

Q2 2019 Earnings Call

Company Participants

- Grace Cury de Almeida Goncalves Tourinho, CFO and IRO
- Pedro Henrique Rocha Nocetti, IR Manager

Other Participants

- Analyst
- Joseph Giordano
- Tobias Stingelin

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for holding. At this time, we would like to welcome you to Qualicorp's Conference Call to discuss the results for the Second Quarter of 2019.

We have with us today Mrs. Grace Tourinho, the CFO and IRO; and Mr. Pedro Henrique Rocha Nocetti, the IR Manager. This event is also being webcast through Internet and can be accessed at the address www.qualicorp.com.br/ir, where the presentation is also available. We would like to inform you that this event is being recorded and participants will be in listen-only mode during the company's presentation and after this, we'll go on to the question-and-answer session, when further instructions will be given. (Operator Instructions)

I would now like to give the floor to Mrs. Grace Tourinho, who will begin the conference call.

Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

A good day to all of you and thank you very much at our earnings results call for the second quarter June '19. Before speaking about the results, I deem it important to remind you of the real material fact that was disseminated on August 8, the purchase and sale of 10% of the company's stake belonging to the founder to Rede D'Or, that is still subject to approval. Junior, the present day CEO and counselor of the company will remain in his administrative role until this operation has materialized.

After this, he will continue merely as a shareholder with a CapEx total of 9.98% of the company. According to the non-compete agreement filed at the end of September 2018, this term set forth will remain even after Junior no longer will be the manager of

FINAL

Qualicorp. And for the time being we are simply awaiting the approval of the administrative council for economic defense.

Now, we would like to focus on the day-to-day of the company and the results that we have been presented and that I would like to share with you very much. Now when we speak about the company business I once again underscore the EBITDA that in the second quarter 2019 grew year-on-year as well as quarter-on-quarter. We had an increase in revenues and margin that we have been able to maintain at a level of 50% for the year 2019. Once again, this is thanks to the continued efforts that we carry out day after day in the company. I also highlight the operational cash generation even with payment of interest on debt and profit sharing scheme that we had this quarter.

I would now like to give the floor to Pedro, IR Manager.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Good morning to all of you and thank you Grace. We're going to go on to Slide number 4, and speak about our portfolio. We have an annual improvement on the churn as a percentage of our base. And once again, this is because of the continuous work that we carry out in retention, something that we have done consistently. And with more efforts in the last 12 to 18 months, we have more accessible products available and this enables us to maintain our clients and avoid that they leave especially as we had happening in the second quarter of 2017.

Regarding gross adds there is a retraction and there is a sequential retraction, less incoming lives when compared to the same quarter. And in the quarter, we had two new portfolio that we would like to remind you of this. Now if we take away this effect in the second quarter, we acquired more organic lives, more sales vis-à-vis the first quarter of 2019.

Additionally, I would like to remind you of the following. We began campaigns with a focus on digital sales beginning in the second fortnight of May in 2019. The results of these campaigns in terms of volumes is something that will still happen in the third quarter in August. We still will have the entry of lives. Now, what I would like to highlight is an additional point. We were able above everything, besides what we were able to sell, we were able to substantially increase the share of the digital channel in our sales. We began with 12% on total sales in January.

We reached 71% in June. And the preliminary information on August point towards 92% of our sales coming from the digital channel, which means that this is an initiative that enables us to carry out faster, safer sales. And besides everything, in the long run we will be able to review our structures within the company and reduce several expenses relating to sales.

Now to -- and with this operational part, we had positive net adds, in somewhat more than 4.400 lives during this semester. Now regarding the third quarter '19, this is a concern for everybody as much of our portfolio undergoes a price readjustment. Preliminary

Bloomberg Transcript

information already point to an improvement year-on-year. We're referring to an improvement of 25% in July, vis-à-vis July 2018.

Now when it comes to the other segments of the company, the only thing that I can highlight in terms of the self-management TPA, we had a loss of sales in the annual comparison. On the other hand, we were able to increase lives in the Corporate as well as the SME segment.

Now, please let us go on to Slide number 5, where I'll speak about net revenues. You can see BRL497 million for the second quarter of June '19, an increase year-on-year and quarter-on-quarter. What we see here and that is very important and something that we always highlight, when it comes to the revenues that you should always follow up on the revenues of our brokerage rate. Sometimes you can see one going up more than the other, but what is interesting is that the company has maintained a consistent margin when we think about these two recurrent revenues.

Besides the sequential improvement the measures that I mentioned before implemented in the first semester came in at the very end of this semester and the impact on the revenues will be felt more -- was felt more consistently as of the month of April. And you'll see an increase in the Affinity revenue and a big difference between the first and second quarter.

Let's go on to Slide number 6 to speak about cost of services and gross margin. Gross margin is an evolution that you have been following up on since 2017. These are efforts that we make to review expenses, review structures to enhance the efficiency of the company when it comes to cost. Two points that I would like to underscore once again, and that refer to ROIC. You should observe the accrued part for the first quarter and for the year where we have savings of approximately 12% vis-à-vis 2018. When it comes to third-party services, you can observe a slight increase. It's no secret that the company invest considerably in systems and in operational enhancements more efficient system for better service to the client.

Now all of this is part of our company CapEx and then it goes on to expenses. And of course it requires maintenance. And during some periods because of the overlay of these systems, we have increases, because we are undergoing a transition. Now, once again, this is a one-off increase. And in the long term you will be able to observe some savings before going on to the administrative expenses. Our expense with personnel had an impact of BRL8 million because of severance pay that happened in the second quarter of 2019. In the long term, we will have savings from these layoffs.

And finally, the SG&A on Slide number 7. We have an increase of 6% in the quarter-on-quarter comparison. Expenses with personnel and third-party services especially expenses with personnel. Here, we have an effect of BRL4.3 million in limited shares that will begin to have an impact on the company results since May of 2019.

Now, this plan was approved in the assembly of April 2018. These limited shares were delivered in May. And of course they will have an impact on the company results for the

FINAL

coming four years. Additionally, we do have an expense that was extraordinary, which is a volume of layoffs of BRL2.9 million in the second quarter once again to give the company savings in the medium and long-term.

Now to end, this part, we go on to our selling expenses. There is a volume of amortizations for new sales that has increased in the year-on-year comparison as well as the quarter-on-quarter comparison. And this mainly reflects the increase in the sales campaigns and awards. Sales campaigns with awards are part of this line of amortization of commission. And you will see in this line item that we have a significant drop in this line item year-on-year and quarter-on-quarter.

At this point in time the focus of the company is to invest in campaigns that are directly linked to sales. We pay additional awards to brokers who sell, especially brokers who sell through the digital channel. What is even more important is that we're not saving on this. We're making the necessary investments and this of course offers us positive results gradually in our volumes sold and in the company efficiency, especially because we see greater efficiency in terms of the digital channel or the amount that is sold through the digital channel and because this adds expeditiousness and safety and sales intelligence. With this we focus all of our commercial efforts to be able to obtain the best results for the company.

With this, I would like to return the floor to Grace.

Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Thank you, Pedro. We go on to Slide number 9, the profit sharing scheme and the bad debts as well on collectible receivables. This is the best historical moment since 2001 for the company. We had several initiatives that were successful in the company. I would like to highlight that the amount of recovery during the semester was BRL5.5 million. Now, this is possible because we have a great inventory of stock.

Once this inventory no longer exists, this will be excellent for the company. And it is very probable that in this line item, we will have a reduction in the coming quarters. I truly believe that we will end 2019 with a performance better than that of 2018, considering that we have been able to enhance not only our management throughout the last 12 months.

We go on to Slide number 10, for financial results. When compared to 2018, there is a slight improvement in the results. We have greater financial revenue thanks to a greater cash volume that was invested. When it comes to financial expenses, there's very little comparison quarter-on-quarter. The -- we highlight what happened with the IFRS 16, where we are calculating a adjustment to present value with the lease expenses. Now with the renewal of debentures that will have an impact on the third quarter '19, we can expect greater financial expenses in the long run.

We go to Slide number 11, the adjusted EBITDA for the company. We had a growth year-on-year and quarter-on-quarter, thanks to the growth of our revenues. But also because

Bloomberg Transcript

FINAL

of a reduction in the cost that we have in these line items we have a margin that gravitates around 50% during the last 12 months. I highlight here as a constant work of the company of adjusting processes to implement digital transformation. The company has made great strides in terms of expenses. We have reduced whatever does not service our client and we're working with innovative implementations to reach new levels.

This year we have a digital sales platform and we're working to be able to deliver new systems that we still do not have. And many people question us stating that the company could still have further cost reductions that would be natural for the company. And this is something that we do day-after-day and that we do constantly whenever we have a new innovation in the company. This is part of how we work and it allows us to grow.

But above and beyond this, we're servicing our clients much more efficiently and expeditiously at present. The company continues to strive to control its costs and to have further enhancements as part of the EBITDA. The number of layoff in this quarter are very important. They represent BRL12.5 million as an impact. This generated because of the evolution of the systems that we have been delivering gradually.

We now go on to Slide number 12, referring to net income. If we compare the second quarter of 2019 with the same quarter in '18, there is a strong increase that comes from an increase in our operating results, which we have already mentioned. When it comes to the first quarter '19, we should also point to an improvement in the tax line item thanks to the payment of the profit sharing. We have a deduction. The tax rate fell 39% in the first quarter to 35% in the second quarter. We're still struggling to improve this to maximize and reduce it so that we can have a rate that is much lower than the 34%, which would be the normal rate.

We go on to Slide number 13, referring to investments and capital structure. The company ended with a net debt of only BRL20 million, due to the very favorable situation of cash generation that we have had in our business. This short-term debt basically refers to the older debentures that are still part of our second quarter balance sheet. It is important to stress that this is a cash position where we paid profit sharing in April, dividends in May besides the interest of the debenture. On Slide number 14, we have our operating cash flow after CapEx, that was positive by BRL127 million lower than the previous quarter because of the payment of interest rate and oscillations in our working capital.

Now besides the issuance of debentures that we have just concluded although this did not have an impact on the second quarter, it is something that began in the second quarter. And we have just concluded this. Now, if we go backwards and speak about which was our goal, we're very close to the capital structure that we had in 2015 where the ideal model was to have our capital divided in 40% with third-party resources and 60% with our own resources.

After we reduce our capital structure, we will have complied with our guidance. We go from 38% of third-party resources to -- and 62% of own -- our own resources. And we have just issued three debentures representing BRL1.3 billion, in Qualicorp beneficiaries, BRL290 million with a term of four years resources used to pay off our previous debt. In

Qualicorp Corretora, we have BRL310 million with a term of three years, BRL260 million used to pay off the former debt plus, BRL50 million that we paid as dividend to the holding of the group.

And in Qualicorp Consultoria e Corretora de Seguros S.A, the present-day name of our holding, we captured BRL700 million with a -- for a three-year period. These operations were settled in the third quarter '19, paying off the former debentures, so they did not have an impact on our financial income statements. Now the cost of these new debentures whose income tax will be paid in the first quarter and third quarter year are more attractive for the company. Once again, we were able to renew them with more attractive interest rates compared to previously. We now have CDI plus 1.15% compared to CDI plus 1.30%.

We now go on to our capital structure optimization that has already begun. It is no novelty vis-à-vis, the strong cash generation that the company obtained through its operations. As we did in 2015, we detected an excellent opportunity of delivering value to our shareholders by optimizing our capital structure. In July of 2019 there was a reduction of capital by BRL980 million. And this proposal was submitted at the first extraordinary general assembly.

However, we did not have sufficient quorum. We do have a new assembly that was convened for August 15 and we count upon the presence of our shareholders to be able to continue on with the necessary paperwork for this operation to materialize. And this is an important effort. We want to have all our shareholders, our greater and smaller shareholders. We need all of you to vote so that we can conclude this operation.

I would like to thank you for your attention, and we now go on to the question-and-answer period. Thank you very much again.

Questions And Answers

Operator

(Question And Answer)

Thank you. We will now go on to the question-and-answer session. (Operator Instructions). Mr.Anderson Vieira from Itau would like to pose a question.

Q - Analyst

Hey. Good morning, and thank you for taking my questions. I have two questions. And first of all, you've talked about the digital transformation and this has had a relevant impact on sales. But what is happening with your clients? What is happening when it comes to client support? And which is the penetration of this service and the impact this could have on other line items such as personnel? Perhaps, -- well, you can expand this digital initiatives and other fronts. This would be interesting. My second question referring to Clube de

Saude which is decelerating. What is happening compared to other portfolio? Thank you very much. And these are my two questions.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Good morning, Anderson, and thank you for the questions. We have adopted the digital transformation and improved. This is a process that encompasses not only sales but also services to clients. We ended up paying incentives for brokers to carry out digital sales.

All of this has brought us enormous gains in terms of processes for the company. To give you an idea in 10 days, we were able to include the clients in our company portfolios in 10 days. This used to take 13 to 14 days. We now take 3 to 4 days. The proposal goes online. We check information using the tool itself which means that we have been able to carry out safer and more expeditious sales.

Now in this process, we have savings in terms of logistic expenses. We are avoiding sales with logistics with checking, with the filing of the proposal, which means that we are able to have significant savings in the sales chain by using this digital transformation. And of course, we are also able to review some of our structures that refer to the inclusion of people in the sale of our portfolios. Another part of digital transformation refers to client servicing. Presently, we're able to do 50% of our service using chat box, the portal, an application that is already available in Android and iPhone. And all of this has enabled us to go back and review some of our structures including third-party services and our own personnel.

This is a process of course, we're beginning to see the results and there will be many more. And I can't refer to the magnitude here. Now, when it comes to the Clube de Saude, the Clube de Saude Anderson has not lost it's sales and so what happened is because of the incentive program that we have for digital sales, we have given trust to the sale of other products that are not for this low income segment, which means that we have diluted the participation of Clube de Saude in our sales.

But in absolute terms, Clube de Saude does have consistent sales and has had them for the last 24 months. So nothing will change regarding Clube de Saude. No nothing will change. This is an extremely interesting segment for us. It helps us to have penetration in different areas of Brazil, where we were not present four years ago. In terms of our strategy, nothing will change.

Q - Analyst

Thank you very much for your responses.

Operator

Mr. Joseph Giordano from JP Morgan would like to pose a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hey. Good morning to all of you. Good morning, Grace I do have a question and I'm speaking about the more excessive -- the plans in terms of health. I would like to know what is happening to churn in the more traditional products such as Clube de Saude to understand that Clube de Saude has a better churn. And finally I would like to gain a better understanding of your new initiative to grow and what we can expect for the end of the year. If you could share with us more details on this new product. Thank you.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Joseph, thank you very much for your question. First of all, when it comes to our mix in terms of churn, we have a very good opportunity of this quarter to present a reduction in the company's churn. We have been working before this quarter. We have been preparing alternative products, once again with a desire to offer our client new opportunities if they want to work with a downgrade. And this has had an impact especially since the third quarter. Now most of our portfolio was reviewed in July.

We still have some portfolios, especially in Clube de Saude. We are working with a readjustment in price now and we don't have the information so far. But evidently the higher in the Qualicorp pyramid the client is, the more opportunities Qualicorp has to offer other alternative products. Evidently while we get to some regions with more accessible products, it is still a very great challenge to find other alternatives. And because of that we do detect a higher percentage of churn at the base of the pyramid compared to the top of the pyramid.

And this has happened constantly and we see it again this year. There has been no variation. The -- we see that the customers at the base, once we have a readjustment lead to a higher churn of 15% to 16% compared to the clients that are at the top of the pyramid, and we are going to continue on with this trend. Now when it comes to Clube de Saude, this is still a project that is part of the company. We still cannot use it as a very good tool to retain the clients in the company. And as soon as we have any changes, we will be informing them to you, but this is still underway.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you very much. Grace.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Thank you for your question.

Operator

Mariana Hernandez from Credit Suisse would like to pose a question.

Q - Analyst

This is Hwang Gabriel, and thank you for taking my question. I would like to gain a better understanding of the updates in Health and what will happen with his project?

FINAL

Bloomberg Transcript

FINAL

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Okay. What will happen with the company? Well we still don't have any idea of what will happen. We can expect any change if there is going to be a change after the approval of the CADE. For the time being, we continue on with business as usual. He is not with us in the call today, because of problems with his agenda. But once again, we continue with the same pace until the CADE offers its approval and then we will inform you of any change in this. Thank you very much.

Operator

Mr.Tobias from Citibank would like to pose a question.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Grace, congratulations for your results. I would like to better understand the digital strategy. It was implemented in mid-May. There still very positive things that will happen. If you could give us an idea of the trends since it was implemented, what you have felt in terms of growth and your activity. And you mentioned that the preliminary data from July showed that July 2019 was much better compared to July 2018. You already spoke about the decrease in your stock of bad debt that you will have less, but which is your expectation? Do you expect to recover more during the third or fourth quarter? Or do you now have a more solid base when it comes to your revenue? Thank you.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Tobias, good morning. This is Pedro. Okay. We're going to begin with the life and digital transformation. What I mentioned regarding July is a year-on-year comparison. If we compare July 2018, in terms in terms of new life with July 2019, of course, we're referring to two months where historically we have a net loss of lives. We have more cancellations than new lives in July 2019. The loss of lives was 20%, 25% lower than in 2018.

And July 2018, we lost 12,500 lives. In July 2019, the loss was 9,000 to 10,000 lives. This is the situation that we observed for July. It is a consistent improvement. Of course, the goal of the company is always to have more lives than not have cancellations. But these are difficult readjustments that we're going through a difficult period. And the performance that we have is much better than we had in 2018, and it seems to point to an improvement in the coming years.

Now when we speak about retention this refers to the strategy to products and the specific commercial strategy. Yes. The incentive to sell came into effect in the second fortnight of May for new lives coming into the portfolio as of June. But the campaign is ongoing as long as the company deems it to be interesting. And of course once the campaign gains traction among brokers, we will maintain it. We didn't have a fast pace of loss of lives between the second and third quarter.

What we see is the contrary, and I think all of this is due to that digital incentive campaign. When it comes to the digital transformation Tobias, campaigns are helping us when it

Bloomberg Transcript

comes to the volume of live. And more than 90% of our sales are -- at present, are being sold through the digital channel.

This is excellent for the company as it enables us to review our costs, and it also enhances our sales intelligence. And this will enable us to increase lives and we will reinforce the campaign if we see that we can bring in greater profitability to the company. This is not only in the medium and short-term where we have a reduction of expenses with personnel and third-party services.

What we will see is a better quality of life for the company. And the other part of digital transformation is the service to clients. Clients can speak to us through the app, through WhatsApp, and the experience with Qualicorp is much better. And this also opens up the possibility of reducing our costs further.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Thank you, Pedro.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Tobias, if you could repeat your last question?

Q - Tobias Stingelin {BIO 18290133 <GO>}

You said that you had been recovering bad debts or collectible receivables that your stock has been reduced because of this. And I would like to understand if going to the third or fourth quarter, you expect to continue with this reduction or if you're going to work at the present day levels of bad debt.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Now, it's true when it comes to our stock. The longer the stock, the more difficult to recover bad debt. We have been working with very positive operations so far and we have had a drop. When you look at our slides and compare what we had in the previous quarter, the drop was a BRL5.8 million, BRL6.8 million compared to the second quarter of 2018. So there is a minor drop and the trend is for this figure to be reduced even further. And all of our efforts allow us to maintain this rate.

I don't think we will had a -- have a sudden drop, but we did have a very high stock and the trend is to reduce this stock. 3.8% was a pleasant surprise, thanks to the work that was carried out in the company. But obviously we cannot maintain the rate at 3.8%. This is a message to the market. It's more probable that we will be at 4%, 4.5%, at that level, because it's due to the losses that we have with lives and because of the change in legislation and that allows the client to cancel immediately.

This is the main point and also because of the efforts that we do with bad debts to recover them for the company to bring in the resources to reduce the uncollectible receivables. And I believe that this merits greater attention. And we have the great

challenge of improving the level based on what we delivered in the second quarter 2019. It is possible that we will have a minor increase.

Q - Tobias Stingelin {BIO 18290133 <GO>}

Thank you very much, Grace.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Thank you for your question.

Operator

We would now like to end the question-and-answer session. We return the floor to Mrs. Grace Tourinho for her closing remarks.

A - Grace Cury de Almeida Goncalves Tourinho {BIO 17244138 <GO>}

I would like to thank you on behalf of the company. What is important is that we're focusing on our day-to-day work with greater concentration, because we have a great deal to do and to deliver. And I request your help and support so that you can be part of our extraordinary assembly, so that we can restructure the company and deliver greater values to the company. I'm counting on each and every one of you and your presence at our assembly tomorrow. Thank you very much.

Operator

The conference call for Qualicorp ends here. We would like to thank you, and have a good day.

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.