Q1 2019 Earnings Call

Company Participants

- Gabriel Portella Fagundes Filho, Chief Executive Officer
- Raquel Giglio, Raquel Giglio - Vice President of Health & Dental
- Ricardo Bottas Dourado dos Santos Machado, Executive Vice President of Control and Investor Relations
- Unidentified Speaker

Other Participants

- Eduardo Nishio, Analyst
- Felipe Salomao, Analyst
- Unidentified Participant

Presentation

Operator

Good morning. Welcome to teleconference of SulAmerica to discuss the earnings referring to the first quarter 2019. We have here with us Mr. Gabriel Portella, CEO of SulAmerica, and the VPs of the company.

We would like to inform you that we are broadcasting via webcast with audio and slides that may be accessed through the Investor Relations website of the company from www.sulamerica.com.br/ir.

All participants will be in the listen-mode only during the presentation, and as we are going to start the Q&A, further instructions will be provided. Our web conference is being recorded, and the audio will be available right after the closure in the IR website of the company.

Let me now hand it over to Gabriel Portella, CEO of SulAmerica, who will start the presentation. Please move on, sir.

Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Good morning, everyone.

As we're doing all of our calls, I'm here to talk about the results of the first quarter '19 with the whole executive committee of the company. I would like to welcome Raquel Giglio, who is VP of the company responsible for health and dental. Raquel has over 18 years' experience in health and insurance, and she's been with SulAmerica since 2011, and she used to be Technical & Customer Relation Director since 2015.

I would like here to thank Marc Antonio, VP of Operations of the company. And during this transition period, he has led all the transition of health and dental together with other directors, Raquel, Ricardo, Theresa, Erika [ph]. So we had the transition. It was very smooth process and seamless process as we had initially planned. The executive committee has people who have been promoted as part of our succession plan. In addition, 20% of the executive committee is owned by women.

Now, speaking about the results of the first quarter, we started '19 with very positive results, increasing revenues and number of insured lives, maintaining underwriting with profitability and discipline in capital allocation and control of costs and expenses. We have had a significant increase in our net income, which is the highest since we had our IPO in 2007. Our pursue for operational efficiency has really provided good results, presented a combined ratio, which is the best for a first quarter since 2008.

The first highlights are increase in our collective health and dental revenues, with very good performance of good sales and a high rate of retention of contracts; we have maintained loss ratio under control, reducing it in the quarter and in the year-to-date, reinforcing our loss ratio control strategy; for automobile, we still have got good performance, increasing our fleet, controlling loss ratio and maintaining stable revenues over the first quarter '18.

SulAmerica Investment has maintained its position of leadership among independent management companies, and we have maintained an excellent return on equity of our own shareholders' equity, which are under our own responsibility. Life, pension massified and saving bonds operations have maintained its pace of growth with all segments presenting significant increase in revenues.

At the same time, together with our growth, we've still invested in technology to prepare SulAmerica for a world that's getting more and more digital. In the quarter, we had new launches. We had the Apple's telemetry code auto.vc [ph] available not only to customers but also to noncustomers. We have expanded physician at home (inaudible), offering it to a number of cities, and we also have medical consultation scheduling in addition to providing teleguidance for physicians during or through (inaudible), making it very comfortable and (inaudible). Very positive quarter, very well-balanced period and very consistent results.

Let me now hand it over to Ricardo Bottas, VP of Control and Investors Relation, who's going to make comments about the best in our financial and operation indicators.

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

Thank you, Gabriel. Thank you very much.

Starting on slide two of the presentation. You can see consolidated revenues of the company. We still have shown growth, reaching BRL5.3 billion in the first quarter or 10% growth. Our main highlight, dental and health, 12.3% driven by the increase in number of beneficiaries, which is part of our commercial strategy and regional expansion, which have been the right choice. Automobile, we had a slight decrease of 1%, but aligned with what the market has experienced, showing the new contracts since the beginning of the year with less risk.

Life and personal accidents had an increase of 16.1%, sustained by travel and credit life insurance. And pension was the last highlight of the page with growth of about 8% driven primarily by VGBL.

Now slide three. We can see the revenues in all the different segments, with an increase in health and dental, which amount to 79% of our revenues of the company.

Slide four. We can see the main indicators and the main highlights. We've already talked about the revenues -- we started on line three with consolidated loss ratio of the company, which closed the quarter in 75.2% and a reduction of 1.2 percentage point, showing the consistent improvement of loss ratio in health and dental and also in auto. Our operating gross margin presented an increase of 1.5 percentage point and growth of BRL127 million, which is BRL650 million in the first quarter, combining revenues and reduction of total loss ratio, leading to gains of operating efficiency.

SG&A reached 8.3% of the total revenues, with a slight increase of 0.3 percentage point over first [ph] '18. And I'm going to go over that, showing the variations of our expenses.

We've also showed good result of our profit, reaching BRL171 million with a return of about 122.3% of CDI. The combined ratio of the company had 1 percentage point and also a combined -- expanded combined ratio of 1.3 percentage point, with a net profit of BRL223.5 million in the quarter, 58% higher than in the previous year. It shows operating margins with the combined ratio, improved profit, but also the positive impact of the social charges that there used to be the first three years, and it's no longer part of that.

The ROAE was 16% year-to-date, 1.7 percentage point compared to the 12 months that we had completed in the first quarter of '19, showing the commitment that we keep on emphasizing: growing the company sustainably.

Now going into a business line perspective, slide five. Operating revenues grew 12.2% for health and dental. Our collective portfolios were very successful, especially small to mid-size health, 19.7% increase, and dental 19.5%. Loss ratio of health and dental reached 79.4% or 1.7 percentage point better than the first quarter '18. But it's important to emphasize that we have to analyze long periods of time when analyzing company performance and loss ratio because sometimes the quarters have to do with seasonality.

Concerning the number of beneficiaries, there was a 10% increase in number of members over first quarter '18 or 10.9% considering only collective healthcare plans. More for dental, 24.5%. And small and midsized companies for health, 8% increase. In addition to recovering our affinity plans -- we had a 35.5% significant growth in the first quarter '19. So this is the number of members: 2.2 million in health and 1.3 million lives in dental.

Following our good performance and good control of loss ratio, our gross margin reached BRL443 million, with significant growth of 35.5% over the same period last year.

Next slide, now auto. We can see BRL697 million in three years, 1% reduction over the first quarter '18, aligned with the decrease of premiums observed in the whole market in a very competitive market that had shown the improvement of some safety conditions in some regions and macroeconomic positive situations.

Our fleet has maintained a good pace of growth, almost 9% over the first quarter '18, reaching 1.6 million vehicles. Our fleet had 0.4% increase over the year. We've reduced the loss ratio in 2.5 percentage points, reaching 59.5% as opposed to 62% same period '18, maintaining our good results provided by the underwriting model that we have that involved new improved processes and also the fewer cases of (inaudible). As a consequence, we reached BRL149 million in gross margin in the quarter, 27% compared to the previous year.

Now property and casual [ph] in slide seven. And we can see here operating revenues of BRL49 million with 1% growth. However, we had a higher loss ratio because of greater frequency and severity in the quarter impacted here because of rainfall in the first months of the year, impacting negatively the gross margin of this portfolio.

On slide eight, we go to life and personal accidents with an increase of expenses of BRL119 million, up BRL16.1 million compared to the first quarter, reaching BRL119 million, especially because travel insurance that had good growth in previous quarter and this one as well, and well -- so with a new relevant contract. As for the frequency of claims in the period, as it happens with smaller portfolio and therefore are more volatile, we had a worsening of 10.2 percentage point in the loss ratio of this project [ph].

In pensions, slide nine. To the right, we see pension reserves that had record (inaudible) for the company of BRL7.3 billion, an increase of almost 14% compared to March last year, especially because of the profitability of the balance of pension funds. Operating expenses grew approximately 8% in the quarter with BRL163 million, especially because the VGBL private debt had a growth of 25%.

Capitalization, slide 10. Operating revenues totaled BRL15 million, relevant growth of approximate [ph] 21% year-on-year, especially concentrated on the rental guarantee product. Margin improved by 67%. Capitalization reserves reached 7% with BRL696 million.

Asset management, slide 11. Important to record here that SulAmerica closed the quarter with BRL41 billion assets managed, growth of 6% compared to the first quarter '18, with an increase of third-party assets of plus 5%; owned assets, 2%; and private pension assets of the total managed assets, about 14% plus.

Operating revenues increased significantly in the first quarter, growing 22% year-on-year. The best performance in the segment was basically because of higher revenues with administration fees that are associated to them, especially multimarket funds and allocation of third-party funds, which are most of our portfolio, about 52%, vis-a-vis 41% of the mix that we had last year. This has to do with the pursuit of the market for better opportunity to allocate their assets in a scenario of low interest rate that are being maintained in Brazil.

On slide 12. As I mentioned, I'm going to give you a bit more color on admin expenses. This year, we reach 8.3%, an increase of 0.3 percentage point. In absolute numbers, our assessment accounted for an increase of 14% in terms of absolute expenses of the first quarter '18.

Main effect for the increase. I'm going to talk about three topics. Higher expenses with taxes, admin expenses, especially PIS and Cofins because of the advanced return that we mentioned of interest on our own capital of subsidiaries controlled compared to the holding. Last year, we entered that in the second quarter, not in the first. So it's a seasonal event; so when we have a longer base of comparison, this is going to be minimized, the effect, about BRL11 million.

More expenses with advertising and marketing. The campaign -- our new campaign is already being at the advertised in the media since April, and therefore, production costs were sized [ph] in the first quarter. But it's already hitting the national meeting [ph] -- media. And this year differently from last year, we had the cost of producing this campaign, different from last year, then it was just promoting the campaign.

Finally, more expenses with personnel because we have more employees. We increased by about 100 people quarter-on-quarter, and basically with projects in digital transformation, quality and health. The effect of the higher number of employees that has mobilized through strategic front of the company, showed a difference of about BRL11 million in the comparison. But this movement is within our plans for the period. So there is no reason for us not to be confident in our capacity to improve our financial expenses -- our admin expenses compared to finance. For you to have an idea, in the first -- last quarter '18, we had a decrease of 16%. So we continue to monitor our expenses tightly, but also thinking of the strategic investments to be made in projects; third-party personnel, technology services, that are sometimes entered as admin expenses.

As for our investment portfolio in slide 13, you can see our strategy and allocation of investments considering the total portfolio and also our own assets, excluding pension operations. Profitability on portfolio reached 122.3% of the CDI. Profitability basically because of prefixed [ph] indexed assets and also variable income assets that had a very good performance in the period, with tax allocations with respecting [ph] the investment policy that was approved by the company's Board of Directors.

Contribution of financial results in the quarter, BRL171 million, growth of 18% year-on-year. In a scenario of stable inflation at low levels, basically, we have a greater portfolio, reaching BRL17 billion in the quarter, a growth of about 9% of our portfolio, and a better result contributed to a better financial result.

With this, I'm going to complete this part, and we are going to open for your questions. Thank you very much.

Questions And Answers

Operator

Now we'll start the Q&A session. (Operator Instructions) Our first question comes from (inaudible) from BTG.

Q - Unidentified Participant

Good morning, everyone. Thanks for the opportunity of your questions. I would like to ask -- start with two questions. First about health. Obviously, you have been mentioning quite often that if you just look at a quarter, you are led to wrong conclusions, so pay attention to one single number in a one single quarter, you may make a mistake. What we saw in this quarter differently from the fourth quarter '18 was an improvement in your loss ratio for health. So what I would like to understand, what is indeed cyclic or seasonal of this quarter and what is structural? So if you could give a bit more color along this line to explain a bit about frequency. Out of this improvement, what comes from a better negotiation with your providers and what is seasonal? I think that would help us a lot to try and understand this number better. That's the first question. Second question, auto. We indeed see a reduction of prices, but interestingly enough, in your case, we see better loss ratios. I would like to understand where you think we are in the cycle. That is, is there still room for auto loss ratios to improve? And do you think the market should really keep lower prices for the remaining of the year. I think that's the question. Thank you very much.

A - Raquel Giglio {BIO 21963986 <GO>}

Hi, Tiago [ph], this is Raquel. Thanks for your question. Well, first, whether it's seasonal or if it is more structural. I think that undoubtedly, there is a structure in it. In the comparison quarter-on-quarter, there is no difference that is really seasonal. So it's very much in line with what happened in the fourth quarter. But structurally, our initiatives are maturing. Health management, negotiating with suppliers, direct purchases, all this initiatives that you were aware of and that we have been designing in recent years. With that, we are strengthening our coordinated care strategy. It was started in 2018, and it has gaining momentum more and more. We have more than 230,000 consultation in the coordinated care program, thousands of members that are benefiting from that. And the physician at home, the physician on screen, all initiatives that strengthen our digital strategy, focusing on members, focusing on the patient. The patient is the center of care. So -- and now we are enjoying these structuring initiatives that we implemented in recent years.

A - Unidentified Speaker

This is Thiago [ph] speaking, about auto. In the market, we do see a slight reduction of prices. But it's certainly not motivated by price -- quite the opposite. It's motivated because of better rates, especially what Bottas mentioned in terms of the fast -- especially in larger capitals. So if you think of this numbers further on, a bit of a forecast. We have been able to pass on this benefit that the public safety is providing us to consumers. I don't think we are going to have price wars for the future. This year is a very atypical year for the car insurance market. We've seen a lower availability of production and this is shown in the numbers of the quarter. The market decreased by 1%, so there is no room for growth. You see the large players are having very homogeneous growth rates, maybe 1% [ph] up or down. And we, differently from what happened in the past, where competition was just based on price, we do not have a very high select [ph] rate. The interest rate is the lowest possible, and that does not bear a loss of results in margins. So for these two reasons, I do not believe we are going to see further on any kind of price wars or prices going down for any other reason other than improve to loss ratios.

Q - Unidentified Participant

Okay. Thank you. Just a follow-up. In terms of what you mentioned in the health segment. So we could say that if we were to quantify the improvement in this first quarter, you would say 100% structural when we compare quarter-on-quarter, I mean year-on-year? So further on, we should expect a continuity of this trend that shows in the first quarter? I think this is my main question.

A - Raquel Giglio {BIO 21963986 <GO>}

Hi Tiago, this is Raquel once again. Yes. It is true to a series of structural actions. But remember, we are talking about the quarter. We always have to look into longer periods for us to -- let alone seasonality. And also it's important to highlight that the sales, commercial teams are keeping up our sales, customer retention at very high levels and all that contributes for the results that we are showing today.

Q - Unidentified Participant

Okay. Thank you very much.

Operator

The next question comes from Felipe Salomao from Citibank [ph].

Q - Felipe Salomao {BIO 19237023 <GO>}

Hi, good morning Gabrielle, Bottas, Raquel, all members. Thank you for taking my question. I have a question about health, specifically about the competitive market in health. The loss ratio of the main competitor of SulAmerica, which is not verticalized, improved significantly in the first quarter. And the player has maintained a very important cause about improving management, price bundles, et cetera. Do you think whether -- do you know whether this player or other players have adopted more aggressive pricing strategies? Because the loss ratio is improving. It goes up, profitability goes up, so they can be somewhat more bold to operate within different pricing strategies. Do you observe that or not? So this is my first question.

A - Raquel Giglio {BIO 21963986 <GO>}

Hi Felipe, thank you for the question. Well, a competitive environment for health and dental. Dental has never been a simple task. It's always very fierce, and we can see really, the competition among the key players. I haven't seen though any increased aggressiveness than what we have observed in recent times. And I don't think this would change our strategy of pricing and client retention. We strongly believe that with well-structured underwriting, we can really retain customers here for longer periods of time and maintain and achieve our expected margins. I haven't seen any changes in behavior of the major players in the market.

Q - Felipe Salomao {BIO 19237023 <GO>}

Great. Thank you very much for your answer.

Operator

The next question from Mohammad Matt [ph], SGP [ph].

Q - Unidentified Participant

Hi guys. Thank you very much for taking my question. I have two questions. The first one just on the premiums in the auto sector. Obviously, the volume or fleet -- on fleet covered was very good. But as expected, their premiums were down given the improvement in the law and order situation. I'm just wondering though, should we then expect for the rest of the year basically pricing to offset volume for you guys? And my second question is on G&A. We've seen for last several years a downward trend in G&A cost as a percentage of revenue. Should we continue to expect that? Or is it going to stabilize as a percentage of revenue or even (inaudible) start increasing? Because clearly in Q1, it grew faster than revenue. Thank you.

A - Unidentified Speaker

Hi Mohammad [ph], good to talk to you again. Your question concerns auto and for the rest of the year and how it's going to be our behavior in the market. And what I have to say is it's kind of an atypical market in terms of top line premium, not only to SulAmerica, but for the whole market and for the premiums [ph] in the market. In my previous answers, I talked about average reduction of premium prices because of the risk scenario. It's difficult really to predict what's going to happen for the rest of the year. But our expectation is to improve a little bit. Going into positive numbers where we can have growth rate market overall close to what we had last year. It's an year with pressure on top line, but we really believe that considering the improvement, and more cars being sold in Brazil, probably we are going to have a positive result from now to the end of the year.

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

Hi Mohammed [ph], this is Ricardo. Thank you for the question. So you asked us about administrative. The reason we have been presenting improvement over the revenues and whether our performance in the first quarter would really present an instability of the index as if we have really reached a plateau of stability or whether there would be further room for improvement as it has been the case in previous years. In my introductions in our call, I've pointed out some specific aspects that really justified the increase, especially to show you that nothing is limiting or preventing us from consistently improving the index. But as you know quite well, we have no guidance concerning the index for upcoming quarters or years. But the issues that have generated this effect in the period are not something that prevent us from improving our administrative expenses over the revenues.

Q - Unidentified Participant

Okay. Excellent. Thank you very much, guys, and good results. Thank you.

Operator

(Operator Instructions) Our next question comes from Eduardo Nishio from Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you all. Thanks for your presentation. I have two questions. One about health. I would like to know from Raquel. Could you please give us a little bit more color in terms of care coordination? And your private project in Sao Paulo, what is it like? And then I'll ask my second question.

A - Raquel Giglio {BIO 21963986 <GO>}

Hi Nishio, this is Raquel. Thanks for your question. Well, our strategy in care coordination can no longer be called pilot. We have more than 130,000 members, more than 200,000 consultations, more than 200,000 physicians in the -- more than 1,200 physicians in the program. So the program is going to grow more and more. So we have seven tranche [ph] within our strategic plans, and we are working now in care coordination to try to massify it more, to have the digital strategy more at the reach of our members in all portfolios. Last month, we released the physicians on screen for children up to 12 years of age so that parents can have guidance from their pediatrist [ph] on screen at home, without having to leave their homes. So this is the kind of strategy that has come out of the program. In fact, care coordination started in Sao Paulo, as you mentioned, and it's true. But today, it is present with more than 19 different teams and cities. We had 61 medical specialties that are taking part in the beginning of the project last year. You're right, it was in Sao Paulo with two specialties. But it really expanded in recent months. And thanks for your question.

Q - Eduardo Nishio {BIO 15333200 <GO>}

What is the schedule of rollouts for care coordination to other states outside of Sao Paulo, outside the state of Sao Paulo? Or even to Sao Paulo inland [ph]? Do you have a scheduled for that?

A - Unidentified Speaker

Hi. Yes, we do. But we will not disclose the dates. But as a whole, we have had relevant penetration in regions where SulAmerica has a higher concentration of life. So it is going to be slower or faster, depending on the region. But the metric is well spread already.

Q - Eduardo Nishio {BIO 15333200 <GO>}

And do you have positive results?

A - Unidentified Speaker

Yes. Very high MPS [ph], always above 80% [ph]. So extremely happy members and the end clients as well. I mean, I'm talking about the company, the provider, because retention levels are also very high. You're talking in corporate more than 95% and SMBs above 93%. And if you allow me, we're talking about care coordinations. We have been talking about that. And we say this is an investment that has an MPS which is short-term but the investment is long term. We are investing in sustainability.

Q - Eduardo Nishio {BIO 15333200 <GO>}

And my last question. That's the second question, really, is much more Raquel's new position -- congratulations as the new VP. Is there anything new that we should expect from SulAmerica in the health segment? SulAmerica has always had a position of innovation in the industry, but should we expect anything new for the coming months? Is there anything changing? Any strategy to change?

A - Raquel Giglio {BIO 21963986 <GO>}

Well, thank you, Nishio. As you know, I have been with the company for eight years now. So my greatest commitment is to keep the strategy that we built together along these years. And news [ph] is -- novelty, something that runs in our veins. So you should always expect the new from our company. And we are working in projects to improve the company's market share, to go into new cities and to structure new products, perhaps more affordable, more regional, different compensation models with risk sharing. So these are the kinds of things that you should expect for further on.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you, again.

A - Raquel Giglio {BIO 21963986 <GO>}

Thank you.

Operator

If there are no further questions, let me hand it over to Gabriel Portella for his closing remarks.

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

I'd like to present my closing remarks by saying that we are maintaining our journey. We are very confident that challenges and opportunities for 2019 will be all fully faced by us as we are very well prepared, as you've seen from our results. And all the initiatives that we have, not only with digital transformation, but all the other initiatives of the company position us quite well to face the challenges in 2019, whatever they may be. I'd also like to thank our more than 5,000 staff members, over 30,000 insurance brokers, business partners, service providers, shareholders and stakeholders as a whole for the support and confidence. Thank you very much, and have a nice day.

Operator

The conference call of SulAmerica has closed now. Thank you very much. Have a nice day.