

Q2 2014 Earnings Call

Company Participants

- Arthur Farme d'Amoed Neto, Executive Vice President of Control and Investor Relations
- Gabriel Portella Fagundes Filho, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Gustavo Lobo, Analyst
- Rafael Frade, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for standing by. At this time, we would like to welcome everyone to the Sul America' Earnings Conference Call for the Second Quarter of 2014. Today with us we have Mr. Gabriel Portella, CEO of the Company and the Company's Vice Presidents.

We would like to inform you that this event is being recorded and that all participants will be in listen-only mode during the company's presentation. After Sul America' remarks are completed, there will be a Q&A section, at that time further instructions will be provided. (Operator Instructions) The audio of this call will be available at the company's Investor Relations website shortly after the event. Today's live webcast both audio and slide show may also be reached through the company's Investor Relations website at www.sulamerica.com.br/ir, by clicking on the 2Q 14 banner. The webcast presentation is also available for download on the webcasts platform.

Before proceeding, we would like to mention that forward-looking statements are based on the beliefs and assumptions of Sul America' management and an information currently available to the company. They involve risks, uncertainties and assumptions, because they relates 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 Sul America and could cause results to differ materially from those expressed in such forward-looking statements.

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

Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Good morning, everyone. Today, we are presenting the results of the second quarter 2014, but before we start the presentation, let me highlight some points I consider very important. First of all, we were able to maintain our revenues growing at substantial speed through several initiatives with our sales channels and by continuing our comprehensive training program. We maintained the vision and that even in unstable economic scenario affecting certain segments, there are opportunities for growth in some segment, products and regions. Coupled with that, we detect a possibility of penetration in our industry.

We are reaping the fruit, among which, we would like to highlight the growth of our savings bonds business. As a result of the integration and widening of our distribution base, as such we consolidated our position as the fourth largest company in the sector and the first largest as an independent company. We have also balanced our portfolio with a better mix of products. Other lines of business continue to show high growth, such as healthcare, SME and also administrative services operation, and massified insurance. We also show a large number of new sales in our business, which partially offsets the contracts we decided not to renew due to specific considerations. We have added 57 new lives during the period. We also have launched some new products, such as a new line of Life and Pensions, Flex Deductible product in Auto Insurance and products with co-participation in Affinity Group Insurance.

In the Life Insurance segment, we have reached the end of the cycle, we have started (inaudible) portfolio. As a result of this initiative, we were able to reduce our loss ratio in 16.2 points, even though there was some compromise in our revenue. In the same way, in the area of property and casualty, we have also had a direct benefit of a reduction of 6.6 points in loss ratio. We are one of the few independent companies in the area of asset management with a positive balance in our investments and we have been able to (inaudible) this base of high volatility with sustained results.

Our administrative expenses continue to be in adequate levels when compared to our competitors, resulting from the strong control in our price discipline. We have cash for important projects, such as, for example, the public -- the television campaigns throughout Brazil and investments and technology and development of new lines.

All of this shows that we are on track with our multi-line product. We have launched new products, we have launched also motivation programs and as a result of -- the results of one line cannot affect the results or performance of other lines that due to adverse conditions show higher difficulty, a good example of this is our Auto Insurance segment. In the first months [ph] of the month, we had a trend of price reductions, but even with auto sets [ph] on the rise, we were able to maintain our loss ratio in a stable level. The market adjusted to reality and corrected price. In the last month of the second quarter, we were able to regain our speed of growth above 13% showing that we are on track.

In Healthcare, even though loss ratio has grown, as often happens in the second quarter, our measures in risk management presented further increases in line with other risk initiatives underway, an example of this is the second half of direct procurement of

materials and expensive medications. It's the process we started last year with the single specialty and at the end of the first semester, the program has also would been rolled out with four more specialties.

Besides, we have a new risk management platforms for companies in a partnership with (inaudible). The results of those activities will be felt in a longer term, but we are now offering material options for healthcare management to our clients reinforcing and heightening the quality of our active health program. This is an investment for the future.

Finally, we would like to inform that, on June 27, an auction at BM&FBovespa; ING sold the balance of its Sul America's stock in a block trade. This negotiation is the end of movement started in 2013 that invested divestment of the company stake in Sul America. The exit of this shareholder does not affect Sul America's business. Even though ING has contributed to the development to our business strategy, in the last few years we have made significant improvements in our corporate governance and managements mechanisms. As such, the current management is able now to operate with autonomy under clear guidelines in order to deliver the best return to our investors.

I will now would like to hand it over to our Arthur Farne, Vice President of the company to comment the results of each of the operations; besides and later we'll be available for questions.

Arthur Farne d'Amoed Neto

Thanks, Gabriel, good morning. Good morning, everyone. I'm going to go over the material that is available on the slides. And I'll try speak a bit slower because we have simultaneous translation and therefore we are going to help the interpreters to present the numbers correctly to those that are following us in English.

So we are going to start with slide two of our presentation, that summarizes the company's consolidated revenues in all of our activities. We have been introduced in the slide for some quarters, especially after we went with the capitalization of our assets. The highlight is Health and Dental, because of the volume of operation we grew by 14.4% in the quarter, and it's also important to show and you're going to see that further on that the portfolio in the period had some growth with an expansion of a phase to redistribution of portfolio and adjustments that lead to the growth that we had.

In Automobile, we had a growth of 13%, the second largest portfolio in terms of services, the fleet grew a bit more than 7% and I think this growth also deserves the -- reminding you that in 2013 our premiums were high because of that issue that involved policy costs. So we are growing over a base that was very large and that shows the strength of the company in this portfolio. As for P&C we are decreasing this portfolio, we have been focusing on massified insurance and this behavior is therefore in line with the design of our portfolio.

For Life and Personal Accidents, we also see a drop quarter-on-quarter in view of some ongoing actions of the company with new products and et cetera, that will take the

portfolio to its right position. In Pension, we have a stable number of contributions that we have in the market until May shows a decrease in pension activity, which is suffering with short-term variations due to the volatility of other assets and perhaps the higher interest rates. Then we have ASO with an increase of 20%, these are administrative services only; postpaid plans. Asset Management a drop of approximately 11% in revenues basically concentrated on performance fees, which is an expected behavior due to the moment the market, is going through in terms of stock market behavior.

And Savings Bonds with an increase of 82.3% quarter-on-quarter. Of course, when we take into consideration the months of the second quarter of 2013, that savings bonds were still not entered in our numbers. We were talking about a growth of approximately 26%, which is still very good growth and show that we are really seizing the opportunities of savings bonds that have being appearing us with incorporation of SulaCap Holding.

On slide three, the next slide. We can basically see the same information, but here in a more graphic manner. You'll see that we have an operation that is less concentrated with savings bonds -- with the savings bonds revenues, you see that insurance premiums dropped by about 8% and I think this is the most relevant aspect in this pie chart of the last six months, that is despite the growth of the company, we have a better break down of revenues.

On slide four. Once again, we have an overview of what is going on with the company in terms of insurance. Again, we have insurance premiums with a growth of 12%, which is good growth. We have to pay attention to what's going on with the economy, which is not going through substantial growth, and even in nominal terms, GDP plus inflation, we are growing twice as much, loss ratio increased basically in the area of health, we are going to resume the topic later on.

Admin expenses, if you compare premium admin expenses ratio, we are improving that is we are improving our operating efficiency. So despite expenses have increase in terms of absolute numbers, because of the incorporation of the structure that we maintained of SulaCap and salary adjustments and et cetera. But still the premium admin expenses ratio has improved. Combined ratio is pressed by a loss ratio, which is going down compared to the previous quarter.

Financial income doubled, our portfolio is benefiting from a higher interest rate and especially increased provisions and private credits. Net income grows by 6% in the quarter, if you think of our six months, we had growth of more than 80%. We had produced 74 million in 2013 for the first six months and we produced 134 million in the first six months of 2014. So if you think of an ROAE, we are talking about a 15% growth.

Going on with our presentation, which is slide number five, which summarizes information of health and dental. And once again, both in the quarter and in the first six months, we had growth of more than 14.5%. Loss ratio goes up, compared to second quarter -- on second quarter and also compared to the previous quarter and six months. Of course there are going to be questions there and we can resume to this point. So anyway, this is very much associated to what we saw in terms of an increased frequency of utilization.

FINAL

And there are issues there involving the World Cup positive and negative effects, some companies that are listed and operated in the industry also showed similar numbers, suppliers had a drop in revenues because of less utilizations, other players in the Payer segment also reflected like ours, some positive effects there.

Gross margin reflects -- what happened to our loss ratio and as I had mentioned before, the portfolio grew by 1.3% if we compare the first six months of '14 and '13.

Next portfolio slide six with Automobile, a good growth of 13% in the first six months, almost 9% compared to 2013, loss ratio going down, the market until May had loss ratio of 61.3. We see that in premiums we had 8.8%; our behavior was above the market average. There were some problems with the market as a whole for some specific issues, but still we have a drop in gross margin, especially because our loss ratio went up and also commission fees. And this has to do with the reclassification that we had in our admin expenses, due to IFRS. Because of that we have to re-account for these admin expenses together with sales expansion and deferred with the remainder of acquisition costs. So with that, our rates are like 1 percentage point higher compares to what it would be like, if we didn't have to do that.

The insurance fleet grew by 7.4%, so we had an increased premium, an increased fleet, stable loss ratio. And perhaps even going again to the average expectation of this portfolio. This portfolio perhaps would tend to move towards an opposite direction, but it's because of an increase of interest rates, we would have a less shortfall pricing. This did happen in the beginning, but the market kind of adopted standing that's a bit more logical in this period that we are going through and that benefited us.

Our behavior in those area -- we have materials here some bank fees (inaudible) but this is not going to affect the loss ratio of life and personal, but anyway we are going to talk about that. Premiums dropped by 4%, loss ratio improved. And again, you can see that we are focused on massified pension.

I am on slide eight, also a drop in revenues of 6% and an improvement in loss ratio, especially when we look at the numbers of the first six months.

On pension, we have stable growth about 10% in the first six months of 2014 with 2013. The markets had the less contribution, but we have about 4.3 billion in results.

Going back to Savings Bonds. We had an increase of 80%, if we normalize the numbers about 26% in our consolidated numbers, six months the same, we grow by 27% if we compare to 800 million that would be the normalized number, 800 million of capital -- of savings bonds reserves an increase of 22% and an increase in our operating income.

I'm going to slide number 11 with our asset management operation. A growth in the volume of managed services of 3.5%, an allocation here that is more directed to more traditional products and that again reflects the behavior of the market as a whole and a very important contribution in terms of activities to our lower results of about R\$11 billion.

Bloomberg Transcript

FINAL

On slide 12, we show the Holdings admin expenses about 573 million for the first six months, 290 in this quarter, an increase of about 10%, but here, I'd like to remind you that we have the incorporation of SulaCap and also the natural increases in payroll and contracts readjustments that are also added. Compared to premiums, we are better showing that the company has been gaining in operating efficiency, despite the maintenance of important investments that have been made to keep and improve our IT structure and other management processes as a whole.

Combined operating ratios 103.2%, when we see the whole numbers of six months, we have 102.6 going to an operating ratio of 97.5%.

Financial income, we had profitability of assets other than pension about 108% of the CDI, basically we are positioned in post products also a bit of PCA, post fixed and when we think of our investment allocation, we have a bit less than a fourth [ph] of our portfolio with private securities and three-fourth government securities and this is what we have in our portfolio.

So, with that, I close my presentation. And now we are going to open for Q&A.

Questions And Answers

Operator

Thank you. We'll now start the Q&A session. (Operator Instructions) Our first question comes from Rafael Frade from Bradesco. Please you may go on.

Q - Rafael Frade {BIO 16621076 <GO>}

Hello, good morning, everyone. I have some questions. I think that I could -- has already opened the possibility of talking about loss ratios in health. If you could please go over the whole cycle of price readjustments, we are closing one, opening another, how you saw the behavior of the loss ratio? What do you think it's going to be like in the future? Gabriel already mentioned several initiatives, but anyway if you could give us an overview of what the previous cycle was like and what do you think it's going to happen for the future? How the market should behave?

And more specifically, if you could talk a bit of the effects of the World Cup specifically in the portfolio? Arthur mentioned, that there were positive and negative effects for some players and I didn't understand how that reflected on your loss ratio, that is how much you were impacted for a weaker June in terms of frequency of utilization and how much you were impacted negatively in the other months?

A - Unidentified Speaker

Good morning, Rafael, this is (inaudible) speaking. I'll try to answer the two questions in the order they were asked. As far readjustment cycles, what we have come across is that 2012, '13, '14, we had growth of readjustments as we have been discussing a long time. In 2012, very much in line, the same for 2013 and the cycle of 2014 that will start in July, has

FINAL

been showing very strong cash, we have been very effective in placing our readjustments and proof of that is that our retention rate has been very high.

So, although readjustment is much higher than the previous year and this is for the whole of the market, we have been able to retain our customers, both in smaller and larger group. Of course, there is the fluctuation of portfolios, there is a variation because -- perhaps at the whole of the population it would be better to work with managed services are not prepaid and there is a fluctuation there, sometimes our corporate plans become ASOs.

But what is the most important is that our second quarter is the weakest quarter in terms of readjustments, it is the last quarter of the cycle because it's going to restart the cycle now we really believe that -- so we are going to have a similar scenario as we had in previous years, which is positive.

As for the World Cup, I think that we have basically a season effect, the calendar effect. We have some business partners, some suppliers that had a drop in utilization of services because specifically of the World Cup and we feel the same. What happened is that, in the first months of the quarter, people used our services more and then we had a substantial reduction during the World Cup, but because of the methodology of capture of numbers, we cannot capture these numbers in this quarter. Again, because it's the (inaudible) of our closing of the quarter in June, we do not have a specific way of accounting for that.

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

Thank you, (inaudible) of people using services before hand, on your part, it is very clear in terms of level of utilization, April and May was much higher than it generally is. So you think that people use the services before hand, but it's very difficult for us to measure that this is because specifically of the World Cup and because people were using the services before the World Cup.

I understand your question. But what we have observed and trying to be as clear as possible in my answer is that, when I look at the quarter as a whole, I do not see a movement of growth, quite the opposite, I see a decrease. So which tells me that we have a calendar effect, people use the services more, but then it was offset by the month of June and in the next quarter, I think we are going to be able to improve that. So when you see the whole of our provisions, I believe that we are going to have a substantial drop in the frequency rates.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. I would just like to ask one more question. You talked about readjustments for SME companies with less than 30 lives, but until now at least to my knowledge, you haven't increased your sales prices, prices (inaudible) -- the prices before, other competitors are doing the same? Could you explain to me that a bit, are you like postponing readjustments for SMEs?

A - Unidentified Speaker

We have two traditional cycles to increase prices during the year. We have the next cycle that starts now in the next days, as we had the previous increase in the month of February. So it is a normal calendar. We start the first price readjustments in February and the second price readjustments in August. So probably for the next days you were going to see an increase in prices. And the brokers are already aware of that.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Thank you very much.

Operator

Our next question is from Mr. Gustavo Lobo from BTG Pactual. Mr. Gustavo, would you please.

Q - Gustavo Lobo {BIO 18719996 <GO>}

Good morning. I have a question about growth. It's very clear to ask that you have been reported -- you have reported expressive growth in healthcare and in auto insurance, you have a very favorable competitive environment, there is no price war. But when you look at volume, we can detect a few risks. Well, in automobile you have a market that's still very slow and they need to pick up in terms of sales, and in healthcare we have the labor markets to think about. And I think there is no outlook for more employment in the labor market. We don't think there will be unfavorable outlook. But how does this impact your volume?

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

Gabriel here, Gustavo. Well, I think you made a very on target observation, but we disagree with you partially, because we have been increasing volumes where we think it's best. Our Automobile fleet has seen an expansion in opportunities not only in new vehicles, we have been able to grow in other regions of the country and in other business brands. Don't forget that we operate throughout Brazil and I think that the strongest impact is on the center of the country, but we operate in different regions as well.

In healthcare, we saw a reduction in new contracts speed, but at least as far as I know this -- while we have been growing different segments that fall outside at the labor market. So there are new companies, so we have a very large market in SMEs to conquer. And we also have to see what the supplementary healthcare insurance (inaudible) have to say about this.

And our growth outlook is still solid and we believe that price is the slight -- this modest component, we have been growing in different regions, seizing opportunities of this market, but still basically untapped (inaudible) some lines that we have decided to work on -- while, put the focus on return rather than growth, we are maintaining our outlook.

A - Unidentified Speaker

FINAL

Just to add to the answer, we'll have -- besides volume, other sectors that drive growth, for example, you have another level of auto theft frequency that during the World Cup was lower. But considering that the whole cities [ph] invested in a lot of security, and at the same time, you have an injection, a monthly injection with new vehicles being sold in the market. And even though there is a drop in sales of new vehicles, growth is still very substantial 260,000 new vehicles even with a drop in curve.

So in relation to the fleet, I think it's very positive what we have achieved. And all of those factors also drives volume, you could have a small reduction in the number of the fleet, but if we also have premiums and volumes to think about.

And as regards volume, I think it's important to mention that in the same unit we have life and pension and we have grown 26% in massified insurance, this is very significant when you look to different markets. You don't detect a weakening of the whole business.

Of course, we can redistribute insurance and we have been geared to dealing our portfolio towards massified. In life and pensions. Of course there was a significant drop to account for the life and pensions, with this significant drop in personal accidents. Well, this doesn't remove the effect of the accounts that were removed last year. And we have seen less this process of sorting things out and we are now in a process of embarking an growth trajectory. And this will drive growth of individual portfolios, which are the most profitable ones. And in pensions, we see the same type of behavior. So I think that in healthcare.

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

And Gabriel, once again here. We also have expressed this growth in savings bonds. And we have seized this opportunity for integration with massified market. So this is one of the benefits of having a multi-line approach, you can have volume coming from different lines and offset for performance and others.

Q - Gustavo Lobo {BIO 18719996 <GO>}

If I may ask another question. What can you tell us about individual in healthcare plans? This is the portfolio that in recent years has been losing profitability steadily and has lost relevance for the company. The more the company grows, the less of those plans you have. But looking in the medium and long-term, could you please explain, well, on one side you have the massified portfolio, but on the other hand its loss ratio is growing. So in the medium-term would it be able or can you see a way of balancing things in terms of loss ratio? Or will this worsen until the portfolio really disappears and vanishes?

A - Unidentified Speaker

Well, Gustavo, here (inaudible). And I have a few comments. Well, it generates -- this portfolio generates gross margin, we had the quarter that was a bit difficult but we have been bringing around 90 in this portfolio and it continues to generate margin for us.

Traditionally, this is an older portfolio and almost relevant for us. So we don't have anything as expenses associated with this. So it's important to consider that this portfolio

as you said, has a vegetative type of maintenance. And therefore, it's something that is more of a cash call for us, it's not like a group portfolio that is targeted by competitors in the market. So we end up getting an efficient return. So, of course, we would like to resume in the traditional way of working with this portfolio and we understand that we had a very one-off effect during the quarter, but this will not affect the performance of this portfolio in the future.

And it's important to remember also that, we also start analyzing loss ratio based on this portfolio, when developing a new product because it's the most stable one. (inaudible) for the question.

Operator

We have one more question from Rafael Frade from Bradesco, please.

Q - Rafael Frade {BIO 16621076 <GO>}

I would just like to have a follow-up. You said that the individual portfolio this quarter did have some complications, anything specific this quarter?

A - Unidentified Speaker

Yes, there are some items. Something is that we still haven't had the authorization of the regulatory agency, traditionally it takes a bit longer, so we are waiting for that. Remember that this is a portfolio that is 80% regulated, we need the readjustment to offset loss ratio. And also we have the reclassification of claims in the individual portfolio and there are two points of the loss ratio that are allocated differently. So we are now classifying them a little differently and -- (inaudible) correctly to tell the truth but there was a bit of unbalance here.

But again, our individual portfolio is the focus of our health actions, we have the rollout of health -- a material to be used in Brazil. We have already started a health coaching process about two months ago. We have almost 1,600 people engaged in phone coaching. And again, the prospects are very good. These are individuals that remain with us in the long-term and we are working very well with them.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) There are no further questions. Since there are no further questions, we are going to turn the call over to the company for their final considerations.

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

Well, we do have some questions on the webcast and apparently they were answered along our talk. I don't think there was anything outstanding. And anyway, if you feel you

would like to clarify a bit more any of your questions, do send us an email. We'd like to close our conference call for today, our IR team and myself are available to answer any of your questions. Thanks for joining us and have a good day.

Operator

Sul America' earnings release conference call is now closed. We thank you very much for joining us, and have a good day.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.

FINAL

Bloomberg Transcript