Q1 2018 Earnings Call

Company Participants

- Eduardo Dal Ri, Unknown
- Gabriel Portella Fagundes Filho, CEO & Member of Board of Executive Officers
- MaurÃcio Lopes, Unknown
- Ricardo Bottas Dourado dos Santos Machado, Executive VP of Control & IR
- Unidentified Speaker, Unknown

Other Participants

- Gabriel da NÃ³brega, Research Analyst
- Olavo Arthuzo, Research Analyst
- Rubens S. Oliveira, Analyst

Presentation

Operator

Good morning. Welcome to the conference call of SulAmÃ©rica to announce the results of the First Quarter 2018. Today, here with us, we have Mr. Gabriel Portella, SulAmÃ©rica's, CEO and the VPs of the company's. This conference call is being transmitted live through webcast with an audio and a slide deck that can be accessed at the company's Investor Relations website at www.sulamerica.com.br/ir. (Operator Instructions)

SulAmÃ©rica's conference call is being recorded and the audio will be available right after its end at the company's Investor Relations website. Now we would like to turn the conference over to Mr. Gabriel Portella, CEO of SulAmÃ©rica. Please start the presentation. Please, Mr. Portella, you may start.

Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Good morning, everyone. As we have done in all of our conference calls, I am here to comment the results of the First Quarter of 2018 with all of SulAmÃ©rica's executive officers. We have started the year with 2 novelties: to place even greater importance to the themes of digital transformation analytics and innovation; and now, there is a new Director of Technology, Cristiano Barbieri, who is reporting directly to me. And now he is taking on the responsibilities of the company's executive committee.

I would also like to say that we have started the year in a very positive way, keeping the growth in revenue and number of members. And as it is our feature of having sustainable growth with focus on profitability. This has permitted us to present again our growth in the net income that was 10% superior to the First Quarter of last year, reaching BRL 141.4 million and a CAGR of 98.7% (sic) (98.6%), thereby confirming our efforts to more than offset the challenge that's the drop in Brazilian interest rates provides to the contribution of financial results. We should highlight an important fact in this quarter.

Our member base in Health & Dental plans has grown 9%, with the SME and Dental portfolios with a great pace of growth.

We could also observe an improvement in the performance of Affinity plans that recovered its growth as compared to last year.

The automobile segment continues to show expressive recovery with significant improvement in profitability and also improvement in the -- in growth in revenues. Our operations in life, pension, massified and savings bonds have kept their trajectory that is positive with growth and profitability.

Now we still have growth in our ASO plans with a consequent increase in margins.

We have kept our expenses under control with significant gain in admin expenses.

And in addition to operational improvements, we have managed to attain a great profitability in the insurance companies on assets.

The company is still showing signs of economic pickup. Important indicators for our business, such as the recovery of the sales of new cars and increase in the number of members in supplemental health. With the prospects (inaudible) more favorable scenario, we are confident that our business model will enable us to have success in making the most of the market opportunities. Now I'd like to turn the conference over to Mr. Ricardo Bottas, our CFO and IRO, who is going to comment the main highlights of the quarter. So then we may move on to our Q&A session.

Ricardo Bottas Dourado dos Santos Machado {BIO 18071813 <GO>}

Thank you, Gabriel. Good morning, everyone. Now going straight to Slide two of the presentation available in our webcast.

Here, we have the consolidated revenue that reached BRL 4.8 million with an increase of 12%. And then, going -- breaking down into the lines that you can see on the slide. Health & Dental, we have had a growth of 14.1%. And the combination of the growth in the member base -- or in membership, that as compared to the First Quarter of 2017, grew 7.8%; and the net increase in members of 233,000 members, thereby reaching at the end of First Quarter of 2018, 3.2 million members in the first period of 2018. So a growth in revenue is a combination of higher membership and adjustments that we implemented after the end of the First Quarter of 2017. In Auto segment, there was a growth of 5.9% in revenues. In spite of reduction of the fleet as compared to the First Quarter of 2017, our fleet, which is relatively stable as compared to the end of last year. And this portfolio goes on as you can see, (non) information that has been available to the market since last night with a recovery of margins.

Then moving on to Slide #4. So providing an overview of the company in the First Quarter of 2018. So skipping the revenue that we have just seen on the third line of this table, you can see the consolidated loss ratio that reached 76.4% in the quarter and a gain of 0.2%, driven by our significant recovery in the Auto segment with a recovery (or) loss ratio of 8.7percentage points in addition to better loss ratio in other lines of businesses.

The loss ratio of Health & Dental has had a 81.1% in the quarter. And in spite of 8.5percentage points superior to last year, it is within appropriate limits and within our expectations considering seasonality and considering that the first months of the year, that normally have higher frequencies of utilization. And it has appeared that it's just before price increases.

We (have also) 0.4percentage in the consolidated gross margin that reached 10.2% of operating revenues. And we are also better in admin expenses that closed the First Quarter of 2018 with 8% of our operational expenses. The margin and reduction in expenses are very important to offset the reduction of the financial results that dropped 35% in the First Quarter as compared to the First Quarter of 2017. It's important to highlight here that the profitability of our own assets of the insurance company with a performance of 111.2% of the CDI in the First Quarter in contrast with 98% of the CDI in the First Quarter of 2017.

The CAGR in the first year was 98.6%. And it was a significant improvement as compared to 100.9% in the First Quarter last year. And that is (inaudible) combined considering -- including financial is 95.25% as compared to the previous year that I mentioned before.

With all these results, we had a growth of 10% in the company's net income that reached BRL 141.4 million in the First Quarter. Our return on equity was 14.3% over the past 12 months. Now we can move on to the Q&A session. Thank you very much.

Questions And Answers

Operator

(Operator Instructions)

Our first question comes from Olavo Arthuzo of Santander.

Q - Olavo Arthuzo {BIO 19964942 <GO>}

Just one point that really caught my attention in your financials this quarter, which is kind -- with -- against my expectations. And this is related to a higher loss ratio in Health. We understand the dynamics of the First Quarters of the year, that it is the quarter just before your price adjustments. But what caused this? Considering the sequence of improvements that we had been seeing in the previous periods. If you could make a comment on that, I will appreciate it.

A - MaurÃcio Lopes

Olavo, this is MaurÃcio speaking. Well as to quarters as we usually see, it does not portray what is really happening in the portfolio. It's like a snapshot in contrast to the movie. So remember that the payments are distributed along the quarter. So different quarters have different numbers of days, have different seasonality, different incorporation of technology that takes place at specific periods such as now.

We have incorporated new lists of procedures on January 1. So looking just at the quarter, you will not find the answer of stability that you were looking for. And if you take the result of all carriers, you will see that there is seasonality. Each one has their own format, it's not linear. So it's impossible to calculate seasonality. Now going to the point that helps to answer your question. It's important for you to note, that we continue roaming out actions. Regardless of the performance of the quarter, that is very strong. So -- and this is related to health, loss ratio and providers. So if you can abstract volatility of the quarter and you think of the actions that we are rolling out, this may explain better the past and future trends of what's going on with this portfolio. Just as an example of what we're doing in this quarter and what we did last quarter. Actually, if you look, the actions related to customer expectations and consumer experience, we started with telemedicine rolling out for the business portfolio. We have digital reimbursement, both in app and also in the site, which increases retention of customers and reduces admin expenses. We have launched Sharecare platform. And then we have a specific product to manage the elderly in the city of SÃ£o Paulo. Then we are expecting it to adjacent cities to SÃ£o Paulo. We have expanded the physician at home to another 6 cities. And we are including an extra specialty in this special program. With regards to our commercial partners, brokers and providers, we are changing the way we provide visibility to our payments and how we receive medical bills through our providers.

We are migrating the authorization for procedures for a new platform, which in -- provides connectivity of customers in terms of approving procedures. We have centralized the entire after sale infrastructure for customers and brokers with SLA, reducing expenses and improving of customer experience. So there is a long list of items that if you look at the -- working on better control of claims, we are working on a better control of health management, which quarter-on-quarter, we have been proving that provides lots of advantages to the portfolio and increases retention and reduces turn -- improves retention and reduces churn.

So my suggestions. And I've been doing every quarter is, do not focus so much on the single quarter.

Look at the overall picture because seasonality will play in unexpected ways in any given quarter. But look at the trends (in) our new initiatives. Obviously, there are many things that I could say why it -- the loss ratio went up a little bit. But none of those factors will explain seasonality as it effectively is. They would all be very specific on one-off items that are -- will not explain the whole picture.

Q - Olavo Arthuzo {BIO 19964942 <GO>}

I would like to ask another question. It also regards the Health segment. There has been an increase in the number of members in all lines. But Health, in particular, has increased quarter-over-quarter. What is this due to? Is it because of acquisition at the portfolio? Or is that linked to the macro economic situation?

A - Unidentified Speaker

That's a great question. If you think about this macro scenario, the products of higher average ticket are preferred today. So some -- although some of the members are moving to lower-ticket options. But that's not the case in SulAmÃ©rica, not only because of the brand exposure but also because of the commercial approaches and the regional approaches for products we have used in the past years. And the uptake of these new technologies and initiatives like telemedicine, previous reimbursement initiatives. And the app has been downloaded over 1 million times. And there are a lot of features: also the network management programs, health management programs, have shown the prospects and already existing members that it is worth maintaining their business with the company. And the churn rate has been very low despite the crisis we have had in the past four years. And we've also had new members that have become part of our portfolio.

There is one additional item that I think I should mention. For the first time in four years, we have had a positive change in the corporate membership portfolio. In crisis years, we have seen an increase quarter-over-quarter, we have just not increased in one single quarter. And we have had an increase in the new contracts and have reduced the loss of already existing contracts. In addition to that effect, there is something else, which is a positive move. So more hires than terminations of employees and their families as part of our portfolio.

Since we have had a significant increase in the number of new contracts in the past years, we expect that this (pro) cyclical movement is -- will be enhanced in our portfolio when compared to other portfolios because we have a higher volume than we used to have. So this growth volume in number of members benefiting us for those reasons and also because of these new moves.

Operator

Next question is from Gabriel da NÃ³brega from UBS.

Q - Gabriel da NÃ³brega

Could you give us more details on this competitive market? How do you see this scenario in the main segment? In this competitive scenario, do you think that you can increase your prices to your customers? There is a second question I'll ask later.

A - MaurÃcio Lopes

Thank you, Gabriel, for your questions. This is MaurÃcio. We are comfortable with the strategy we have chosen for the past quarters. And we are following that. If we think about a trend we are observing and what we've been doing, the first adjustment that was announced for the SME portfolio is 3% lower than last year, almost 3.5% lower. What does that mean to us in practice? This means that we are looking forward. And we expect lower variation in the average cost of hospitals. So lower variation of prices to customers. If there is a lower variation rate, our level of churn rate is going to be lower than previous years. So I expect that different health operators will join us in this trend, which naturally will make the market more stable when people will have more predictability in terms of the permanence of the members in their portfolio. We are responding to these reductions from 19-something to 16-something. And we will now announce, in the next month, the adjustments for the other portfolios. And we expect this medical inflation to be lower. And this competitive market, we'll be more stable. And we are rolling out the strategy as planned in the past.

I would like to (send) Dal Ri and other members to talk about other segments. He's from (RI) .

A - Eduardo Dal Ri

In Auto, we are following the improvement in economy. The higher output for us is that there is a higher number of cars in the market. There is a 2-digit increase in licensing of cars.

Although 2017 had already a pickup. But it was about 7%. But this year, we are impressed with a much higher number of new licenses in the market -- car licenses. When you have more new cars in the market, the whole chain of used cars is also positively affected.

The perspectives we have for this market that leverages the Auto market as a whole is good because now these interest rates have lowered too. So we believe that Brazilian consumers were not spending so much in times of crisis. But this is changing now. The insurance market on the other hand, is much better, much more competitive, more rational. And I believe that the Selic rate drop, the floating interest rate dropped -- has dropped. And this contributed to new adjustments and better balance between the increase and acceptance of the market. So it's a positive trend that the trend that started in the last quarter of last year is still a good trend. And we don't expect this to change in the medium-term.

A - Unidentified Speaker

Excuse me, Gabriel, I would like to talk about life, pension and savings bonds. Well in pension, we are seeing a quite significant movement in the scenario with dropping or falling interest rates with more sophisticated products. We used to have them float into pension funds with strategies more focused on fixed income. And now it's changed quite significantly. More than what goes into PGBLs and VGBLs is going to multimarket, which is good. It's good for customers because they have products that will help them to offset the falling interest rates. And it's good for those offering the products because, with greater expertise, we can offer or charge slightly for those products. So we have a quite optimistic vision for pension here in Brazil. With regards to life, the industry in this year has been growing very much in line with what it grew last year because of 10%. And in the visual, life, it grew -- is growing more and more with more and more share. And we have -

- there are many initiatives for us to use this good time when the main cause is because of the impact we had on real income. So earlier this year, we launched the digital signature for people to contract life and pension plans. We have included new coverages in our life products. Still, in pension, we have opened our architecture. Our Internet banking has been renewed. So we have started many different initiatives for us to be ready for the growth not just in life but also in pension. In terms of investment, we also have a quite significant flow. And I think it's very much in line with what I said about pension. It's a major flow for multi-market funds and now -- a share that -- which we didn't see last year. We have launched different products. We have a product portfolio that is very complementary, very competitive, practically all strategies at the high. Then in the press release, you can see that we had 24% of the share, we had a multi-market (inaudible) 42%, which is quite significant. So so long as we have that perspective vision of Selic rates at the low rate, we will have a quite significant flow to these more sophisticated products. And if we have a competitive portfolio, as we already have, I think that we can see an improvement that will be significant in our margins in the area of investments.

Q - Gabriel da NÃ³brega

I have another question. Could you give us an update on -- you said that you might sell some assets as you reported to the market. What's lying behind that? Could you disclose some more information, some more detail about this operation?

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

Well this is Gabriel speaking. And there are 2 pieces of news: one is speculation, the other is fact. We are not going to comment speculations. The fact is that we sought advisors to analyze different alternatives. And the rationale is that our portfolios that are still small. And the company. And we want to see alternatives in terms of the channels and scale and (once to) seek alternatives for the development of these companies. This is what's lying behind our process, just as we seek opportunities.

In other fronts. And that we are not going to go into too much detail. But we are always paying attention at opportunities with the aim of improving our market positioning. So this is a fact. And this is how you should understand that the rationale lying behind that is precisely what we are seeing.

Operator

(Operator Instructions) Our next question comes from Rubens Oliveira from Banco Plural.

Q - Rubens S. Oliveira {BIO 20500659 <GO>}

I have a question related to costs. Costs were a highlight this quarter especially because your G&A ratio dropped significantly year-on-year and your admin dropped 7%. So this was driven by a drop in third-party services and other admin costs. Could you give us some more color on what accounted for the significant reduction in costs?

A - Ricardo Bottas Dourado dos Santos Machado {BIO 18071813 <GO>}

Rubens, this is Bottas speaking. As to this reduction, we would like -- we like to address this with the same transparency as when we talk about seasonality in Health. It's important to understand. And using MaurÃcio's expression, to look at the whole movie rather than just a snapshot. So looking at the period, this drop in expenses, it's a combination of what happened in the First Quarter in the item of audit. For example, First Quarter last year, we had more (fines) than we had this year. And this is a significant item because when you look and you break down each one of the lines and you look all the items, there are things that we are constantly pursuing. And Gabriel always says that. Whenever people ask us for the challenge of the drop in financial performance, there is a whole set of actions involving many different areas of the company and admin and general SG&A is just another line. So if you look in third line of services with the significant reductions. And that are improvements that come from previous years, such as changing the company's headquarters to a new headquarters with lower maintenance costs, reducing our look -- operation costs. So we don't have a silver bullet. So the company works in an integral approach in terms of reducing expenses. It's important to deliver to good results. But it's also important to understand the right seasonality that are differences in comparison bases. But the message that needs to be very clear is that the company pays great attention to the control of admin expenses.

Operator

(Operator Instructions) If there are no questions, I turn the conference over to Mr. Gabriel Portella for his closing remarks.

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

Thank you very much for your questions. Thank you for the opportunity of giving answers and clarifying our performance. And I would like to thank the entire executive committee but also the more than 5,000 colleagues of SulAmÃ©rica and also the more than 30,000 independent brokers, who give us special attention. They are the support basis of our growth. So thank you all for your hard work and dedication. And have a good afternoon.

Operator

The conference call of SulAmÃ©rica has now ended. Thank you very much. And have a good day.