Q2 2017 Earnings Call

Company Participants

- Arthur Farme d'Amoed Neto, Vice Chairman of Board of Executive Officers
- Eduardo Dal Ri, Unknown
- Gabriel Portella Fagundes Filho, CEO
- Marcelo Mello, VP
- Mauricio Lopes, Unknown

Other Participants

- Eduardo Nishio, Analyst
- Gabriel Gusan, Analyst
- Gustavo Mendes Lobo, Analyst
- Gustavo Schroden, Analyst
- Lucas Lopes, Analyst
- Rafael Frade, Analyst
- Thiago A. Kapulskis, Analyst

Presentation

Operator

Good morning. Welcome to the conference call of Sul America to discuss the earnings regarding the Second Quarter 2017. Today, with us are Mr. Gabriel Portella, Sul America's CEO. And the company's VPs.

(Operator Instructions)

Now, we are going to turn the call over to Mr. Gabriel Portella, Sul America's CEO, that will start the presentation. Please, Mr. Portella, you may go on.

Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Good morning, everyone. I'm here in Sul Paulo once again gathered with all Sul America's VPs to talk about the earnings of the Second Quarter 2017. When we look into the quarter in a more short term, the numbers have the effect on the expected directions. But a bit more intensive. We'd still highlight 3 relevant points. First, we continue with important growth in health and dental.

And in this period we are proud to highlight that we reached the level of 3 million lives insured with 2 activities together keeping the pace of new sales and offsetting the high level of unemployment in the country. Second, the auto segment is showing signs of recovery, still impacted by the adverse scenario in the market, it's already had growth in revenues and improved the loss ratio compared to the First Quarter '17. But our own asset portfolio had the profitability of 102.5% of the CDI totaling BRL 212 million. So our net income has BRL 80.6 million, 36% below the Second Quarter of '16. But you know that, that quarter was a record quarter for Sul America that year.

Also, we call attention to our consistent growth -- journey of growth and profitability. When we compare to the First Quarter last year, we see growth of operating revenues of 7.6%. And that is consistent in all business lines. We have been improving our productivity permanently measured by admin expenses over our expenses ratio. In the period, we had an improve of 0.3percentage points. Basically, because of the seasonality already known in the insurance market. And so high level of effective rates [ph] of cars especially in regions that account for an important rate of our work, the loss ratio in the segment grew by 1.6%, slightly above expected. But without changing our journey. And we -- when we look at the quarter of the results of the first half of '17. And compare it to the same period last month, we are only 10% below.

In a nutshell, we have lots of positive points to highlight. To close, I would like to say that in recent years, we have been coping and facing consistently one of the strongest periods of recession in the country, the prospect of economic recovery, inflation under control, pickup of investments, further reduction of interest rates, encourage us for better periods. This is what we have been doing. This is what we are going to do from now on.

With that, I'm going to turn the call to Arthur Fame, VP of Controls and Investors Relation to comment on the main indicators of the quarter. And then we are going to open for Q&A. Thank you very much.

Arthur Farme d'Amoed Neto

Thanks, Gabrielle. Good morning, everyone. The quarter accidentally brings a series of issues, that's by the reports that analysts and the companies published all legitimate issues. And I think consequence -- as the consequence of the numbers that we presented. From the management's perspective, the message is that we are pleased with the numbers we are delivering to the market this quarter, especially, because behind these numbers, the priority of the company has been to invest in the quality of its financial function. So results of our balance sheet, they all reflect our priorities.

I think the quarter also brings something important showing that this is an era of transition for a new compact, especially because of the macro issues that may have an important effect in a Brazilian economy. The economy heating up, revenues are starting to grow more vigorously in the context of the country's interest rate, is all that's reflected in our financial results.

When we look at revenues on Slide two starting our presentation, you see that the insurance operating revenues have growth of 5.6%, basically motivated by the growth of almost 10% of our health and dental operations, auto, a drop of 11% and in there, approximately 70%, also growth -- show growth of 5.6% of this line. But behind these numbers and we are going to explore that a bit better with the heads of business area, also has good percentage of sales in the market that is still affected by unemployment. We continue with a member portfolio that is relatively stable. And this portfolio was increasingly volatile. It does not behave the same between quarters because of regulatory issues and so much other seasonalities that you -- that monitor those business already know.

In auto, our message is quite positive, if you have a sequential comparison to the First Quarter, you see positive actions everywhere. It's better in terms of revenues, in terms of loss ratio. And also, the numbers that (inaudible) have been producing in terms of new cars in the internal market and (inaudible) for the year shows growth in the segment of 4%. So the market is picking up. And we'll benefit from the primarily supply of new cars. Of course, the competition is still adjusting to the new environment, especially, in the macroeconomic scenario and the interest rates that are in place. But positioning itself with regards to underwriting and all the other issues affected by the high level of taxes and (inaudible) in some regions of the country. Some are more exposed to it, some less. But anyways, they are all responding in line with that.

I'm going to continue in the presentation, I'm going to skip the next slide because basically, it reflects our breakdown of revenues. And I'm going to Slide four that brings a summary of our results. So I already talked about our revenues, we are growing on a 6% in the period. Loss ratio worse, worse in health and worse in auto. Consolidated revenues accompany that. But admin expenses, as Gabriel mentioned in the area of production show improvement with regards to revenues, which to us is an evidence of the success we have been having in the management of resources and in our quests for better efficiency. We are consistently improving those indicators.

Investment income that was the object of some reports that were published, shows drop in absolute numbers in the quarter. It's still stable, if we compare quarter-on-quarter. But behind this number we have the profitability above 102% of the CDI in the period and this is an important aspect that we can explore further on with Marcelo, when we move on to our Q&A session. I think that the rise in the quarter is quite good, especially, in a scenario where interest rates are going down. And we're going to experiment that so further on. And this reflects the capacity of the company to deliver sustainable results, despite the volatility of quarters.

With that, I'm going to stop my first introduction and we are going to open for Q&A.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Gustavo Schroden from Bank of America.

Q - Gustavo Schroden {BIO 18713982 <GO>}

I have 2 questions. The first, to discuss the loss ratio in health, especially because it was showing a relative resilience especially, if we take into consideration a weak economy, high rate of unemployment, companies shutting down. So we understand that the result of the initiatives that you used were successful in past quarters. But the point is that the loss ratio in health did grow up a lot. If we had seen a lower decrease, it would be kind of less effective. But it is also a bit out of line with what we expected. So what happened this quarter for you to have such an extraordinary number, at least according to our expectations? Did you have any one-off situation? Was it a collusion of factors? I'm going to ask this first question now and then I'm going to go to my second question.

A - Mauricio Lopes {BIO 20668973 <GO>}

Gustavo, this is Mauricio. Thanks for your question. Well the way we see it, is that we have the effect of a characteristic seasonality of the quarter. I understand that your (inaudible) was a bit stronger than you -- what you'd expected. But as management sees it, it's not really out of control. We did have a final cycle of price adjustments, this is an annual cycle, we are just finishing that today. The last month of June was the last month of our effect of price adjustments in portfolio. We had in the month of April. And May, a worst result because of seasonality. And also the (inaudible) adjustments of calendar in between quarters.

But if you don't look only the quarters. But just the half of 2017, we continue with the best half of the year since 2012. But we had a very good quarter -- a Second Quarter higher than expected. But if you compare to the Second Quarter of '16. And if you remember that call, we had loss ratios that were very low, quite surprising. So the comparison between the 2 quarters is at the cars because one that was extraordinarily good and the other extraordinary bad. So I prefer to look in to the whole scenario rather than a single picture. We continue doing well. And the trend of this portfolio continues to be stable. We have a slight reduction. But we are growing our portfolio with regards to that. So the management believes that it was an occasional situation that's not going to affect us further on.

Q - Gustavo Schroden {BIO 18713982 <GO>}

Just as a follow-up, I understand the quarter. I think that it makes sense to look at the whole scenario. But the Second Quarter of '16, as you very well put it, was one of the best Second Quarters you delivered. So I understand that comparing numbers is difficult. But if I need to compare to 2015, the loss ratio is quite higher, I'm talking about the Second Quarter specifically. It was really the worst that you usually report. It was a bad historical levels, if we go to 2015 rather than 2016, this is what they wanted to understand really. So from what I see, you have an issue of seasonality. But you did have one-off situations that made this quarter be a bit worse than the quarters of previous years. Is that the message?

A - Mauricio Lopes {BIO 20668973 <GO>}

Yes. As I mentioned, the result of the Second Quarter '16 are difficult to compare. And I think that there are a series of things that may lead -- may have led the quarter to a worse scenario. The end of the quarter was a bit more abrupt because we had price adjustments that were fixed 12 months ago. And the effect of the payment did not follow the cycle of adjustments or we had some increase of cost ratio in some specific day of the quarter. And each day accounts for a lot or we had an increased seasonality because of the contagious diseases in the two months, I mentioned. So all that together, may lead -- may have led us to a worst quarter. But again, if you look at the grounds of the portfolio, the dynamics of the portfolio, if we go to our metrics of management monitoring, we do not have red flags.

Everything has been rolled out. All the actions are into action. We have a new set of actions that have been developing in recent quarters. That will show very good results. If they follow previous actions, the commercial area continues to be very competent to manage its numbers. And the retention cells that work internally are at full force. So both in claims and the premiums in terms of retention, acquisition, we have no indication that we are having a deterioration of our portfolio, at least not structurally. It happens. But we don't have a concern about that.

Now trying to look forward and you have somewhat anticipated for the next quarter. You have just finished the price readjustment process and let me understand them. So price adjustment plus the initiatives you have in place, do you expect third and Fourth Quarters to be better? Do you think the loss ratio will also improve better than what we have had in the Second Quarter? And I'm just comparing the Second Quarter against last year and the third.

And fourth and so on and so forth. So do you think that these pricing adjustments will be enough to compensate for the loss ratio? Because the number of life system was under pressure if we analyze all the other segments apart from the ASO, they are all under pressure. So can we expect that the price increase and the initiatives that you have already in place will be enough to keep on showing a resilient loss ratio you used to have? If any periods in annual increase may be lower than what we initially expected, can we expect that? Can we expect improved loss ratio in the third and Fourth Quarter?

We don't have forward-looking statements here. But let me try to understand you in a way that would make sense. In our post-sales areas of Sul America, we have adjusted the readjustment values that would make sense to the portfolio. We don't think that we have really used any price adjustment below what we initially thought would be the right one. We don't have any internal filling of underachievement here. We have really achieved the goal that we have set for post sales. Secondly, portfolio seasonality is really something clear. We don't think that considering Sul America's portfolio, there will be any dysfunction of the seasonality like we have always had.

What we have today and we have tried to do that for the past 24 months is to have, let's say, last striking seasonality, something that we have already said in the past. We have been trying to do that to manage seasonality but still, the portfolio we subject to that. So I think that you should keep on considering seasonality and it's something relevant in your understanding of results. If I may make an additional comment, you have pointed out that ASO was at a different level of premium compared to the others. In my opinion, ASO is a market trend and it has been the case in many other countries, it's still a very strong product. And we have been getting organized to have a stronger presence in ASO.

The investments made by operations post sale to provide quality of customer care in ASO had been really significant. And when we analyze our portfolio, we'd really have to realize that ASO is bringing expertise to us, it's bringing more bargaining power as part of our product portfolio. It really expands the possibility of regional presence. So it's important not only for the number of lives. But also for the quality of the operation we have.

Operator

Next question, Thiago Kapulskis with BTG Pactual.

Q - Thiago A. Kapulskis {BIO 19187926 <GO>}

I have 2 questions. First concerning health, second concerning auto. In health, despite all the cost concerning loss ratio, we can still see you outperform in terms of number of members, one more quarter that you had an increase in members even though the small increase. But the scene of the market is of decrease. So you have outperformed. Do you think that you can keep up with this trend in terms of increasing the number of members?

And I'd like to hear from you why even though there has been a decrease in market, maybe some other players who captured life, that are being lost from companies that are going bankrupt, or going out of the market. So what is your main differentiating element that would maintain this increasing trend? Secondly, concerning auto, even though the loss ratio has been decreasing on a yearly basis, now this quarter showed some situation, which was less negative and even the main player in the industry has shown some improved loss ratio. Do you see an increasing and improving trend? Do you think that in the next quarter, we can see improved loss ratio on a year-to-year basis?

A - Eduardo Dal Ri

Thank you, Thiago, this is Eduardo. I'm going start from auto and then moving to, we'll carry on. Yes. We are very glad with the trend and what's going on with the Auto Insurance right now. We do believe in the improvement. We've been building that, the conditions for the improvement to become a reality as soon as possible. As I said in the last call, we have readjusted all the conditions we have -- we have also included some regions that had a very high rate of debt. And we just excluded that on our conditions and policies. So we really had the impression of an increase on-average premium. It has a short effect in production, in results.

But we think that Sul America and some other players that have been doing that adjustment to the reality of risks, which will probably even take for a while then the decrease in interest rate, our average premium is growing. And it's well adapted to the new risk rate and interest rate. We think that the market in the short run will follow along the same dynamics and as we've seen in previous cycles that production will be resumed. So there might be some monthly oscillation or quarterly oscillation. But we really think that this is how the market will perform from now on thanks to some of Sul America actions and also the price increases in the market overall.

A - Mauricio Lopes {BIO 20668973 <GO>}

Now, Mauricio speaking. Let me carry on. Talking about health. Then if you have any questions, Edu is here -- Eduardo is here, you can complement. In health and dental insurance, we have maintained the same way of selling, we don't see any deterioration in our selling policies. And we have experienced some changes in house that have granted more assertiveness in what we're selling in the regions where we are. Providers, for example, we have revisited them some months ago. We have a team now for people credentialing providers, it's a new dynamic, there is no centralization or credentialing anymore, we have changed the profile of our team.

So we opened new areas for (inaudible). We have excluded regions we're not very profitable so we are selling more and better in the regions we focus. We are now focusing on smaller size companies, which are more profitable. We've been doing that for 12 months and very diligently, through our distributions team. In addition, something that should be added, which is an important piece of data, depending some on the portfolios because of the unemployment rates in the country, there is the decrease in the movement of beneficiary in existing contracts. In other words, some of the portfolios have been deteriorating because of unemployment rate. But that has changed in recent months. This is great, this is going to bring more stability to the portfolios in upcoming months. In summary, what we saw in the past, is a good performance, good regions, well-focused portfolios. And unemployment rate may get better and impact us positively in the midwest.

Operator

Next question, Eduardo Nishio, Banco Plural

Q - Eduardo Nishio {BIO 15333200 <GO>}

I have 2 questions as well, one for health and the other one for auto. Well for health -- or concerning health, can you please elaborate on some issues of the quarter. And how is that going to impact the margin for next quarters? For example, infectious disease, do you think that things would be better in future quarters? Do you think the adjustments will be enough to adjust everything, calendar days?

And in your release, you talked about the frequency. So tell us something else about the frequency? Do you think that this is going to change in upcoming months? The second question concerning auto, please tell us a little bit more (inaudible) in practice, why is there disconnection between Rio and Suo Paulo in terms of theft and robbery. In Rio, yes, we are going through a problem of public safety, a very serious one, there is -- was an increase of 30% in number of theft and robbery. Whereas in Suo Paulo, there was a decrease of 14%. So please tell us, why it has happened? And how we can expect it to change in upcoming months? Now in Rio, the Army is starting to provide services so it might help decrease this rate.

A - Eduardo Dal Ri

So Eduardo speaking. Let me start talking about auto. Very good question. And we compare our states where we have good presence in Rio, we have more lives because of our tradition. And the 2 states are very different. In Rio, there has been a decrease compared to the previous two years and in Suo Paulo. But in Rio, conversely, there has been an increase of 30% just compared to previous quarters. If I compare that to the past 2 or three years, that would be at least 20% increase on a yearly basis. Suo Paulo was the first state despite the federal legislation that was being discussed, Suo Paulo anticipated and thought -- created its own law in the state for cars.

So the regulation with local logistics with the police, everything that the police needed to differentiate here, what would be a good recycling company rather than illegal chop shop, which really have a region of the vehicle that come to be dismantled, thereby the chop shop or just from debt. So this is the legislation that has been approved and has been in place in Suo Paulo and it has really been effective. Of course Suo Paulo is discussing the impact of a crisis in the country. But the police are very active in closing its illegal chop shops. So Suo Paulo is really an excellent example and probably one of the very few examples we have in Brazil, dealing with the issue like that. In Rio, the things are exactly the opposite. The main problem is the economics crisis in Rio. There are -- the use of criminals for really arbitrary fact. But also those who used to operate only in drug trafficking and migrating into theft and robbery.

And as a consequence, the peak has reached 30% to 40% compared to last year's same month. In Rio, they still haven't effectively implemented the new laws chop shop, even though they are expected to do so, in fact the entire country is expected to do so. Because of all of the budget limitation they have in Rio, right now, they haven't managed to have a control over that issue. So the main difference is economics. But also a more comprehensive initiative and action to implement this law against chop shops. Do you think that the army in the country -- in the state will change things a little bit? Well that's what we hope for.

The first weekend with the army on the street, it went quite good. But it means nothing, right, it means nothing? We think, it will make a difference. But if they tend to be more assertive because if -- but if it is to improve trouble in Rio, the index will improve. But we have no data to support that.

A - Mauricio Lopes {BIO 20668973 <GO>}

Mauricio speaking. Thank you for the question. What do we have in this quarter? Clear, it's a seasonality. In some regions, infectious disease and respiratory infections were very relevant. In Suo Paulo, some pediatric hospitals could not view their client's demand, very dry season, low temperature, children in day care during the vacation period. So it increased the number of infection cases. So it has impacted our results. In the calendar in fact, we have one additional day from the First Quarter to the Second Quarter, it means BRL 50 million to BRL 70 million. So if one day of the First Quarter was just transferred to the Second Quarter, the comparison between both quarters really changed because you are taking BRL 70 million from one and putting into the other. So the gross difference would be BRL 120 million.

And this is why I think the whole picture is better than the snap shot. And this is not something new. I've been emphasizing. I'd say that when we have a good quarter, when we have a bad quarter. So the combination of these 3 factors, is leading to a potential deterioration of the quarter. But be careful, analyze a whole picture, our whole picture is good, it is the second best First Quarter in the past six years and it should be emphasized because it gives us a broader understanding than what we can only see in one quarter.

Q - Eduardo Nishio {BIO 15333200 <GO>}

So I think -- do you think that all of the infectious disease has made a difference? Or do you see any other elements, anything else that could explain this increase?

A - Mauricio Lopes {BIO 20668973 <GO>}

Well when we have a higher churn, the frequency would be higher definitely. But apart from infectious disease -- respiratory disease, nothing has really stood out. In the year-to-date, with the combination of our whole portfolio, nothing except from respiratory cough has been detected as a problem, quite to the contrary, all the ongoing actions when we look at the effect of the quarter, the actions in place, there are no adjustments to be made. They are all very well focused, nothing has to be readjusted to be honest of course. Had it being -- if there had been any deterioration in this quarter confirmed, this quarter, we would adjust things. But that it doesn't seem to be the case. And that price adjustments that have been employed, are by both safety in the Dental and Health, are very close to what we have planned. So no adjustments to be made here.

Operator

(Operator Instructions) The next question comes from Rafael Frade from Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

In health, I would like to understand the loss ratio in individual's life, Mauricio very well put it despite that comparison with '15, '16. The First Quarter in general looked very good. But individual, if the highest loss ratio that you had in individual. So could you talk a bit about those portfolios. Second, Mauricio did talk about new sales and that this is going quite well. So I would like to know a bit of the movement for the quarter. We perhaps had heard of new contract that you could be getting in the quarter. And when you take a look at the customer base, what's relatively stable. So I would like to know if you had major movements in the quarter?

A - Mauricio Lopes {BIO 20668973 <GO>}

Thanks for the question. Mauricio. Well the individual loss ratio is becoming more and more volatile. So the portfolio decreases. It's 170-something-thousand lives in a trajectory of higher dependents. So we should expect quarters that are more and more volatile, you are going to have good and bad quarters. In this quarter specifically, all the effects we talked about do apply to individual, as there is even one thing that is worse here, as we had a very strong churning and big metro purposes that led to some deterioration. It is not permanent, you know we want the portfolios to grow back to its traditional levels. And remember, that it continues to be our main focus in terms of health and loss ratio management. So it is a priority for the company. So what we see in the portfolio is high achievement with progress.

So you see, members are really accepting more programs, rheumatoid arthritis, both maxillary, chronical diseases in general -- chronic diseases I'm sorry. And we have been also working with active aging problems that have yielded very good results. So we see that there is a lower mass. And a lower mass has problems with (inaudible) so although we get good results individually with each one of the members, we have less members to work with. And the runoff was very strong. And I think that's the explanation for the portfolio. As for movement, while I mentioned that we are working in new regions, in portfolios that we haven't explored before, a smaller account. So we see that the smaller accounts are bringing higher profitability profile. Again, normal market dynamics, nothing different from what we saw in previous years. So life goes on.

Q - Gabriel Gusan {BIO 16184494 <GO>}

If you allow me a follow-up for individual. I think it's very clear what you're saying with regards to volatility and do you have a smaller portfolio. The concern is that if you get a bit of a longer spectrum, the account related loss ratio is going down. Okay, because of the several restrictions that you're having in individual portfolios. Higher components of aging, higher restriction of prices. So you have been talking about the series of initiatives you are taking. But my question is not exactly with regards to volatility. But how do you see the risk of this portfolio in a long time for it to go to, I don't know, loss ratio above 100%, do you see this possible to occur?

A - Mauricio Lopes {BIO 20668973 <GO>}

I think there are 2 items there. With regards to individual loss ratio in increasingly lower portfolio, we are going to have high volatility and deterioration as you mentioned, however, we see this situation in a very bad to (inaudible) economic cycle. If the cycle gets better, you keep more lives during more time in the portfolio. And then you'll have less adverse situation that can change the loss ratio profile. So you can see in the future a portfolio that is decreasing loss ratio, rather than increasing. But that takes time.

It depends on the macroeconomic scenario. And also depends on as to put some (inaudible) in place. What I see, is a pipeline of projects directed by the projects (inaudible) that is very strong and they are working very much on the individual portfolio, the volume of investments from the company are no small and they are quite well structured. We are not reacting at just on a one-one basis in each portfolio. We are working in a structured manner at a very sustainable manner. So if the macroeconomic situation changes, we have a possibility to get better results. And if there is no change in the microeconomic scenario, all the areas are working very consistently to work on the loss ratios a shows an individual portfolio. Also important to remember is that the price adjustment granted by the regulator to these portfolios, has also been higher in recent years, which brings us some relief with regards to loss ratio, of previous years like 3, 4, five years ago.

Operator

Our next question comes from Gustavo Lobo with JP Morgan.

Q - Gustavo Mendes Lobo {BIO 18719996 <GO>}

I would like to talk a bit about efficiency. Your admin expenses are very low with relevant drop in -- with personnel, I would like to know if this is the new level for the coming quarters, if there was anything specific, any expense that has been allocated for the First Quarter and up for the second? What happened here?

A - Arthur Farme d'Amoed Neto

Well. Lobo, this is Arthur speaking. I think you identified this correctly, it is a dropping trend in those lines. We are improving quarter-on-quarter there. If we talk about maker trends, if you take a look at our history that, that reflects the results of how our initiatives to seek for excellence and efficiency. I think this is a must when we go into this context of dropping interest rates in the country. I think this is one of the elements that we have to do that is our reach. Despite the drop in efficiency that we have been showing.

One important piece of data is that when we compare historically, any metric revenues for headcounts in the company has been improving significantly and sequentially. And this is an indication that investments in tools and technology that the company has been making have enabled us to work at a higher level as we have. But was a stable picture perspective. Not only in terms of personnel. But we are also keeping a level of investment in innovation processes, operating efficiencies, some of them we talk about when we talk about our business unit. But all that fitting the next level of expenses that you have been seeing. I think this is the first impression about what you said.

Q - Gustavo Mendes Lobo {BIO 18719996 <GO>}

And my second question is a bit more complex, I believe. We know that the future scenario for any insurance company with the decreasing interest rates and lower economy, is that the scenario is difficult to offset writing with financial results and you go through periods of transition with a more pressure profitability as we are seeing now. Do you have any visibility of when this transition period is going to finish, that is when profitability is going back to a more stable level for the company?

A - Arthur Farme d'Amoed Neto

I think your comment is important. But it brings a predated aspect when you say weak economy. We are not betting on the weak economy. We are betting on the fact that a decreasing interest rate as it's happening and you're seeing, prepares ground for a strong recovery of our economy, we are talking about an emerging country, it cannot grow at the levels it is growing. And it will not at those levels. And everything that has been done and the reactions that we reach in the different industry supports those impression that economically speaking, the country is picking up. The quarter particularly and perhaps, even the whole year of '17 when we look back, can be seen as a year of transition, of course the interest rate is going down faster than the economy is picking up and when this happens, you lose more in finance than you win in revenues. Then there is a giant effort of us to keep our expenses controlled, not only as main expenses.

But operating expenses as well, more recent that you mentioned about that all the efforts that we are engaging to manage our loss ratios. And Marcelo with Life and Pension and (inaudible) and the Savings Bonds are doing. A point to this you have not mentioned. But is also part of your question is the financial results components and with this regards, if the one has, we operate, we don't know for how long and an environment of lower interest rates, on the other hand, the pickup of economy we reflected in our revenues will make us to have a higher volume of reserves and assets to manage. The trade-off for right now, is still unfavorable. But should not remain so permanently. I'm going to turn the floor to Marcelo that is right next to me to talk about to what we are doing in terms of asset management, because as managing loss ratio, admin and operating expenses are taking place in our talk, financial part of it is fundamental. And what Marcelo and his team have been doing, is extremely important for us to keep our results.

A - Marcelo Mello {BIO 21963995 <GO>}

Gustavo. Good morning, this is -- more recently, you're following the company's allocation portfolio. And our main objective is to companies that remain of the company. What we can do additionally in terms of allocation is something that we are -- we're paying attention to, our credits portfolio that today accounts for 17% of our portfolio. So conservative in terms of issuances, we are following most recent issuances, some -- we go along some results because rates are too regressed compared to demands. But we are paying very much attention to that and the idea is to improve our credit portfolio. As for market's risk, there is room for us to take some risk. By means of arbitrage, nominal interest.

But also acting very cautiously, because of the most recent valuation of our assets as we see. So this is room for more risk management and of course, respecting the company's aspect for risk. But at any moment, we can take actions very cautiously again. And when we open a position at risk, we have to have some kind of hedge. Because the level of conviction that we have for the market, we see that we can have opening up positions best with some hedge, that will offset any loss due to short-term volatility as we saw on May '17 and '18 when we had the audio of the heads of JPS [ph].

Operator

The next question comes from Lucas Lopes from Credit Suisse.

Q - Lucas Lopes {BIO 18956724 <GO>}

I would like to talk about the loss ratio of the mix portfolio. You have been expending your portfolio of small and midsize business for the past two years. So more SME and last large companies, how does it help you? I think there are two ways of having it impact your loss ratio. First, small and midsize companies, you said they are more profitable, you can have better prices. So looking at the snapshot, SME has loss ratio than the midsize client of large companies. And by attracting new companies, you also have the grace period to taking to account. So please tell us if this effect on your loss ratio?

A - Marcelo Mello {BIO 21963995 <GO>}

Thank you, Lucas for the question. Yes, SME has been increasing significantly in recent years. The loss ratio of SME is lower than the loss ratio of Large Accounts, similar to any other business, smaller customers tend to have more profitability than the very large customers and these clients play different roles in our portfolio. What's important to answer such here, is what we have been doing with our commercial perspective department. But also the internal work of improving the level of services provided to our customers, our SME portfolio is as good as our system is efficient. We have been investing on how to provide services to SME so that it would add value to them, attracting them without adding any burden to our services. I think it's important to mention that digital channels we have, our SMEs, for health and dental, had enormous functionalities in small size customers.

And so all the problems they have online not spending any time and not increasing anything in the cost of operation. The press is very well-adjusted, the service is good, stable network. And we've operation structure that is very efficient. We don't lose clients in SME, much we are losing those clients, much less than what we would have expected with the prices. So the portfolio is very resilient. And we have been making it get larger at least for the past three years, increasing its mix in the portfolio. It's a consequence the loss ratio of the portfolio as a whole is benefited. So your point is correct.

The SME growth usually, is it associated with a significant grace period or do you think that usually those are profitable clients?

We have been provisioning system that is independent from grace period. Because we are selling one more life for SME today, the real loss ratio would be very low, about 1% loss ratio in the month. But we provision the steady state loss ratio of the portfolio. So the life just comes into the portfolio as if there were no grace periods. And this is how we work on the provision in a very conservative way. Thank you very much.

Operator

If there are no further questions let me give the floor back to Gabriel Portella for his closing remarks.

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

Well I would like to start by thanking all of you, who were in this session especially, our 5000 staff members who are very attentively observing what we say believing that the positive signs of the country has reached, will mean even better second half of the year. I would also like to thank the strong contribution of our 30,000 insurance brokers. And business partners that work with us. Thank you very much everyone for your participation. Have a good day.

Operator

Sul America is closed now. Thank you very much. Have a nice day.