Y 2019 Earnings Call

Company Participants

- Gabriel Portella Fagundes Filho, Chief Executive Officer & Member of Board of Executive Officers
- Raquel Giglio, VP of Health and Odonto
- Ricardo Bottas Dourado dos Santos, Executive Vice President of Control and Investor Relations, Chief Financial Officer
- Unidentified Speaker

Other Participants

- Eduardo Nishio
- Felipe Salomao
- Mauricio Osorio
- Samuel Alves

Presentation

Operator

Good morning. Welcome to the Conference Call of SulAmerica to announce the Results of the Fourth Quarter of 2019. Today here with us we have Mr.Gabriel Portella, CEO of SulAmerica and the company's Vice Presidents. This conference call is being transmitted live through a webcast with audio and slide that can be accessed at the company's Investor Relations website at the address, www.sulamerica.com.br/ri. All participants will be connected in listen-only mode during the company's presentation. And then we are going to start the question-and-answer session when additional instructions will be provided. (Operator Instructions) SulAmerica's conference call is being recorded, and the audio will be available right after its end at the company's Investor Relations website.

Now I would like to turn the conference over to Mr.Gabriel Portella, CEO of SulAmerica, who is going to start the presentation. Mr.Portella, please, you may start.

Gabriel Portella Fagundes Filho {BIO 18012687 <GO>}

Good morning, everyone, and as in all on our conference call. I'm here gathered with SulAmerica as to speak few comments on the performance of the fourth quarter in year of 2019. This was a landmark in SulAmerican history with record of operational performance keeping the positive trend of growth with profitability. We have reached a net income of BRL1.2 billion, 30% up as compared to the earlier quarter and a return on equity of 17.6%, a consistence result for our shareholders.

We should highlight recent strategic movement to mark a new age in the company. We have announced the agreements with Allianz to divest from automobile and multiple insurance. And now -- we completed an divestment from savings bond and also the investment to buy also acquired 25% stage with proforma -- due to the investment the transform. So we are focusing more on people with health and dental pension and life and asset management. For 2019 I would like to highlight (inaudible) EBITDA margin of 4 million members for health and dental (inaudible) we can also be energetic (inaudible) additional product. There are 2.3 million members in health, 1.7 million of members in dental. Record EBITDA (inaudible) above the market and in a sustainable rate with profitability.

Once again, we are reporting positive application of our loss ratio with a gain as compared to 2018 and bear the results (inaudible) was indicated (inaudible). (inaudible) coordinated care. Our coordinated care (inaudible) has more than (inaudible). The automobile in fact in challenging environment growth we have (inaudible) 11% up from the quarter in the year before. (inaudible) environment for investment. So in terms of (inaudible) social governance (inaudible) social interest (inaudible) our growth (inaudible) raised our CAGR to full (inaudible)

I can stay this estimation to mainly innovation that to have launching revenue to technology or invention (inaudible) before going to mention just a few, the doctor at home in (inaudible) versus doctor on the three the psychologist three, net co-pay stimulated and the broker although that is factor in digital additions to the whole coordinated care platform. So many innovation help now that to be recognize as the most innovative insurance company in Brazil with a record of five awards won in Sul America [ph] annual innovation the 2020 (inaudible)

Unidentified Speaker

Good morning, everyone, good morning (Technical Difficulty) these segments help and better has presented a growth of 11% in the year with a combined growth of members.

And I'm going to give you more detail when we talk in more details about health and also the effect of the annual adjustment that are applied to policies that are very important for the economic balance of these countries that have had a quite positive dynamics over the past few years, even with a gradual reduction in the level of adjustment in the (Technical Difficulty)

In Automobile we have had a drop of 2.8% in the year and the quarter slightly sharper in drop because of the more challenging environment in the market, but it's important to stress that we have preserved our fleet with a slight growth in the -- at about (inaudible) stable at about 1.7 million cars. So as we had said before in property and casualty, we had travel and insurance that have grown 27% and 96% respectively as compared to previous periods.

We have also had a growth in tension with a 25% a growth in revenues along the year driven by the growth of our reserves that have evolved by 12.4%. As a highlight as part of tension, there has been a growth in VGBL product that have grown 44.2% in the year and the VGBL reserves that have grown 26.4%. And lastly, we have had an evolution of our asset management operations growing 17.3% in 2019, an excellent result for SulAmerica investments when we raise many funds and have many more assets under management and we have the growth in 2019.

And especially, in Q4 as Gabriel has mentioned and I would like to stress is the volume of assets under management have reached BRL46 billion at the end of the period, an increase that was very significant and I highlight an increase of resources or funds from third-parties that have grown 13%.

On the next slide, we can see health and dental which represent as a result of the increase of our revenue 78% share and cars has experienced a decrease compared to previous year, representing 15% of our total revenue in '19, as a result of the small increase of revenue that we observed in 2019.

Now, giving you further details about transaction of our divestment of the car business, we have been approved by the antitrust authority and also the initial authorization by SUSEP. And right now, we are working on the spin-off of the corporate, which are going to be subject or rather object of the operation we are working on adjusting all the activities of Auto and also Massified. And we will be ready to tackle the business up to the end of the operation in the first-half of the year. We have just completed in the end of January. We've been effecting February, the transition for the divestment of our saving bonds operation which will no longer be part of the consolidated balance sheet of the company. It will be there in the first quarter because of January, but then it won't be there as of the second quarter 2020.

Now on Slide 4, we can see the main highlights and indicators. And I will skip revenue as I've already talked about it. The third line of the table, we can see loss ratio. As a consolidated rate it was stable in the fourth quarter and year-to-date, but I'll talk further about health and dental, which was somewhat of the stability, where we have observed some improvement.

Gross margin improved 1.2 percentage point in the quarter and 0.2 percentage point in the year, which amounts to BRL277 million in absolute terms or 11% growth over -- '19 over '18. The growth in margin aligned with control is cost, and expenses has led to an operating gross margin of BRL2.8 billion or 11% and net profit of BRL1.2 billion or 31% over the previous year.

In the quarter, the profit totaled BRL453 million, growth of 15%. It's important to highlight that in this quarter as in previous quarter, we had the effect of interest on equity which brings down effective rate, it was 21% effectively. But in the previous year, we also had an interest on equity report and the rate was BRL16.7 million in 2020, below what we have observed in the period. When the line of income tax before net profit, there was an effect which was had also been accounted for in the previous year of a reversion of liability of BRL600 million.

It was associated to failure in some tax lawsuits. And if it happens there is some operations that have transactions that have to be done based on the tax liability. And if there is a law of this is, then we have to account for it, it was BRL60 million. There was another that had an unfavorable decision and amounted to BRL60 million. So these are our facts that when we compare head-to-head, there is no impact. But these are not things that can be anticipated, we don't know whether they are going to be repeated in terms of volume or date of occurrence.

Now going to the administrative expenses, there is another positive highlight in the period which is the index over operations was 8.3% of total revenue, or 0.4 percentage point, it showed our operational leverage of controlling expenses. And in administrative expenses, we've also included the investment made in technology, innovation and project, about which we have been describing to the market continuously. It's also important to mention in G&A, and we have to understand the figure as a whole positive and negative effects, which may not be recurring.

In the quarter, we included expenses associated with the transaction of divestment of car and P&C in the spin-off of our operations. It amounted to BRL24 million in the quarter and BRL29 million in the year, just for your information, we are going to keep on reporting these facts, because they have to be combined with the effects of the final transaction whose main impact will be accounted for in 2020.

The expenses we've had found increased somewhat more than its G&A as a whole, and this is also a combination of the fact that we have salary workers agreement increase and also an increase in our headcount almost 200 people more in our staff.

And it was observed in all our strategic projects involving innovation, digital transformation, coordinated care, and all of the wave of innovation we have experienced in the company, bringing new teams and people really fully engaged in the project.

In terms of SG&A line once again, there is a point that I would like to highlight. Its within tax, it's a reversal of a non-operational PIS tax. It is a result of what I had mentioned before and amounted to EUR 37 million gross before tax, which have been accounted within SG&A.

It's important to show that even though we are highlighting issues which should not be extrapolated, positive and negative effects seem to be balanced out, but theoretically these ones would not be part of these operations they are not likely to be replicated in future periods.

It's also important to talk about margin, and it had an important effect we have highlighted that it is a reversal of a provision in life BRL64 million in technical reserve. The net effect was BRL39 million, and it was a requirement to meet through that requirement, which needed a combination of coverage of pension and life products, that have different characteristics. As such, we had to adjust the provisions to reach the appropriate level.

It's also important to highlight, when we talk about net profit and to complete this description so that Investors and Analysts can understand our results, despite the sale of saving bonds had just been completed by January 20. In 2019 throughout the year, we didn't document equity matters of Caixa Capitalizcao in 2019. Just for comparison reasons, they were BRL32 million. They were not documented in 2019 or accounted for in 2019 because the database is December 2018.

All business that (inaudible)described for the vast analysis and comparability of earnings, as a whole may not be recurring, but in general terms they offset each other, there is no net effect on our final net profit. Let me emphasize the financial results It was practically stable, but there was some effect from the reduction of the interest rate focused more on the last quarter of '19, showing that the result in the fourth quarter was below 7.2%.

The main cause here is the effect of the decrease in the interest rates SELIC. But as a result of the competitive market and the auto business, we decided to increase the number of payment installments for the operations of cars, which can be paid in up to 10 installments with no interest rate, which also has an impact in the accounting result of 2019 over 2018. And despite all the effects, we also had a positive impact growth of our portfolio of investments. The portfolio of the insurance company except for pension, it reached BRL10.2 billion or 5% increase over 2018 and our performance reached 117% of CDI as opposed to 111% in 2018.

CAGR was 96.6%, with 0.4% percentage point reduction, the best indicator in this historical series for the past five years. And an expanded financial index which also includes the net results, showing a small but significant improvement, considering the reduction of the interest rate. Therefore, it is a very good indicator of performance and our capacity to really compensate the results and the financial results of that. So our return on average net income was 17.6% in 2019, within our strategy to try to balance growth and profitability.

Now moving to Slide number 5 to talk about health and dental. And affinity portfolios have had positive growth in revenues have grown in dental 31% in the year, 45% in the quarter. So here there's an inorganic effect of the acquisition of Prodent that has been fully booked in the last quarter. SMB has grown 17% in revenues in 2019 and 13% in Q4, and corporate and affinity have grown 10% in 2019 and 9% in Q4. The consistent growth both in the quarter and in the year indicating the consistency of our portfolio in spite of we are still betting, but waiting on a recovery of the economy and also the recovery of unemployment rates.

Talking about members in health and dental, we have exceeded the mark of 4 million members in 2019. Another highlight with the acquisition of Pordent that has driven our book of members to grow by 44%. In affinity portfolio, we've had a growth of 5% in number of members and net lives have grown by 46,000 in SMB, 3% growth, with a net addition of 17,000 lives, additional lives. So collective plans have grown by 84,000 live net also considering AOS plans. So with revenue increase and loss ratio that I'm going to mention in the next slide, so the gross margin in health and dental closed the year up by 16%, reaching BRL2 billion.

So now moving to Slide 6 the health and dental loss ratio. So on the top of the slide, you can see the evolution of quarterly loss ratio where you can note that we have the care loss ratio, under control in Q4 '19 with a consistent positive evolution, but we also highlight the loss ratio in quarters may suffer the impact of a seasonal effects or one-off effect, and we always emphasize that it's much more important to look at longer periods of time to understand the behavior or the trend of this item, so here I'm going to focus on the lower slide, where you can see annual history of loss ratio, and you can see a consistent trend. And I would like to emphasize -- or you to look more carefully on our pursuits to balance and to find a balance between growth and sustainability, and this is one of the highlights of all the initiatives that we have in terms of coordinated care, our partnership with medical providers in our accredited network.

Now moving to Slide number 7, automobile. Automobile. Automobile close the year with a revenue of BRL3.3 billion. And the revenue has been lower by almost 3% as compared to 2018. The reduction is explained especially by the reduction of revenue in Q4, which was a drop of almost 10%. And this reduction has a first component that is already the reflect of the drop in average premiums all the policies on the market as a whole, and also for SulAmerica because of better robbery and theft indicators especially, but also because of scenario -- in a competitive scenario (Technical Difficulties) that is stronger especially in Q4.

Loss ratio has remained at a good level, especially considering the lower revenue and lower average premiums, closing the period at 61%, which is worse than the year before, but still within our tolerance rates considering the competitive environment and average premiums. And insurance fleet, once again grew almost 1%, totaling 1.7 million vehicles at the end of December in a scenario that is also challenging for the automobile insurance market that also depends very much on the recovery of the economy and sales of new cars.

Now, I close my part and I move to the questions-and-answers session.

Questions And Answers

Operator

(Question And Answer)

Thank you. We're now going to start our questions-and-answer session. (Operator Instructions). Our first question is from Samuel Alves from BTG Pactual. Please.

Q - Samuel Alves {BIO 18720076 <GO>}

Good morning, Gabriel and Bottas. I have two quick questions. And the first one, could you give us an update about SulAmerica Directo? you had mentioned that you were considering new geographies, new partners for Sao Paulo platform. Can you tell us a little bit more about the rollout for segments in Sao Paolo, how is this evolving? Number one.

And second thing, is just an update of the competition scenario in health. We have seen an important -- of your competitors selling or giving up many lives during 2019. Do you feel any type of reaction and changing in the competition scenario, because of this competitor on the industry as a whole in early 2020?

A - Raquel Giglio {BIO 21963986 <GO>}

Right. Samuel, this is Raquel Giglio. So as to Direct product, day before yesterday, so the sales were made available for Massified channels. So the product in Sao Paulo, the Direct sample, especially with Dr.Consulto with German Hospital and Children's Hospital, Sabara, and Maternity, Santa Maria, is also part of the project. And then, we have a partnership with Hospital Santa Cruz, DASA labs and in the over Rede [ph]. So there will be other Directo products in the future, but this step of heavy massified product both for affinity and SMB is an important step. So this has started just a day before yesterday.

As to the competition environment, this is seasonal. So sometimes competitiveness is slightly fiercer, our competitors are more aggressive, and at times, it's not so fierce. So we have seen some aggressiveness, but undoubtedly, we're still trying to price our products in the right way with long-term partnerships. We want to have longer contracts where we know that the entry price is the right one. So, dumping has never and will never be part of our strategy.

Q - Samuel Alves {BIO 18720076 <GO>}

Thank you Raquel. This is very clear.

Operator

Our next question comes from Felipe Salomao from Citibank.

Q - Felipe Salomao {BIO 19237023 <GO>}

Good morning, Gabriel, Bottas and other members of the Executive Committee. Thank you for allowing me to ask a question. Number one, it's about the regulation capital. According to your opinion, considering the sale of your automobile business, once it's complete what is the surplus? What is the adequate surplus of regulatory capital for the company in a sustainable way as of 2021? If we look today, the excess regulatory capital means BRL1.7 billion to BRL1.8 billion. So what is the level? What will be the regulatory capital, once you complete the sale of your automobile business? Thank you.

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

Hi, Felipe, this is Bottas speaking. The essence of your question and as you know, we don't determine that kind of guidance or indication about the future, we don't give any guidance concern our willingness, or our planning of capital use, but I'll try to give you some color in terms of the capital to the end of the period.

You mentioned BRL1.7 billion, and it's important to understand and what -- and the metrics, right? That can be used for your estimation purposes. In health, this is simple to estimate according to ANS rules in place, and this discussion is uphold, but we believe it's going to be resumed shortly, which is something that has been discussed with the market, which is to go into convergence of solvency market going on risk-based capital.

So getting it closer between just having the right reserve capital for HMOs and insurance company. But till then, our model observance required by a net for the health operation, our main operation of the insurance company. I'm not considering dental or post payment, but that's a simple calculation. The average of the last three years of loss ratio, one-third of that the annual average of the loss ratio. So we closed the year with the solvency area of 107%, of the requirement, which is an index that we have maintained and this is information that can be obtained from data submitted to A&F.

Concerning car, we are going through a spin-off, and this is something where you can have your estimate, considering capital access. Part of that is, also going to be in the operations of the spin-off and the requirements that we have in the end of 2019, for the operation of car, amount to BRL700 million. So that's very close to the number we disclosed when we completed the transaction, it's going to be allocated to Allianz. When we close 2019, considering the size of the fleet, and even the fact that I've pointed out in terms of premium, it closed at BRL700 million as the required capital.

And then, there are a number of other minor effects of company, in -- we see that won't be repeated in 2019, but I cannot talk about forecast. But for example, resources were already allocated for investments in Orama, our investment company and there, we can see BRL100 million capital excess, which were used in the first quarter to make the investment, we had already planned. There is just seasonality. And another example without want -- to be any longer. For regulatory reasons, we should have a capital access to cover claims to be settled. So I have to have assets and collaterals, which end up being translated in excess capital. So I think that -- with that it can help you get your estimates.

Q - Felipe Salomao {BIO 19237023 <GO>}

Great, Bottas. Thank you very much, and thank you for sharing the information.

Operator

We carry on now, Eduardo Nishio with Banco Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Good morning, everyone. Thank you very much for the opportunity. I have two questions. First, concerning coordinated care. You've published further data about this segment. Very strong growth, getting to 10% of your bases. Can you please elaborate on margins of this process and also the rollout, are you just adding new customers, are you using your own life? And can you give us some idea about profitability and the geographic distribution of the product in states?

Just tell us about the loss ratio of this product. With coordinated care, can you have a better control of your loss ratio? Your NPS is high, really showing greater growth in the long run. So this is the first question.

Second one, concern product data to Direct, your entry-level product. I would like to know more about the margins. Is it a product based on volume that you get through margins -- throughout time? Or is it a product in which you already have a good margin right from the beginning compared to your high value or higher premium products?

A - Raquel Giglio {BIO 21963986 <GO>}

Hi, this is Raquel. Thank you for your question. I'll start with the second question first. Concerning product Direto, it is not a product at an entry-level, low-income product. It's still focused on some high income groups, it's -- income class is A and B, B plus. This is based on restructuring and coordinated care, and it has started from our new assumptions, our new belief. In the second-half of last year, it was sold for companies that have over 30 lives, and right now, we are start selling it Massified.

In terms of coordinated care, it's no longer a project for a while, it's something that permeates our whole strategy. It's focused on the beneficiary with the right flow. These are not only for people who have one specific profile of utilization. We have a population certification to know who will be generating claims and not.

So some tests we hadn't been mapped or visits, this is also part of the strategy of coordinated care. Concerning that accessibility, and also coordinated and a whole we have a number of innovations. Medical education over the phone, using video. People can be in Brazil abroad, traveling, so that's all readily available.

We have the doctor at home in over 50 cities. We have primary care units, operating through different partners. We have coordinated care physicians over 1700 with different specialties and other modalities such as psychologist, PT and dietitians. We have been working with different providers, we have the psychology on the screen some new tool. And this is all part of our coordinated care strategy, everything based on innovation and technology, of course, always with excellence in customer care.

We also have the delivery of chemotherapy and in monobiological data -- medications I mean. So we can monitor deliveries, we can monitor the new prescriptions, and the NPS of this action is 100 points. So the satisfaction of our beneficiary here is really complete.

I'm also going to ask Cristiano Barbieri, who is our VP of Innovation and Strategy to talk about what we've been doing with the app. And before I close, coordinated here is the core of our strategy. As a consequence, the results of coordinated care is already part of our results. It's not set apart or separated.

A - Unidentified Speaker

Hi. Good morning, everyone. This is Cristiano speaking. The app that we've been investing on an yearly basis has become one of the main channels of communication, and the main entry port of care -- to coordinated care. We have over 1 million users with an app and over 600,000 clients who use our app monthly, with 61% growth over last year.

So we had 61% increase in number of transactions through our app. All our innovations are taken to our customers these and transactions or medical, they are always through the app.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you very much. One last question. In coordinated care, in product Direct, let me tell you -- let me hear about margins. Coordinated care throughout time, will lead you to better margins and better NPS. With the product Direct, if you could compare the products? Direto against your portfolio, does it have similar margins to your traditional product?

A - Unidentified Speaker

First, to launch a project, we define the margins and we have target margins. So I think that the main challenge that we have, not just in SulAmrica, but the industry as a whole. When we ask these many questions in terms of care coordination, how to expand the market even further. So if we have 23% of the population that catered or included, how can we go to 25%, 35%? So we wanted to expand the market and our business.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you.

Operator

So our next question comes from Mauricio from Credit Suisse.

Q - Mauricio Osorio {BIO 16235425 <GO>}

Good morning. Thank you for the opportunity of asking a question. Number one, congratulations for keeping the loss ratio under control for many years, extremely impressive. I have two questions. The first one is because you have the merit of having lowered your loss ratio. Do you have an intention of translating that in to price in many more markets.

It's question number one, and question number two is related to the question of operational leverage. Do you exclude the automobile business you already estimated the loss of synergy in general and administrative expenses?

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

Hi Mauricio, this is Gabrielle. I'm going to start from your second question. So there is a lot of movement as you've been seeing for both companies, but the whole concept is to preserve the operational efficiency of SulAmerica, and what still remains of the operation.

So we do not expect any of this synergy, because we are engaging the company to have the right size, as it needs to be in terms of revenue. Of course, at first, we have some additional costs, because of this separation, in spin-off, but they are one-off expenses, they have been taking place ever since we signed the agreement.

But the concept of the operation is to preserve operational efficiency based on the discipline that we have been practicing, (Technical Difficulties) first to have the discipline. So we do not accept anything except what we mentioned. There are some investments that are necessary for us to make the operation happen and to make the most of the value of the transaction. Now, Raquel is going to answer your question.

A - Raquel Giglio {BIO 21963986 <GO>}

Hello Mauricio, this is Raquel. So certainly -- so the main strategy that we have with coordinated care in a direct line, and other product that we are going to launch, is market penetration. And we have been consistently demonstrating an improvement in our loss ratio at levels that seem to be quite appropriate. So, if we can transfer to consumers in terms of adjustment and pricing to have more and more lives, we are going to do that.

All of that, without losing the focus that we have always had on customer retention, so our customer retention is very high in SulAmerica. In distribution of Directo and all other shelf projects, we also have a commercial area that increasingly more specialized, and the brokers that support us.

Q - Mauricio Osorio {BIO 16235425 <GO>}

Thank you, and congratulations once again really, it's really impressive.

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

Thank you.

Operator

(Operator Instructions). If there are no further questions. I give the conference back to Mr.Portella for his closing remarks.

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

Thank you very much to everyone for attending our conference call. And I would like to thank once again the effort and dedication of the great team that I have with me that is responsible for all the initiatives and results that we here have been obtaining, and all the -- more than 5,000 workers, and our 39,000 insurance brokers that are part of our history and our partner -- part of our business, and our business partners too, and our service providers and shareholders too that support us and other stakeholders of SulAmerica.

Thank you very much, to everyone. Have a nice day, and have a good Carnival.

Operator

The conference call of SulAmerica has now ended. Thank you very much, and have a good day.