



S P E Y S I D E

C O R P O R A T E R E L A T I O N S

Brazilian Healthcare: Opportunities for foreign investors

March 2016



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Executive summary

Brazil has the fifth largest population on Earth with 206 million people¹ and the seventh largest GDP with USD 2 trillion². In spite of the current economic crisis, it still figures as a regional power and is definitely a player which cannot be ignored in the global healthcare sector. Brazil also has one of the biggest public health systems in the world, covering approximately 150 million people.

Brazil spends 9.7%³ of its GDP on health, thus reaching OECD levels, although not necessarily achieving similar outcomes. This spending is split 46%⁴ (USD 82.8 billion) in the public health system, and for 54% (USD 97.2 billion) in the private health system. The latter covers 25.9%⁵ of the population, and the public health system, called SUS (Single System of Health), serves 75.1% of the population.

The Brazilian health system is underfinanced, although public investment has been growing quickly: it has increased 260%⁶ from 2003 to 2012. In spite of these impressive numbers, there is still growing pent-up demand on the sector for several reasons. One of them is the common problem of poor administration of resources and corruption that tends to affect public services in Brazil; but other factors play an important role too. Brazil has been through a major social economic transformation in the past decade that resulted in the expressive growth of consumer power. Access to better healthcare services is one of the main aspirations of this vocal middle class. The recent social economic transformation was also mirrored by a strong epidemiological change in Brazil; seen especially with the increase of life expectancy and an ageing population. These factors bring new pressures on Brazilian healthcare systems which are at a critical inflection point from both a funding and infrastructure perspective.

In January 2015, a law allowed foreign direct investment (FDI) for the first time in the Brazilian healthcare sector. Some see this as a critical step of progress for the sector; and the most important since the creation of the public health system in the early 90s. This law opens enormous opportunities for investors, especially in providing hospital services. The country has a deficit of over 13 thousand beds⁷ and an enormous gap of medical infrastructure, especially in its more remote areas. In a nutshell:

1. There is huge pent-up demand in the Brazilian healthcare sector on both the public and private systems;
2. The country has been going through dramatic social economic and epidemiological transformations in past years that introduce important new pressures to the already burdened healthcare sector;
3. The current political and economic crisis limits the capability of the government to deal with the complicated needs of the Brazilian healthcare;
4. Brazil is seeking foreign investment to help the sector and may be prepared to dilute its past economic nationalism in order to achieve this.

¹ Brazilian Institute of Geography and Statistics (IBGE), 2016

² World Bank, 2014

³ World Bank, 2013

⁴ World Bank, 2013

⁵ National Supplemental Health Agency (ANS), 2015

⁶ Ministry of Health, 2013

⁷ Central Intelligence Agency and National Association of Private Hospitals, 2012

History of the Brazilian Health System and Foreign Capital

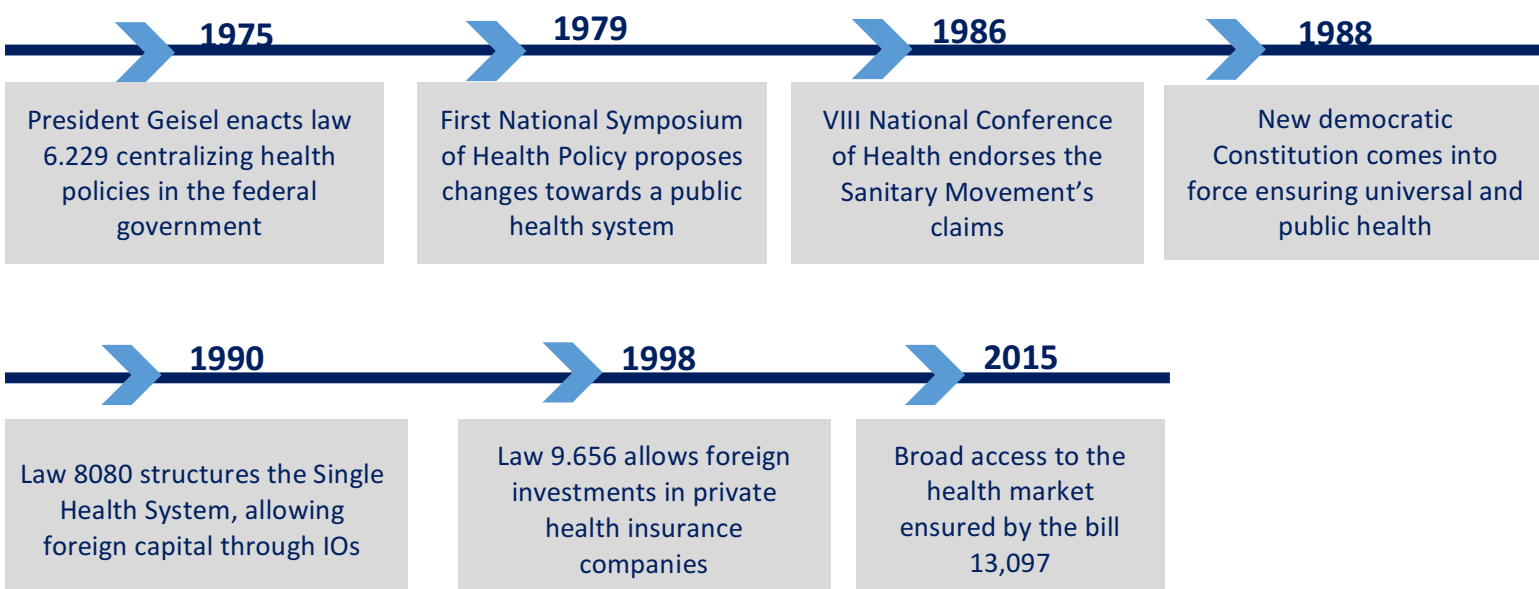
Despite the significant control of the state in Brazil's health market, national and international private investors have been gaining increasing ground in this field. This must be understood in light of the evolution of health policies in Brazil, which have been experiencing important changes over several decades. The state, which traditionally had quite a limited role in health policies in the past, started being pressured by the civil society to absorb such responsibility in the late 1970s. Amid protests for the democratization of the country, a group of civil leaders, demanding universal access to healthcare, emerged, called the Sanitary Movement.

The state then began expanding its role in health policies. The 1988 democratic constitution, which enshrined health as a citizen's right, required the state to provide universal and equal access to health services. Article 196 of the Brazilian constitution says 'Health is everyone's right and a duty of the state'. The Constitution also forbade direct and indirect participation of foreign capital in the health sector, except in cases defined by the law (Art. 199§3º). A couple of years later, the Single Health System was structured and once more, foreign capital was forbidden, with one exception: capital provided through international donor organizations.

Unremarkably, the government has been challenged by the difficulties of offering effective universal healthcare with good outcomes, which has led to more flexibility regarding alternatives to finance the health system, such as by foreign investment. In June 1998, the law 9.565 was enacted to regulate private health insurance schemes; opening the national health market for foreign investors a bit more. Companies and individuals established abroad were now able to create, participate in and expand investment in private healthcare insurance plans (Art. 1§3º).

In 2009, the first legislative attempt to broadly allow foreign investments in the national health market was introduced. Senator Flexa Ribeiro introduced the bill 259, arguing that the state could not properly support SUS by itself. Even before the bill 259/2009 had its legislative approval process finished, the liberalization for foreign capital in the Brazilian health market was included as an unexpected rider in the provisional measure 656 in 2014. These foreign investments were included through a *maneuver* by federal representatives Manoel Júnior and Eduardo Cunha, were controversial and it was alleged the two maneuvered the bill's passage in *quid pro quo* for investment banks that had donated to their election campaigns.

President Rousseff enacted the provisional measure, which then turned into the law 13,097 in January of 2015. According to this bill, foreign investors are authorized to create and control hospitals in general, such as philanthropic institutions, general and specialized clinics; actions and research on family planning; non-profit health services of companies intended for its employees. A major liberalization for FDI in Brazil!



Pent-up demand for better healthcare services

1. Social economic transformation and growth of the Brazilian middle class

In the last decade, it was possible to observe a strong economic transition in the country and the rise of a new social economic reality. This transition created a new Brazilian middle class, which became more demanding for better public services. In 2013, Brazil saw major public demonstrations, uniting millions of middle class people in the main Brazilian cities. Such demonstrations hadn't happened since 1992, when the first President to be democratically elected, after 21 years of military dictatorship, was impeached due to his evident corruption. They had a profound impact on the political elite and party cadres.

The main complaint behind the demonstrations was the bad quality of public services; and health was top of the list. Some severe problems affect both the private and public health systems in different manners. Within the public system, the main problem is the lack of consistency of quality and access to care across the vast Brazilian nation; from global metropolis of Sao Paulo to the Amazon region. Brazil's sheer size and socio-economic diversity presents unique challenges perhaps only comparable to those of Russia or China. Although the current Constitution created funding mechanisms to establish SUS (the public health system) to be equal for all the population regardless of their state or municipality, this mechanism (called the 'tripartite system') is failing, and the reality is that health indicators vary dramatically throughout the country.

STATE (best and worst results)	CHILD MORTALITY RATE <i>per thousand people</i>	STATE	HOSPITAL BEDS <i>per thousand people</i>
Santa Catarina	10,1	Rio de Janeiro	2,92
Espírito Santo	10,1	Goiás	2,85
Rio Grande do Sul	10,5	Rio Grande do Sul	2,82
Amapá	23,9	Tocantins	1,7
Alagoas	24	Amazonas	1,67
Maranhão	24,7	Amapá	1,6
BRAZIL	15	BRAZIL	2,35

To cope with this challenge, in 2013, the Federal Government launched 'Mais Médicos', a public program aimed at bringing foreign physicians to the country to work in remote areas. Even though the program was seen as weak and controversial⁸; lacking a strategy to improve the medical infrastructure in the interior of the country, the population approved the measure.

Within the private health system the problems are different. The biggest part of the population that has access to private health insurance is located in the main urban areas and thus they have access to medical infrastructure, although it can be insufficient and of variable quality in some cases and areas. According to the National Supplemental Health Agency (known as ANS in Portuguese), the agency which regulates the private health market in Brazil, 25.9% of the population has health insurance (medical or dental), but this rate varies among the different regions of the country: in the South 32.8%; the Southeast 36.9% (includes Sao Paulo & Rio de Janeiro); the Midwest 30.4%; the poorer North 13.3% and Northeast 15.5%.

According to the General Index of Complaints (IGR), organized by ANS, the number of complaints increased 85% from June 2015 to November 2015, reaching 16,103 amongst the large players in the sector by January 2016. The most common complaint regards quality of health treatment; with prior authorizations and cost of

⁸ The main critics to the program include its lack of clear mechanisms to evaluate the performance of these professionals and favoring mainly Cuban professionals.

procedures, comprising 29.7% of the total. Regarding the medium-sized private providers, the most frequent complaints are the quality of health treatment (35.9%).

The IGR index is used to evaluate the health insurance plans and organizes them into 4 levels. A company that is frequently in the lower levels can be banned from the market. In December/2015, 75.5% of the companies were in the top-level of provided services, and 9% in the lower degree. In the last quarter of 2015, 46 of them were suspended.

There is a consensus among medical specialists and local investors, that the Brazilian health system has numerous challenges, but the most prominent gaps and pent-up demand lies in the following areas:

• **Lack of hospital beds:** there is an average of 2.4 beds per thousand inhabitants in Brazil, while the WHO recommends 3 to 5 beds. There is an estimated deficit of 13.7 thousand beds and this problem affects all regions and even wealthy states.

HOSPITAL BEDS



• **Lack of infrastructure and specialists:** found more acutely in remote areas, while a strong infrastructure exists in highly populated areas, such as São Paulo and Rio de Janeiro, although still insufficient for the size of the demand.

INFRASTRUCTURE IN GENERAL



• **Low quality of private health insurance:** ANS, the regulator for the private health system, suspended the activities of 73 health insurers due to poor performance in 2015. This sector rates 2nd in Brazilian consumer complaints.

PRIVATE HEALTH INSURANCE PLANS



2. Brazilian epidemiologic transformations

Brazil has been going through an enormous epidemiological transition in the last several years, which is another factor of pressure on the health system. Some of the components of this change are:

- **A Greater degree of chronic and acute diseases related to lifestyle:** these lifestyle diseases have risen in the 'league table' of mortality and morbidity causes in Brazil. According to the Brazilian Ministry of Health, in 2013 the four main causes of death, in order of prevalence, were cerebrovascular disorders; acute myocardial infarction; respiratory diseases; and diabetes: strokes, heart attacks, lung cancer and diabetes.
- **Ageing Population:** The elderly population of Brazil is estimated at around 2.6 million people and this number is expected to triple in the next 20 years. Life expectancy has been increasing rapidly and is currently 75.2 years.

Health indicators have massively improved in Brazil in the past 30 years. From 1990 to 2012, the infant mortality rate in Brazil decreased 70.5%, according to the Ministry of Health. The current infant mortality rate in the country is 18.6 per 1,000 live births. Still, there is a lot to improve when compared to the USA where the rate is 5.9 or Germany where it is under 4! If it once was fashionable to talk of the BRICS markets, then Brazilian infant mortality is much higher than China (10 per 1,000 live births) or Russia (7).

Brazil has met all the UN Millennium development goals except for maternal mortality, with the current rate of women dying from pregnancy-related causes is at 44 per hundred thousand births⁹. Although this is an impressive 23% improvement, it compares unfavourably to the USA (14); Germany (6) or even China (27)

The country figures in an intermediate situation where chronic 'lifestyle' diseases are growing fast and people are dying less of tropical diseases and other typical conditions common to developing countries, such as malnutrition, diarrhea and malaria. However, Brazil still struggles against mosquito-borne dengue and the much-talked of 'new' Zika virus. All of these epidemiological and regional differences affect the Brazilian landscape of healthcare and thus pose an extra challenge for any government aiming to provide equality of outcomes in healthcare across a country of such a continental size and huge diversity.

3. The current crisis and reflections on the healthcare sector

The current economic crisis in Brazil is causing enormous pressure on the healthcare system and further challenges the Federal government, states and municipalities to provide appropriate health services. There are severe problems in drug supply and a lack of all sorts of medical equipment and infrastructure in general. Some states have declared a deep crisis in their healthcare systems, such as Rio de Janeiro, Pernambuco, the Federal District and Rio Grande do Sul. The *de facto* insolvency of some systems is a real 2016 risk.

However, besides the economic recession, there is also a political crisis in place casting a shadow on the already complicated situation of the healthcare system in Brazil. The current government is going through a major political battle and facing one of the most severe corruption investigations ever, which is hurting the ruling party power down to its deepest roots; destabilizing the coalition. The government may fall.

This lack of political and economic stability affects the capacity of the government to control the economic crisis and deal with problems related to the healthcare system. To cope with the political crisis, for example, President Rousseff chose a Minister of Health from the PMDB party¹⁰ in exchange for political support. However, the measure has deteriorated the situation of healthcare in the country, as the current Minister is seen as challenged on managing his brief; and inexperienced in the issues; and perhaps is unlikely to remain in the position for very long.

The job losses arising out of economic crisis also mean unexpected demand for the public health system as some people drop out of the private system (as they cannot afford private insurance coverage or employer coverage lapses). It is against this background that foreign healthcare investment is sought in Brazil.

4. Investment opportunities for foreign capital

In 2015, the law 13.097/2015 approved foreign investment in the Brazilian healthcare sector, opening enormous opportunities for investors, especially in hospital and hospital services provision. The bill was rapidly approved and sanctioned in January of 2015 in the midst of a large provisional measure including many articles of different nature. This voting was controversial and there is an Action of unconstitutionality

⁹ United Nations, 2015

¹⁰ PMDB is one of the largest Brazilian parties and was the main ally of the Workers Party's base of supporters for almost 12 years, but since 2014 there has been some fractioning of the support and PMDB has been pressuring Dilma for political positions in exchange for support.

moved by the Socialist and Freedom Party to delete this article of the law¹¹. Although this is unlikely to happen, the Supreme Court is expected to review the case.

According to medical specialists the main legacy of the law and the arrival of foreign investment in the Brazilian hospital sector may also be the introduction of international best practices, as Brazil's hospital system, across both private and public spheres, have been criticized for being poorly managed; unhurried and struggling to meet the demand of users who see themselves as consumers, as much as patients¹². Critics also say hospitals don't have a strong clinical outcomes review process; and tend to be weak on investigating medical negligence. In part this is also because Brazilians don't (yet) have a culture of suing doctors or hospitals where they suspect medical negligence.

Although the law hasn't been regulated¹³ and there is no clear jurisprudential understanding concerning it, some transactions have already transpired as an outcome. The first was by global private equity provider, Carlyle, which acquired 8.3% of Rede D'Or for USD 824 million in April of 2015. This law is expected to have greater impact in Brazil as local players adapt to meet its juridical criteria. For example, not-for-profit (or non-profit) health institutions may be entitled to receive foreign capital, but first need to change their statutory definition to become a for profit institution.

In our view the main advantages of investing in the Brazilian health sector are:

- Providers have been able to increase prices, but have to a degree managed costs, as compared to more mature markets, which has improved the profitability of the sector for outside investors;
- Low regulatory risk, as Brazil went through a strong regulatory process review in the late 90s and 2000's, and probably has a settled structure of regulatory bodies, so widespread regulatory upheaval is not expected;
- Regulation is mainly focused on the payers (HMOs) and not on the hospitals;
- There are no hospitals valued over USD 1 billion listed on the stock market, whereas internationally there are over 30, which shows that the sector is rather underdeveloped in Brazil, considering the size of the market.

However, the main risks analyzed by funds and investors regarding the sector are:

- The bargaining power with the payers (HMOs) has increased due to a reduction on the number of players on the private sector after large number of mergers and extinction of smaller HMOs;
- Strong state intervention in the healthcare sector through central activist policies such as PDPs (the PPP programs of the health sector) and Mais Medicos
- Holding the quality of clinical care to account is a key success factor for hospitals; and this is not always well established in Brazil.

¹¹ http://ambito-juridico.jusbrasil.com.br/noticias/289470427/ampliacao-de-capital-estrangeiro-no-setor-de-saude-e-objeto-de-adi?ref=topic_feed

¹² Arguably this breakdown in the traditional 'deference' between patient and doctor, and patients demanding *value-for-money* and optimum performance from medical suppliers, is part of an advancing global phenomenon

¹³ In Brazil, laws need to be 'regulated' after they are published, where the Executive branch determines how to apply the 'effects' and results of the new law

Conclusions

We foresee a field of opportunities in the Brazilian healthcare sector in the next years, as well as some risks originating from the current macroeconomic and political instability. We believe the main strengths of the sector are:

- a strong regulatory environment that is a legacy of the creation of regulatory agencies created in the late 90s
- the epidemiological transformation which the country has been going through in the last decades that has increased life expectancy (as well as a parallel fall in infant mortality)
- The ageing of the Brazilian population has created more demand for the consumption of healthcare services.

We consider the Law 13.097 from 2015 to be the main source of opportunities for foreign investors in the sector during coming years, especially in provision of new the hospital services. And, while private investors are unlikely to fund clinical infrastructure in remote areas, we see likely opportunities for hospital infrastructure growth outside of Sao Paulo, Rio and Brasilia and into tier two and tier three cities.

Given the parlous state of state health finances (at federal, state and municipal level) there may be unrealistic demands placed on incoming private sector investors; but ultimately government is likely to recognize the need to make health sector investment attractive if it is to be viable and sustainable.

This said, we think it is important to bear in mind the current unstable political and economic environment in Brazil, and risks for dramatic changes in both taxation (up) and government health spending (down). These factors, coupled with legacy strong state intervention in Brazilian healthcare; may give some investors serious pause for thought.

While it may be true that the first investors to arrive in the Brazil hospital sector will be the ones to seize the biggest financial opportunities, it is by no means an easy investment decision. Scale of opportunity is equally matched by some thorny challenges and contingent political risks which, while not insurmountable, require careful handling. Nonetheless we expect to see further private equity involvement in the Brazilian healthcare provision sector; including new foreign entrants. This will be a very important moment and proof point to demonstrate that Brazil recognizes that its economic sustainability means more openness to foreign capital.

Appendix – Recent Deals



October/2012: Announcement of the purchase of the largest group for health insurance in Brazil, with more than 4 million members.

USD 5 billion



December/2015: The group also invested in hospitals, such as the Samaritano and Santa Helena.

USD 325 million

USD 175 million



September/2015: The Private Equity Fund bought 13% of the leader in diagnosis in the São Paulo municipality and aims to expand to other regions in the country, focusing on the premium class and excellence in management.

USD 88 million



November/2015: The GIC negotiated with a Private Equity Fund for the acquisition of 26% of the largest group of particular hospitals in Brazil. The Carlyle Group, owner of 8% of the company, also injected more capital in the chain.

USD 824 million

USD 450 million

THE CARLYLE GROUP



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