

4Q18 Conference Call Transcript – Q&A

Operator

Ladies and gentlemen, we will now begin our Q&A session. Our first question comes from Olavo Arthuzo – Santander.

Olavo Arthuzo (Santander)

Hi, good morning everyone. Thank you, Gabriel. Thank you, Ricardo. I would like to talk a little bit more about co-participation, more about the impacts from the service providers' point of view. We recognize SulAmérica's strategy to tackle high loss ratio in different ways, and co-participation has been playing its role for a few quarters, the beneficiaries end up being more diligent when they use the plan. So, in this topic, what I would like to hear from you is what do service providers as a whole feel as a reflex of this increase in co-participation, because I imagine the numbers of emergency room visits and even hospitalizations has reduced. I would like to hear from you if that makes sense and if this should increase. We know that many providers have volume targets, so could we also say that we will gradually see an economic shift to the operators, kind of equalizing the profitability among players of the industry? Thank you.

Gabriel Portella (CEO)

Olavo, Gabriel speaking. I will let Marco Antonio Antunes speak, he is our Vice President of Operations, currently also responsible for the Health and Dental areas. So, he is going to answer your question, if necessary we can complement, although his answers do not need complementation.

Marco Antônio Antunes (Vice President of Operations and Technology)

Thank you, Gabriel. Thank you, Olavo, for the question. Co-participation is a mechanism that SulAmérica's operators have been using for a long time. The main goal of co-participation is to engage beneficiaries in the commitment of how to use the network, so of course it somehow affects, direct or indirectly, the provider, but as co-participation is reversible, paid by the company or by the employee. What we would manage is how these products with co-participation can bring a more adequate use of the network. Today, co-participation represents almost 70 to 80% of our products, most of the new products that we sell have co-participation. We don't see and can't establish, because the provider doesn't know if the client is in a plan with co-participation or not, and it can't and shouldn't influence the beneficiary use of network or the volume in the emergency room, ambulatory or in the consultation office.

Olavo Arthuzo (Santander)

OK, thank you.

Operator

Our next question comes from Felipe Salomão – Citibank.

Felipe Salomão (Citibank)

Good morning Portella, Bottas, Guilherme. Thank you for the opportunity. My question is related to the health loss ratio. As you mentioned, there was a deterioration close to 180 BPS comparing 4Q18 versus 4Q17. Could you please give us more details about the reason behind deterioration? Was there an increase in frequency or were there others reasons? Specifically,

we know that the majority of contracts have the prices readjusted during the third quarter so it worries me when the loss ratio of the fourth quarter increases because it could be an indication that the price readjustments made in the third quarter may not have been sufficient and it could anticipate some quarters with the loss ratio deteriorating. Is that what happened? Could you give us more details that explain this deterioration? Thank You.

Gabriel Portella (CEO)

Hi Felipe, this is Gabriel. I will begin and then Antunes will complement the answer. First of all, the fourth quarter showed a decrease and the main reason is seasonality. The second point which I think is important to comment is that we have been trying to reduce the volatility rather than seasonality in the quarters, as Bottas mentioned. In the past we had variations of 16% between quarters and last year the variation was 8%. The effort of the Company, with all its tools, is to ensure the smoothing of this process and provide not only for you, but mainly for us, a reduction in volatility. The key point is that, for the fifth year in a row, our annual loss ratio, which is always our main target, is decreasing, so the trend for the loss ratio is confirmed. 2018 confirmed that we have a decreasing trend, a trend of positive results. Volume increases, delays in receiving invoices, all of this is part of the day to day process, but there was not an increase in frequency. If you look at the first quarter of 2018, you will also see a 200 BPS increase in the loss ratio and, at the time, the comment was the same - what happened? – and we could see a correction in the following quarters. It is a long term process and there is a trend of reduction.

Marco Antônio Antunes (Vice President of Operations)

Felipe, just to reinforce what Bottas has mentioned in his speech, in 2012 we had a difference of 1,500 BPS when comparing the quarter with the highest loss ratio to the lowest, and in 2018 we ended the year with this difference in 800 BPS. In other words, the Company is working to reduce the difference from the highest peak of loss ratio to a lower one. In relation to frequency, just completing what Gabriel has mentioned, what have been keeping frequency accurately under control in the last quarters and we did not notice, at any moment, in admissions, previous authorizations of procedures, exams, any type of volume increase, and what makes me very comfortable from a technical point of view, is to know that the effect of frequency, utilization or seasonality may have influenced the fourth quarter, and what we measure and believe in is, as Gabriel said, this difference between the quarters, a volume that decreases in a month, from a quarter to another, may have interfered somehow, but we don't believe that it had great influence in the fourth quarter.

Felipe Salomão (Citibank)

Perfect. Thank you very much for your answers.

Operator

Our next question comes from Nicholas Baines – Bradesco BBI.

Nicholas Baines (Bradesco BBI)

Hi, good morning everyone. Thank you for the opportunity. I would like to know if you could explore a little bit more the G&A evolution in this quarter, detailing, if possible, the amount related to regulatory fines in the quarter and if there were any expenses related to Mauricio's exit or if they will be booked in 2019. Finally, what is the G&A growth expectation for 2019? Are you providing any number? Thank you.

Ricardo Bottas (Vice President of Control and Investor Relations)

Hi Nicholas, I understood your first question, I am not so sure if I understood your second question but I am going to start by the first one and then I will let Gabriel and Antunes speak. In relation to G&A, in the fourth quarter, what we notice when comparing with the previous year was the booking of provision for regulatory fines, which did not happen last year, it doesn't mean that in 2017 it did not happen, actually it happened in different moments, in 2017 there was a possibility, publicly announced, of a REFIS for ANS' fines. It is a matter of when these events happen during the year, but at the same time, there is a correlation between this volume and the increase of the portfolio, etc. It is a continuous quest to minimize these effects, but I would say that it is much more a matter of comparison basis than an unexpected increase. I think this is the main point in relation to this aspect. In relation to third-party services, in the fourth quarter we verified a higher volume of third-party services associated to consultancies and technology services that are strongly associated to the acceleration in some fronts given our digitalization strategy, innovation, coordinated care front, some additional developments that we are doing in the auto and massified portfolios, which also demand support, additional enhancements in pricing tools. This year there was a higher concentration in the third and fourth quarters, notably in the fourth quarter we verified a higher concentration due to the execution of these services related to projects impacting the period. So there is a strong correlation, again, this is our challenge, it is constant, we are not going to stop investing because of this, but we have the challenge to reduce and control costs in other fronts so that they can sort of finance the constant development that we do in our processes. This is one aspect of third-party services. Talking about the personnel, it is related to the Company's better results in relation to our plan, also in the technical and operational aspects, given our compensation models to all employees and executives, there is a need for higher provisions given the greater results and greater expectations of participation of variable compensation according to the Company's performance, so, there was a better performance, if there was not, we would not incur in these expenses, it isn't a relevant point, it is associated to the Company's better performance. In relation to other tax expenses, also, if you look at the figure for the quarter there is a relevant impact, but it wasn't relevant in the year as a whole, that are aspects related to tax expenses, notably PIS and COFINS related to interest on capital from subsidiaries to the holding, we did those deliberations from subsidiaries to the holding during the fiscal year, eventually there is a difference between the amount of PIS and COFINS that is allocated in the fourth quarter and what was booked in other quarters, again, in the full year, this effect is neutralized. In general terms these were the main effects in terms of administrative expenses. Could you please ask your question about Maurício again? Just to make it clear and, after that, Gabriel and Antunes will answer your question.

Nicholas Baines (Bradesco BBI)

It is great, thank you, Bottas. The first question was also related to G&A, I asked if you could detail the amount of regulatory fines and if there was anything in G&A related to the fact that Maurício left the Company or if the impact will be in 2019. Thank you.

Ricardo Bottas (Vice President of Control and Investor Relations)

Are you saying that the G&A is related to the fact that he left the Company? Is that the question? The answer is no.

Gabriel Portella (CEO)

It is associated to the provision that Bottas also mentioned, due to the good results and the provision for compensation of executives and employees.

Ricardo Bottas (Vice President of Control and Investor Relations)

Speaking of regulatory fines, this variation was lower than R\$10 million in comparison terms, but it's neutralized in the full year.

Nicholas Baines (Bradesco BBI)

Excellent, thank you.

Operator

Our next question comes from Eduardo Nishio – Brasil Plural.

Eduardo Nishio (Brasil Plural)

Good morning everyone and thank you for the opportunity. I also have two questions. The first one is related to what you are trying to do in the loss ratio, smoothing, removing the volatility between quarters. I know you have mentioned that before, but just to make it clearer: what are you actually doing to try to smooth this numbers? How can we look at the quarters from now on to try to predict better the seasonality among the quarters? In theory, the first quarter is the weakest and the fourth is the strongest, but is it really that? With this smoothing, will this continue in the future? This is the first question. The second one is related to costs, that was already approached but that are three items which I think are important for us to better understand the topic. First: in others administrative expenses we saw a significant increase year-over-year, the impairment and other receivables also increased significantly and, finally, the last one I think you have already mentioned, Bottas, are the regulatory fines, the amount is still not clear. Looking at the third quarter numbers I realized that was an increase of R\$50 million, I would like to confirm if it was, more or less, what was booked as regulatory fines in the fourth quarter. Thank you.

Marco Antônio Antunes (Vice President of Operations)

Hi Nishio, thank you for the question. I am Antunes. On your doubt related to the loss ratio difference in the year, is important to make it clear that the work we do ... we look at the annual loss ratio, of course there is certain seasonality throughout the year like Gabriel has mentioned, which is natural for the portfolio, some periods of the month are influenced by epidemics or by flus, but this isn't what we are talking about. What we are talking here is this difference in loss ratio as a result of the volume levels or something related to the referred network, we have been investing a lot in technology in the last few years, so that we are able to capture occurrences in the referred network as fast as possible, so we can understand this volume dynamic, gradually reducing it. Of course, there is a limit due to the seasonality itself and without seeing an increase in the frequency of these procedures. This is a work that began many years ago, in 2012, 2011, and it is going to take a bit more of time, but the idea is to reduce the difference each year.

Eduardo Nishio (Brasil Plural)

I just want to understand this topic a little bit more: is this the capture, through technology, of costs associated to volume in the month, in the quarter?

Marco Antônio Antunes (Vice President of Operations)

Yes, Nishio, there are two things. We could not change seasonality because it is directly related to what the population is feeling, so, these loss ratio differences when we look at epidemiology or diseases, it is inherent to any health portfolio. What we do is to try to reduce this seasonality is to work on the volume received throughout the year and this is what we do every quarter.

Eduardo Nishio (Brasil Plural)

Thank you.

Ricardo Bottas (Vice President of Control and Investor Relations)

Nishio, this is Bottas speaking. In relation to G&A, I would just like to understand what additional details do you want, but, related to fines, we saw a variation in the year, in line with our expectation, this volume was lower in the previous year, in 2017 this volume was lower because as I commented, there was the creation of REFIS which had an extemporaneous effect, but the regular volume given the size of the Company's revenues remains stable in relation to historical figures. Is it OK? Regarding a higher volume of expenses, I think that we already mentioned it few times, in absolute terms, it's not only related to indexation associated to inflation indicators but also to a change in behavior in the past few years. We do not disclose how much of our investment plan is booked in this line because our commitment is to continue to dilute G&A, but respecting the investments being done. There is a change in behavior, we can feel that administrative expenses are more pressured in a shorter term than in the past, when the investments in technology were clearly fixed assets and amortized over the year. So, in the past, these expenses and investments took some time to flow through the expenses account. Nowadays you don't buy equipment, you sign cloud contracts, assistance contracts, services, specialized consultancies that normally are booked as expenses immediately, and you don't even do the immediate recognition of this as an investment to later do the amortization, maybe in technology, in up to 5 years. I think this change pressured us, mainly in the last year, in the last two years, this behavior change is natural, I think this also happens to others companies, given the nature of the change in the dynamic of investments. Previously the investments had a much longer cycle, demanded much more planning and nowadays they are much more dynamic, small deliveries, scalability, and so forth. I think that this dynamic and our way to make fast deliveries and accelerate also represent a challenge for us. That's why I say that even though expenses grew in absolute terms, increase, we are satisfied with our capacity to continue diluting administrative expenses. I think this is the main aspect, Nishio, I don't know if I answered your question but, again, there is also an administrative expenses seasonality when you look at each quarter, so you need to eliminate these effects. I think the variation in the year is also important to understand the behavior of administrative expenses, OK?

Eduardo Nishio (Brasil Plural)

OK, thank you.

Operator

Our next question comes from Guilherme Grespan – JP Morgan.

Guilherme Grespan (JP Morgan)

Good morning, Gabriel, Ricardo, Guilherme. Thank you for the opportunity. I would like to talk about the health segment. When we look at the loss ratio, over the last few years, we can see a good job in terms of loss ratio management, which has decreased sequentially, 50 BPS to 100 BPS every year. Looking ahead, from what we have been discussing with you for a while, we understand that coordinated care is one of your biggest initiatives to help in this sequential reduction of the loss ratio. I also think that part of the pressure in expenses comes from this investment cycle. So, if you could give us an update about the initiatives, if you can see any window from now until the next 6 months, or in a year, that we could start seeing new initiatives being implemented and performed. Also speaking of loss ratio, if you could talk about the negotiations related to closed packages of procedure, which percentage of the medical cost is related to closed packages? Thank you.

Gabriel Portella (CEO)

Guilherme, it is Gabriel speaking, OK? I don't see a window, I see a huge balcony and we are always looking forward and with assertiveness. I think this whole investment cycle that we have done since 2011 in the health segment and also in the other areas of the Company, have shown maturity over the years. In 2018, the health and auto cases were great examples of investments that we have done in the past were always looking at the future. The coordinate care program was an initiative that we began in 2018, but nowadays it is no longer a pilot, it already has 130 thousand people in our platform and it have more than 1.100 doctors in our network, this is a change of concept, in which we intend to look at and follow the beneficiaries in a holistic way, tracking all attention points. We admit to you that our objective in this project phase it isn't to look at its impact in the loss ratio, but rather to implement a model on an even larger scale. We strongly believe that it will be a decisive factor for responsible utilization and better doctor follow-up, for a better experience for the beneficiary, we only see advantages in it. There is still no impact in our loss ratio, that is much more due to all investments and actions that were made over the time, now we are showing an improvement in the loss ratio and further investments for the future, that is why we believe that it is a balcony rather than a window, we have something very big, given our position for the future. It still may seem theoretical, but the answer to this is exactly our increase, month by month, day by day. We monitor the expansion of our beneficiaries in the coordinated care platform and the satisfaction rates and all others initiatives implemented and we will continue to do so. The market dynamics did not change, we changed our position. In relation to your second question, Antunes is here by my side, today all bundled payments represents almost 20% of our total cost and I think it is increasing from both sides. It is coming not only from our side, but also from the providers who understand the necessity to move toward operators and we have been capturing this. The idea is to have more predictability, more cost control, just as well as all the other initiatives. So, despite a challenging scenario in the health segment, all the investments that we have made in the last few years, the investment we have started last year and what we are going to reap for the future make us very optimistic about what we still can do.

Guilherme Grespan (JP Morgan)

Perfect, thank you.

"This document is a transcription with text adaptations made in order to make reading and understanding of the speeches in it easier. The text depends on the quality of the audio and on the speakers' discursive clarity, therefore it counts with adaptations that increase the legibility and coherence without affecting the speakers' discursive ideals.

Declarations about events or future results are based on certain premises and analyses that are completed by SulAmérica ("Company"), representing exclusively the expectations of management relative to the future of the business and the continued access to resources to finance the business plan of the Company. However, the real results of the Company and its controlled entities depend, substantially, on changes in market conditions, government regulation, competitive pressures, sector and Brazilian economic performance, among other factors, may differ significantly or implicitly from those declarations.

This transcript and its contents are the property of the Company and, therefore, should not be disseminated or reproduced partially or entirely without the consent of SulAmérica."