella, Executive Vice President of Health, and Mr. Carlos Alberto Trindade, Executive Vice President of Auto and Property and Casualty. 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 one week. Today's live webcast, both audio and slideshow, may be accessed through the Company's Investor Relations website atÂ www.SulAmerica.com.br/ir by clicking on the banner, webcast 2Q12. 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'll turn the conference over to Mr. Thomaz Menezes, SulAmerica's CEO, who will start the presentation. Mr. Menezes, you may begin the conference.

Thomaz Menezes {BIO 16674464 <GO>}

Thank you. Thank you. Good morning, everyone. And thanks for participating in our earnings call today. I'm here together with Arthur Farme, our Vice President of Controls and Investors Relationship, also with our Vice President of Health and Dental, and Carlos Alberto Trindade, our Vice President of Auto and Property and Casualty. Where we will comment the quarter's results and at the end, as usual, answer any questions.

We've experienced strong growth in all business lines, but our results were negatively impacted by the high loss ration in health and life which we will comment separately further in the presentation. The financial results were also affected by the reduction of the interest rate, thus generating a net income below our expectations. We continue to invest in expanding our presence throughout Brazil with opening of four branches in this quarter. We also expanded our product and service offerings with the launching of products specifically targeting SMEs -- small and medium enterprises.

We also announced during this quarter the agreement to acquire Sulacap, the fourth largest capitalization Company in Brazil, which once integrated to SulAmerica business will allow us to reach a new market segment and a new niche of consumers. We are still waiting for the approval from the rigueur authority entities.

In regards to sustainability, the Company had an active participation at the (human niche) during which the principles of sustainable insurance, the (bare sea) were launched and we became signatories to which we believe is an important initiative for the insurance market. Within the quarter we also became signatories to the United Nations' environment financial initiative which aims to link financial results of the Company to the sustainable development.

The Company remains confident in the Brazilian insurance market development and our business model and in all initiatives that are being implemented to continue growing in premiums, managing our claims, managing our cost controls, risks, and advancing the Company's financial results. I will switch over to Arthur now to comment on the quarter results and then at the end, as I have mentioned, open up for a Q&A session. Arthur?

Arthur Farme {BIO 1845065 <GO>}

Thank you, Thomaz. Beginning now on slide two, we have a table for the Company's main performance indicators for the Second Quarter this year. The first line, we know a 13% increase in premiums which is being pushed by the group, the growth in the group segments, growing alone 23% quarter on quarter. Our combined ratio ended at (acquired) 104.6% as we show on the second line, mainly due to the loss ratio in health as we're going to see at the end of the presentation.

Further down, we have active financial results at a (temper) which had dropped 27% in the quarter, would lead into a yield of 97% in Q2, 108.3%, that leads us to consider Q3 -- sorry, the six months. Overall the Company posted a net income of BRL3.6 million in the quarter down 87% from Q2 '11.

As we move forward in the presentation to slide three, we see here again increasing premiums of over almost 14%, 14% as well for the six months. There's a chart on the right that confirms that we maintained the same set of our mix in our revenues with health and automobile which is adding more than since the 90% of our total revenues.

Moving further in the presentation to slide four, here we're providing some details on our health and dental operations, indicating the health premiums in the quarter reached almost BRL1.8 billion and BRL3.5 billion for the first six months. It's been really -- which was nice is the portfolio has experienced robust growth of some 23% compared to Q2 '11 as well as 24.5% over the six months of the same year.

I guess we -- the way we understand those results and this performance as reflecting the growth in the sale of new policies, an increase of 9% in the membership as well as adjustments applied to the rates of our currently existing policies. I guess we should also note here that the portfolio of SMEs has reached about 300,000 members, 23% over last year's figures with revenues -- premium revenues growing 30% over Q2 '11. SME now represents 19% of the health segment and we believe this should continue to experience high growth rates in the following quarters.

As a good example, also included in the slide, we have experienced expressive growth rates with a growth of 25% in members. This is pure organic growth as we have already incorporated the portfolio of dental plans from the Company we acquired last year. The loss ratio in health was 88.2%, that's seen in the upper right corner of the slide and the ratio shows an impact, both the performance of both the group and the individual lines and it's partly accretable to the seasonality in fact that marks this business line.

I guess it is also worth noting here the fact that this line was also impacted by premium adjustments in prior periods in which competitive conditions have not provided enough room for larger rate adjustments. I'd also say it would include increasing the medical costs which have been experienced in this field. The latest available data by AMF which refers to the First Quarter this year, so (America) was growing 17.4%, this compares to a market of 15.5%. So making us one of the largest groups in the Brazilian private healthcare segment with a 9.6% market share.

As we move further down this presentation to slide five, we're talking here about the automobile line. We saw a 5.6% growth in this quarter over Q2 '11, a growth which we deem as negatively impacted by the competitive environment seen in the past months. We kept our strategy to seek higher profitability in this portfolio independently of market factors of industry related issues. This strategy may or may not come at the expense of an increase in the top line in the insured fleet. However we ended the quarter with close to 1.5 million insured vehicles. The chart on the upper right corner of the slide shows a loss ratio in the quarter of 67.7%, down 100 bps from Q1 this year, down a little bit from Q2 -- sorry, up four points from Q2 '11.

As we move further in the presentation to slide six, this refers to our property and casualty segments. The portfolio's very diversified, the composition as charted at the bottom right of the slide shows that our strategy is to focus on the mass sales products and also bundle the residential, condominium, and small businesses products. Premiums saw a slight increase of 1.6% in the quarter and the loss ratio grew 730 bps to reach 65.5% compared to the same period in 2011. The increase in loss ratio was mainly due to the performance of the trends in the cargo market and marine line and to adjustments in provisional contingencies.

Slide seven addresses our life and personal accident segments where premiums increase 4.6% and 8.6% in the quarter and the first half respectively. Loss ratio was 56.1% in the quarter just ended with the year on year comparison kind of distorted due to a premium deficient provisions we had last year. Results also benefited from the money lender insurance which is responsible for some 12% of the life and the coastal accident portfolio. So the breakdown is shown on the chart on the bottom right of this slide.

Slide eight represents our results for pension and the VGBL operations where contributions had total BRL197 million in the first half of the year and reserve lending at BRL3.5 billion in the same period. The VGBL piece alone increased 15%, totaling BRL783 million in the BRL3.5 billion total.

Slide nine, our asset management operation reached BRL22 billion in assets under management with close to BRL4.5 billion of net increase between Q2 '11 to Q2 '12. The asset management line has generated a gross margin of BRL11.1 million in Q2 '12 to increase -- an increase of 68.6% over Q2 '11 and that is mainly due to both higher volume of assets under management as well as higher volumes of performance fees.

Slide ten, we have G&A expenses. The ratio, the right side of the chart was pretty much stable as compared to Q2 '11 and higher 20 bps for the six months of 2012. The slight increased was already expected by the Company by the reduction of revenue that we used to get from service providers and the expense recovery.

The slide, slide 11, goes back to the combined ratio which ended the quarter at 104.6%, pretty much in line with last year's figures and also due to the performance of our loss ration.

Slide 12, this is a portrait of our investment allocation strategy. The upper half of the slide will show a BRL4.8 billion portfolio which represents financial assets not linked to pension and VGBL operations. The return of this portfolio was 108.3%, the base rates of the CDI for the first six months of the year, and as we close the pension and VGBL amounts, the total comes to BRL8.3 billion as shown on the bottom half of the slide.

Slide 13, the last slide, we're summarizing our net income figures of BRL3.6 million in the Second Quarter and another BRL16.4 million for the first six months. We see a big climb of 10% over the six months to that 87% quarter on quarter. With this first part concluded, I'll switch back to Thomaz and later we'll be able to take your questions. Thank you.

Thomaz Menezes {BIO 16674464 <GO>}

Thank you, Arthur. Before we open up for questions, as mentioned, I would just like to reaffirm -- take this opportunity to reaffirm that even with the impacts coming from the higher loss ratio and financial results in our results this quarter, that the Company continues optimistic with the insurance market potential and confident in its strategy to grow in all lines, in all segments. I would like to reinforce our commitment to grow sustainable, profitable, and with our underwriting risks under control.

So as agreed, I now open up for questions. Thank you.

Questions And Answers

Operator

(Operator Instructions) The first question comes from Guilherme AssisÂ of Raymond James.

Q - Guilherme Assis {BIO 16143141 <GO>}

Good afternoon, everyone. So I have actually two questions. My first question would be regarding the SME segment which has been one of the segments that you guys have been growing the most. I'd like to understand the dynamic here in terms of the growth and the loss ratios that you had in this specific segment and whether we're going to see any kind of adjustment in terms of growth in this segment related to the underwriting of the additional risk in this segment. That's my first question.

My second question would be regarding the decline in the acquisition and selling expenses that you had pretty much for all or in all the group insurance business that you had. I'd like to understand what is going on, if this is something that you expect to keep the selling expenses at these -- or rather that you presented during the quarter. Those are my questions. Thank you.

A - Thomaz Menezes {BIO 16674464 <GO>}

Guilherme, this is Thomaz. Thank you for your questions. The first question related to the SME and the middle market segments, I think the results that we are seeing is basically reflected on the right strategy that the Company has taken in order to take advantage with the overall sort of economical growth of this segment. As we all know, with the stabilization of the economy, more formation of jobs, a bigger perception of the business entrepreneurial, offering of benefits and insurance to employees is something that not only helps to attract but also retain talent, I think we have benefited from the right strategy to focus not only on the commercial side working with brokers and partnership and distributer, but also in the product design and underwriting criteria which has led us to grow as you mentioned in the health BME more than 30%, selling more than 25% on dental and increasing more than 300,000 lives in the overall health -- I think we also launched products for life related to this segment, SME, and also looked at opportunity within the RFPNC segment for products that we'll take advantage of as well. Business is growing and growing in the middle class and growing in the SME. There's a huge opportunity there with more formal jobs.

Q - Guilherme Assis {BIO 16143141 <GO>}

If I may just add to the question, I think my specific question is whether -- I know you've been growing quite consistently in that segment but that clearly the loss ratios haven't been really great. I'm not sure. From your numbers I can't tell if there's any relation to a growth in the SME and loss ratios. My question is whether you had to give up part of this growth, particularly in the SME in order to improve the loss ratio? In the future should we expect any deceleration from that, in that segment or in the group segment as a whole, as part of the adjustment that the Company will have to do?

A - Thomaz Menezes {BIO 16674464 <GO>}

To the contrary, I think the loss ratio on this segment is better than the overall portfolio. Although the loss ratio is stable, I think the faster and stronger we grow the segment, it will help us overall on our loss ratio.

Q - Guilherme Assis {BIO 16143141 <GO>}

Thank you. And regarding acquisition costs?

A - Thomaz Menezes {BIO 16674464 <GO>}

There's a difference in acquisition costs -- a bit high depending on where you compare, a bit higher there but then there's a way you will defer this cost so the average commission could be a bit higher to the large groups. But overall the bottom line is better on this segment and that's why we have a strong focus and actually doing quite well on this segment, not only in the SME segment but also on the dental which also has a better loss ratio.

If we move on to your second point, I think that again this is part of our strategy that we have set within our distributer partnerships and our distribution costs, our cost of acquisition. We have implanted a series of initiatives not only to increase the number of partners and the number of brokers and partnerships that we have within the Company but also we have designed a model that we enumerate the distribution based on growth and based on profitability.

So I think that the result of this has been quite positive where we have been able to reduce our distribution costs, more in line perhaps with the market but clearly focused on results. We don't expect any further movement on this side but I think this has been good results from our strategy that we have implemented in the last couple quarters.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Thank you.

Operator

Our next question comes from Iago Whately of Fator.

Q - Iago Whately {BIO 16356183 <GO>}

Hi. Good afternoon. I understand that one of the reasons behind high MLR in 2012 was the incorrect pricing of health insurance policies in the beginning of the old cycle, I mean mostly in Q3 '11. So besides the price adjustments of individual plans which were lower than inflation, why contracts were mispriced? Was that part of the commercial strategy or a difficulty to price contracts in new segments?

A - Thomaz Menezes {BIO 16674464 <GO>}

Yes. I'll take a first look at this and then I'll Gabriel to add on. I don't think the expression long pricing is appropriate because on the individual as you know that is dictated and decided by the local agency. With respect to the SMEs or in the group rights, we priced according to the contracts that we had with the individual companies up to a certain loss ratio or results at that time and looking forward of course it has actually performed a bit different than we expected for a couple of reasons -- not only frequency and we have been able to keep our medical costs under inflation and under but we have seen a level of frequency and utilization higher than expected.

So it's important to mention that we are at the end of a readjustment cycle -- so we are at the last month of a 12 month readjustment cycle which from this month on we expect to implement price adjustments in all our portfolios and our new products. Gabriel? I don't know if you want to add any other comments?

A - Gabriel Portella {BIO 18012687 <GO>}

On inflations, it was basically related to the pricing of our products that we have. There's no commercial driven, profitability driven, but sometimes we can forecast some things that happen in real life. For example, medical doctors readjustment in a high level of the market, this impacts our portfolio. But remember, all the group contracts that we have, those are break even contracts.

Then we have two types of adjustments in those contracts. One, when you look back, you see the break even that we have combined and the second one is the forecast for the next 12 months for the medical inflation. For this particular year we are putting more than two digits around 14% of medical inflation for the next 12 months, added with the break even contracts that we have which follows.

Q - Iago Whately {BIO 16356183 <GO>}

Thank you, Gabriel. Should we expect any improvement in MLR in the last quarter of 2012? Or it only will be seen in 2013?

A - Gabriel Portella {BIO 18012687 <GO>}

There's a big influence of the seasonality in the last quarter, always, according with our methodology, the influence of the seasonality is very strong. And always in the last quarter of the year. Thank God we have Christmas and other things that people goes to parties and not to the hospitals and doctors. Then we expect a recover of operations in second semester as a whole.

Q - Iago Whately {BIO 16356183 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) The next question comes from Roberto Savaris from Barclays.

Q - Roberto Savaris

Hi. Good afternoon, gentlemen. Could you please comment on the performance of the group plans? You said it was less responsible for membership growth in the industry? And this segment is associated with the increase in focus or not? Okay? Thank you.

A - Thomaz Menezes {BIO 16674464 <GO>}

Just to make sure that we understand the question, you want to know the participation of the affinity of the group on health?

Q - Roberto Savaris

Yes. Affinity.

A - Gabriel Portella {BIO 18012687 <GO>}

I guess somebody's asked about the affinity segments and kind of policies. That pretty much follows performance of group health facilities -- nothing much different both in terms of new sales and also in terms of the MLR, the traditional group health announced that there were additional contracts and performance the same way. It has slight differences in loss ratios for certain policies which are compensated by acquisition costs and have a comparable gross margin at the end of the day.

Q - Roberto Savaris

Thank you.

Operator

(Operator Instructions) This concludes our question and answer session. I would like to turn the conference back over to Mr. Menezes for any closing remarks.

A - Thomaz Menezes {BIO 16674464 <GO>}

Okay. I want to thank you for the participation on the call and for those that did ask questions, for the questions. Of course this was a challenging quarter and we look forward to a better second semester in the year. As we comment here, mainly for health, we are at the end of a price increase cycle and our expectation is for the next semester as it has been in the past, not only a function of the price adjustment but also new sales, that we tend to have a better semester.

I wanted to highlight that we continue to be firm on our strategy and we have demonstrated despite the competition strong top line growth -- basically in all lines. We grew premiums in 14%, we're growing high double digits on health. We are growing on life. And we have a better expectation for the second semester specifically related to auto where we have definitely in the first semester focused on bottom line and profitability where we think the market will come to an overall movement that will benefit our strategy.

We continue to be absolutely confident with our strategy with the opportunities that we have within the market and within the lines of business that SulAmerica is strong and thank you for the participation in the call.

Operator

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