FINAL

Bloomberg Transcript

Q3 2014 Earnings Call

Company Participants

- Adolpho Cyruaco Nunes de Souza Neto, Chief Financial Officer
- Carlos Marinelli, Chief Executive Officer
- Joao Ricardo Kalil Patah, Investor Relations Officer

Other Participants

- Rafael Frade, Analyst

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2014 Third Quarter Conference Call. Mr. Carlos Marinelli, CEO; Mr. Adolpho Souza Neto, CFO; and Mr. Joao Patah, Head of IR, will present the results. This event is being recorded and all participants will be in a listen-only mode during the company's presentation.

After Grupo Fleury's remarks, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions) This event is also being broadcast live via webcast and may be accessed through Investor Relation website at fleury.com.br/ir, where the presentation is also available. Those following the presentation via the webcast may post their questions in advance on our website. They will be answered during the Q&A session as long as we have enough time.

Before proceeding, let me mention that forward statements are based on beliefs and assumptions of Grupo Fleury management and on information currently available to the company. They involve risks and uncertainties, because they're related to future events, and therefore, depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Carlos Marinelli, CEO of Grupo Fleury. Mr. Carlos, you may begin your presentation.

Carlos Marinelli

Hello, and good day to all. I would like to welcome and thank you for your patience of all who are joining us in this third quarter 2014 earnings release of Grupo Fleury.

Going directly to the presentation, please join me from the slide three. In the third quarter of 2014, Grupo Fleury reached gross revenue of BRL505 million, an increase of 3.1% over the same period of 2013. Highlights as for Fleury brand's growth of 14.5% and for operations in hospitals growth, which achieved 8.8% in the Same Hospital Sales concept. As for our regional brands excluding Rio de Janeiro, we marked growth of 5.4% period-over-period.

During the third quarter, EBITDA reached the milestone of BRL98 million, which is equivalent to a 21.6% margin on net revenue, 439 basis points increase over the third quarter of 2013, meaning [ph] 29.1% increase in absolute terms.

Net income reached BRL31 million or 6.9% on net revenue. We also pointed out that the net cash amounted to BRL52 million. Our cash flow from operations reached BRL78 million, an increase of 82% compared to the same period of 2013.

One of these factors [ph] that best explain these results, this result is the average revenue per exam, which grew 10% in the PSC. This growth was enabled by the enrichment of our mix of exams and services together with the reinforcement of the strategic positioning of our brands, which is differentiation and excellence in what we delivered to our customers with numbers already in compared with the effects of price readjustment carried out in the second half of this year.

It is important to mention that these numbers are the consequence of our intense and focused hard work that we have undertaken since the second half of 2013 related to the control of costs and expenses in addition to a selection of the portfolio of services and health lines [ph]. This work is ongoing and has clear outcomes and those that have been allowing us to capture the increasing demand for our services, primarily the industrial re-brand in addition to ensuring better operational performance of all our business. Reduction plans we will continue, will be improved and will be important to ensure better levels of profitability.

The last highlight of this page is the announcement we made yesterday about the payment of a total of BRL100 million in dividends for November, 21.

Continuing on page four and talking a bit more about the operational highlights for the period. We comment on the unification of brands in Rio de Janeiro in the form of a co-branding between Labs D'Or and our main brands, creating the Labs a+ brands. This unification aims to bring synergies and strengthened the brands' presence of all main brands in Rio de Janeiro markets.

Also related to brand in Rio de Janeiro, Felippe Mattoso remains the best market in imaging and clinical analysis, services for the premium segment in Rio de Janeiro. Our medical products and business teams has been striving constantly to maintain the strengthen this premium position in Rio de Janeiro.

For Fleury, our premium brand in Sao Paulo, we launched a smartphone app to schedule exams to clients who prefer the convenience of serving their scheduling online. This app is

FINAL
Bloomberg Transcript

also the first of its kind in Brazil and besides reflecting greater convenience to our customers, it's part of our strategy to optimize our training process with differentiation.

Also in the third quarter of 2014, we had the approval by CADE of the acquisition of the LabsCardiolab, in combining Labs D'Or, Menezes da Costa and Felippe Mattoso brands. The restriction imposed was on the sale of our total revenue equivalent to BRL28 million. Another positive highlight is the signing of a contract with FINEP for a total funding of BRL155.4 million from which BRL100 million has already been released in early October. The funding has 97 months term with 24 months grace period and will be used to invest in the company's innovation projects.

In the communication area highlights, it's important to comment our presence at the 48th Brazilian Congress of Clinical Pathologists and the award that our doctors received during the XIX Brazilian Congress of Gynecology and Obstetrics.

Going to slide five and to tell you a little bit more on the gross revenue, we see an increase of share of three brand in the brands portfolio and a decrease of Rio de Janeiro share compared to the same period of 2013 due to the discontinuation of Unimed's contract and due to the revising of the service offering while searching and improving profitability.

I'll pass now to Joao Patah, Investor Relations Director, who will bring you more detailed information on our operations in the period. Joao?

Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Thank you, Carlos. Good morning, everyone. I'll continue the presentation with further explanations and details on our patient service centers group. In slide six, the first graph on the left shows the revenue per square meter of 4.14 per quarter, which was higher than the third quarter of 2013 and the highest quarterly figure since we began through distribution metric. The 1.1% growth happened at even after the opening of 4,700 square meters in the first half of the year for re-brand. It also reinforces the focus on the asset efficiency and the tendency towards enrichment of services as already mentioned by Carlos with an increasingly complete and complex offering. This is also reflected in the increase of nearly 16% in the average size of our centers and 17.1 growth in revenue per patient service centers as shown in the graph at the bottom of the slide.

The two graphs to the right show both the increase in the average ticket consequence of price adjustment and improved mix and the continuous growth in existing centers as measured by same-store sales figures. It's noteworthy that the overall PSCs growth tendency is of higher rate as asset selection in comparative basis for Rio de Janeiro (inaudible). At the same time that new openings and expansions in the premium brands mature their capturing after demand.

On slide seven, we break down the growth and indicators by brand's block, keeping even more clear and transparent the difference stages. Firstly, Fleury brand continues to grow double-digits. Some centers are at high capacity utilization levels after periods of high

FINAL
Bloomberg Transcript

FINAL

Bloomberg Transcript

same-store sales growth and the branded [ph] its expansion plan for next year's to keep capturing the demand for superior quality services. The same happens with Weinmann, our premium brand in the south, we are celebrating 85 years this week, being more and more recognized among patients and physicians as the leader in the region.

About Rio de Janeiro operations, the portfolio selection, performance in the 4Q 2013 is to affect the comparison basis, but is already showing positive signs of improvement, enrichment of mix, and efficiencies of assets as measured by the average revenue per exam and revenue for the PSC. The main focus of the region is to the recovery of profitability, which will add to the closure of 25 PSCs since early 2013, in three of them during the third quarter and to detailed control of costs and reduction offering.

For other regional brands, a selection of the offering was also performed, focusing on the intermediate height of one segment. Even with the selection, the rate of growth reached 5.4% with 13.1 same-store sales growth, also signing the progressive improvement in the assets utilization.

The next slide referring to be B2B business highlights the 8.8 Same Hospital Sales growth, which allow us together with new operations in Brasilia Federal Capital and growth of 4.5% in the Diagnostic in hospital business lines, offsetting discontinuity of 11 small operations promoted in 4Q 2013.

Going to the deductions and allowances on slide nine, the relative number was similar to the same period of last year. Compared to the first half of the year, the improvement is due to the lower needs of provisions related to cancelled contracts. Adolpho will comment a little further on receivables.

Let us now turn to the costs and expenses. Beginning with the evolution of some of the drivers on the right hand, the graph on the number of employees at the top right of the slide shows the step of deductions carried out in Rio de Janeiro in the end of 2013. This number, which together with medical services explained the line of personnel and medical services costs, is steady this year with occasional reduction in institute restructures and new plant closures, mainly in Rio de Janeiro has done in third quarter.

While at the same time, expansion in the offering of premium brands may bring some additional operational personnel for that specific patients of the centers. The same happens in the rest of the square meters and the number of PSCs, which are connected to the fixed costs such as rents, utilities, facilities, maintenance and telephone lines, among others.

Reduction in the number of centers is related to the closure of unprofitable locations, usually (inaudible) while the growth in total square meters is related to the recent expansion offering in Fleury brand -- environment brand. Simultaneously, with each of these drivers, the company has strengthened in the recent months, the management of cost and expenses. From detailed analysis in each account using tools such as the metrics budget to keep the focus on what is essential and differentiating factor to the clients with the cost management that has evolved in organization. As a result, the sequential growth

FINAL

Bloomberg Transcript

in costs that was seen until early 2013 as illustrated in the left of first graph has been stopped and inverted, more than offsetting the inflation [ph] of rate increases.

On the slide 11, we have served evolution of the main fixed costs with a reduction in absolute terms in most of when compared to 3Q 2013 despite inflation of the period, salary readjustments, and the increased offering of services.

As for variable costs, revenue growth of 3.1% was not reflected in the relative increases in materials and medical services costs. One important improvement, as discussed in slide 12 was the reduction of 297 basis points in cost of personnel and medical services with a 25% increase in gross revenue per headcount.

In gross profit, the set was a 24% increase in absolute terms and 455 basis points in relative terms, achieving 27.2% gross margin, the best since the third quarter of 2012. Margin evolution continue as a trend for next periods, but I take this opportunity to remind you that 4Q is typically a seasonally weak quarter what can reduce temporarily the positive curve brought by the operational leverage and expenses dilution.

Before other highlights, I emphasize that SG&A is also improving in controlled important [ph]dilution. SG&A, excluding depreciation represented 9.6% of net revenue, even with the superior marketing campaign compared to previous quarters in this third quarter. Comparing to the previous year, improvement in total expenses for the third quarter of 2013 had a positive non-recurring effect as commented last year.

Now please, Adolpho will continue the presentation.

Adolpho Cyruaco Nunes de Souza Neto {BIO 21636124 <GO>}

Thanks Patah, and good morning everyone. Turning now to the below the line in slide 14, restructuring the profile of our debt, which is primarily composed by the debenture issuance in 2011 and 2013. I'd like to take the opportunity to mention again the signing of the contract with FINEP in August of 155 million with a term of 97 months and interest rate of 4% per year for which we already received the first installment of 102 million in early October. This loan, which has the purpose to fund projects related to expansion of our patient service centers, IT projects for productivity increase, and the development of attending processes, reinforcing the Group's commitment to in-operations and helps to maintain an efficient and low cost capital structure.

The financial result for the quarter was net expense of 16.5 million compared to 14 million in the same period last year. This change was due to the increase in the interest rates and the fact that we have a smaller amount of cash invested.

The next slide, number 15, shows the breakdown of our rate of income tax and social contribution, which in the first nine months of 2014 was 37.9%, all of which relating to deferred taxes as the tax issued from the goodwill from our acquisitions generated a cash debt equal to zero.

FINAL

Bloomberg Transcript

In the next slide, number 16, you see that the net income for the quarter was 31 million, up 70% over Q3 of last year or 52 million, excluding deferred taxes, the so-called net cash income, representing a margin of 11.5% of net revenues in the quarter compared with 8% in the same period last year.

The next slide, number 17, shows the profile of our accounts receivable at the end of the quarter, which shows a reduction in the gross balance of 30 million against the same period last year even with our revenue growth. Furthermore, as a result of finalizing some negotiations with HMOs, we have improved our aging profile with a decrease in the participation of the overdues for more than 120 days, mainly due to the reduction in the amount of overdues with more than one year.

Going on to slide 18, cash flow, we see that operating cash flow in the quarter was 77.5 million, an increase of 82% of the previous year, mainly due to improvements in working capital, both receivables and suppliers. As announced yesterday, we will have a new dividend distribution in November of 100 million, arising primarily from retained earnings and supported by the generation of 199 million of operational cash flow year-to-date.

Investments in CapEx, which are detailed in the next slide, were 24.6 million in the quarter, focused on our expansion program, which represented 52% of total spending and IT projects, which represented 37% of the total. Considering the year-to-date results, we forecast that the total CapEx to be spent in 2014 will be below 150 million, but there will be a carry-over to 2015 as we continue the investments for the expansion of the Fleury brand in the 2015-2016 period [ph].

We will now turn to the Q&A section.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Rafael Frade with Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hello, good afternoon everyone. You mentioned in your (inaudible) the expansion plan that you have and I would like to understand a little bit, how you are seeing the competition for this expansion, mainly in Sao Paulo despite, is this is a threat for you or not or you see much more a measure of your capital to execute this expansion, then really concerns from competition? If you could comment a little bit about the competitive scenario, it'll be great.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Rafael, Ricardo speaking. I'm not sure if I understood the whole question. But going through our expansion plan, the reason why we delayed or postponed some openings of patients service centers is not related, is zero related to the competition. On the opposite, what we have is a very big, a very high demand for our premium services and what we are doing is to expand, exactly to keep capturing the growing demand for these quality services. So our plans or the postponement or the moment to do that is not related to the competition. I don't know if I understood your question exactly what you meant.

Q - Rafael Frade {BIO 16621076 <GO>}

Thanks a lot. I think that yes, I do not express very well. I would mention looking forward your expansion for the next two years, competition is a threat? You see the competition as a threat or really it has a booming demands given the low investment for maybe all the players recently and you're seeing plenty of demands for your services much more a matter of doing good execution or is that you have some concern related to the competition in movements from competitors?

A - Carlos Marinelli

Rafael, this Carlos Marinelli speaking. And just to complete what Patah just said. Pointing out this issue and competition that you meant [ph], the issues that always, competition is always a threat. We do respect our competitors. We do believe that some of them have become better compared to us to other time. And we do think that this is something that make us going forward and bring more innovation, more excellence to our services. But I wouldn't say that any of our initiatives on expansion is threatened by the competition. Just to make more clear this point, we don't have any issues on going to some place with a premium brand or top intermediate brand, just because of the competition or being this point or that point, just because of the competition. We have our very strong expansion plan. It's well based on direct marketing knowledge. And the Sao Paulo is the place where there is very few opportunities to have more and better patient service centers and that's what we are doing. I would say that for the other regions of Brazil, of course, there are regions where our brands, they are very well placed on the market, but competition is always a threat and we will look into it with the proper research in terms of knowing what they are doing and knowing what they are offering and bringing a better offer in terms of what we think is a better offer in terms of medicine.

I don't know if I answered directly your question. Please help me out.

Q - Rafael Frade {BIO 16621076 <GO>}

That's okay, Carlos. That's very helpful. Thank you. Thank you, Joao.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Thank you.

Operator

(Operator Instructions)

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

FINAL

Bloomberg Transcript

FINAL

Bloomberg Transcript

Hello, Joao Patah is speaking. I'll answer a question that came to us in the webcast about our CapEx expectations for this year. As you know we have spent so far during this year little bit more than BRL70 million. Our expectations right now for this year is that we will not spend more than BRL120 million or BRL130 million in the total of the year, mostly because some of our expansions will be done mainly in 2015 and also in 2016. So it's a postponement of some projects. Of course, if we would reduce it, then the amount also of money that we're doing in each project, we are being more careful in each line of expense and with each line of CapEx, but also there is this postponement of the expansion plan, the demand and the offering for next years, we continue to believe it's strong for us to expand, but for this year, it will be lower than firstly expected. So some of these CapEx will then in 2015, and so going directly to the question for 2014 will be lower than firstly expected.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Carlos Marinelli to proceed with his closing statement. Please go ahead, sir.

A - Carlos Marinelli

I would like to thank you all for listening and again reaffirm that the primary focus of the company will continue to search for better levels of profitability along with its strengthening our position of depreciation. We understand that the performance of our brands in the premium segments and in the top intermediate segments will continuing, bringing service excellence for our clients, whether they are patients or doctors and also to the health plans operators. The sustainability of our business will continue to be putting our knowledge to better and more effective served medicine through innovation.

I also would like to invite you all to be with us next Thursday at our Fleury Investors Day. For those who are in Sao Paulo, we'll be very glad to host you here at our headquarters for the presentations. The event will be also available on the Internet by live streaming. Thank you very much and have a good day.

Operator

That does conclude the Grupo Fleury conference for today. Thank you very much for your participation. Have a good day and thank you for using Chorus Call.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily *reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*

FINAL

Bloomberg Transcript