

## Q1 2017 Earnings Call

### Company Participants

- Grace Cury de Almeida Gonçalves Tourinho, Chief Financial Officer, Chief Operating Officer & Investor Relations Officer

### Other Participants

- Joseph Giordano, Analyst
- Leandro Bastos, Analyst
- Leonardo Anguiano, Analyst
- Marco Calvi, Analyst
- Rodrigo Gastim, Analyst

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen, and thank you for standing by. Welcome to the Conference of Qualicorp to report the Financials of the First Quarter of 2017. Today, with us we have Mr. Mauricio Ceschin, CEO; Ms. Grace Tourinho, CFO and IRO; and Mr. (00:35) Investor Relations Manager.

This conference call is also being simultaneously transmitted on the Internet through a webcast, which you may be access at the address [www.qualicorp.com.br/ri](http://www.qualicorp.com.br/ri) and on Engage-X platform, where it is available with the respective slide deck. We also inform that this conference call is being recorded and that participants will be in listen-only mode during the company's presentation. And then we are going to start the questions-and-answers session and further instructions will be provided.

Now, I would like to turn the conference over to Ms. Tourinho, who is going to open this conference call. Please, Ms. Tourinho, you may start.

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

Good morning to everyone. Thank you very much for your presence here today. I am going to start the presentation for Qualicorp Financials. And before I would like to tell you that we in fact what you are seeing now is a result of work that we did not own in this quarter but also things that we have been doing for a long time. Every quarter the company has been delivering good results. And then we have to do what was the (02:25) market and we have been doing our work gradual every quarter in trying to provide to investors the best profitability possible, paying out dividend. We have been paying out dividends over the past two years at 100%. And this year too, on May the 25, we will be

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paying out dividends regarding the earnings of the second half of last year. And in this moment, we make our work concrete (03:03) and we have every day work that we do every single day in the company and we get the result of it, the result every quarter.

All of you who will then have contact with me every day. You've been talking to me with investor relations staff here. When you look at our financials 12 months and you compare it to the previous 12 months, you'll see a considerable improvement. So the improvement that you've seen now in the first quarter, and there have been other positive factors still happening in the same period, it is the result of work in previous quarters that will continue in the company. So costs and expenses, we are very difficult seeing thing (03:57).

Now going to the presentation and talking about the quarter in itself and going straight to slide 3, where you can we indicated, so once again it's a great honor to report our results with not just the EBITDA margin of 40% (40:23), a growth of 8 percentage points as compared to the previous quarter. An EBITDA of BRL 237 million relative to results of intense and constant work in cost reduction in every single line, especially administrative sales, marketing, third-party occupancies, expenses and also net provision for bad debt, which is still positive this quarter. And these are just (04:57) as I've said before part of them related to the restructuring of our head count. We have made some changes in the company rules, and we will see the results especially in future quarters.

We also highlight the reduction of more than 50% of our net debt reduction, generation of cash in excess of BRL 200 million in this quarter.

Now going to slide number 4, here you can see an improvement in churn (05:31). Those of you who have been following us every quarter, you know very well that this is a quarter that is in terms of churn, it's lower. So when we have readjustments in July, it happens effectively in the first quarter and the return is heavy in the third quarter. And in the fourth quarter - so we can't compare the fourth quarter to the first. So we are comparing a much worse quarter to a much better quarter - the first quarter. So it's usually good at even low churn still at high level, but obviously everyone understands the economy we are dealing with. So, there is not much money out there in the markets, and our customers also have difficulties we anticipate, even though this is an extremely resilient product that everyone wants to have. So the drop in sales is also a consequence of the overall economic scenario and it's challenging.

There is also seasonal effect, especially with carnivals, so we have fewer days to work on sales and the company ends up delivering less than - a net add of less than 20,000 lives. We are not going to change the guidance for the year. We believe that we will be able to recover the lives that we could not add in the first quarter. Usually, the first quarter is stronger in terms of sales position.

Now, we're are still analyzing the market closely and we're open to good businesses including the alternatives of growth for the company, and this was the case of the acquisition that we've just made in the fourth quarter 2016. We will consult the acquisition that we released to the market last quarter will become effective in the second quarter of 2017.

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Now going to slide number 5. We'll be talking about the net revenue. Here we have 11.5% consolidated growth year-on-year, once again showing the revenues of our business. It's good to remember that in the middle of the year, more or less in June 2016, we have an increase in PIS and COFINS, that has affected over the growth revenue and have a negative impact in 2017 because of higher PIS and COFINS. We can still deliver 11.5% to the sales revenue. There is also the month of January that provides the benefits to 2017 as compared to 2016 with regards to INFS (08:44) because of the operation that we transferred and we started in February 2016.

When you compare the sequence of minus 1.6%, it is basically due to a smaller revenue in Affinity because of the smaller sales volume and also because of the mix of product sold. When you look at the line of Corporate segment, and that is two points to highlight. The first one is the loss of Corporate contract that we have been announcing since last quarter usually with a lower margin. If you compare year-on-year, which led to a reduction in the revenue in the segment of about 17% (09:34). We have also had an increase in revenue of CRC/Gama. I don't know if you remember but in 2016, along that year, revenue were - every quarter one business unit, and this ended up accumulating, if you compare year-on-year 2016 to 2017, and it added 52% of being consistent because of the maturation, and then we are evolving this offer project that was supposed to be a benefit (10:12).

However, there is a reduction when we compare the previous quarter, and this reduction is a result, especially because of employees of companies that hire CRC/Gama, is also a restructuring of the head count. It's not related to CSE, but it's a reduction, which obviously, if there is an increase, it will also be reflected in future periods.

Now, going to slide number 6. We'll be talking about costs. Near the gross margin, it shows a slight growth comparing both periods, which was highlighted was an excellent impact of the restructuring of personnel amounting to BRL 3.7 million in the quarter, with an impact in the quarter, there is a solid improvement.

With regards to the comparative increase in the line of personnel expenses, an increase of 12.6%, this is especially due to the deliveries in the CRC/Gama because of the expansion of projects, and the increase in lives under management. If we excluded this number, just Qualicorp we will see a reduction of about 2% in spite of the impact of the labor termination. The increase in the line of financial (11:58) head count portfolio adjustment. If we look in the sequence, there's a slight reduction because of the seasonal reduction of sales in this quarter.

Now going to administrative expenses. Here are the main highlights (12:15) as compared to Q4 2016. And it went up by only 2.6% compared to the first quarter 2016. This reduction is basically a reduction in head count and also changes in executive positions. If we consider all lines of personnel, including cost and expenses, sales and administrative, we have been able to obtain a reduction of 9.6% as compared to Q4 2016 in spite of the BRL 7.5 million reported for terminations in this quarter.

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It's important to highlight to you that more terminations – our company did (13:08) others did it in March but (13:13) had more and more difficulty to deliver.

So when we decided that we were going to have this reduction in head count, so that we work within that for more difficult times because the year has only just started, it will be difficult for me to deliver. And I did not deliver in full what was expected. And the failure in the movement is because we were working before. So every IT delivery that was delivered in phases, so there is the billing and then the restructuring and delivery background. So we have been doing it along the year so that we could be free from the deliveries that everyone had to do. I had to present to the company as a whole what we have already done this a long time and they didn't wait for anyone to ask me to do that. So we did it gradually.

And today, I think that this has become more or less the spirit of the company of saving not just in one department but in every department. So everyone has been doing that, and this is a result of joint work of everyone.

In terms of third-party services, we know there is an increase that is very much because of expenses of CRC/Gama with IT and telephone services. So we can see a recovery if we compare to the fourth quarter of 2016.

With regards to depreciation and amortization, here basically the mix in amortization of former executive offices and about almost BRL 80 million referring to the software that was being developed and that went live and then started delivery, and it's amortized.

About expenses with occupancy. We need to adapt all our costs, admin and sales. Comparing to Q1, 2016, we can see a reduction of 11%. Considering the change in 2016 of the moving, we moved 10 units to Barueri, where rental is cheaper. Also, the return of seven floors in our headquarters in São Paulo. In this manner, we were able to gain almost 3 percentage points in the margins comparing year-on-year and 1 percentage points as compared to the two quarters in a row.

Slide 8, commercial expenses. For the third semester in a row, we were able to reduce sales expenses. So we are specific (26:42) in our strategy this quarter in terms of expenses, with sales campaigns and advertising, focusing more on online deals without generating the new leads for the sales channel, which provided us almost two percentage points of margin. We also see a drop in expenses to personnel. The drop is basically a result of the reduction in the number of internal salespeople and smaller sales, which obviously (17:14).

We also spend less with the variable compensation commission. We should also highlight on this slide the index BRL 2.6 million because of terminations, basically. We know that in future quarters, especially in next one, Q2, which is a quarter where we will need to have more sales, these expenses might go up a little bit. (17:50) amount corresponding to the sales that we make.

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Now on slide 9, provision for bad debt. It was a great surprise this quarter, surprise for you, because of the results, but we had been aiming at these results. And if we compare to the fourth quarter, it's not fair. And it's not fair because those who know the company very well know that most of our portfolio is adjusted in July, and July based on the 60-basis-point provision for bad debt dropped strongly in the fourth quarter. So comparing the fourth quarter to the first quarter, it's not fair because obviously the first quarter is cleaner, we have a more stable portfolio, people have already been able to be pay and they're still paying. This is the trend in the last - it's really great in the fourth quarter.

Additionally, apart from the seasonality of the business that you know very well, we conducted work to recover losses, and we were able to recover more 11.2% than the previous quarter especially because of the SERASA (19:19) work offering discount and taking advantage of the money of severance accounts that the government released for the individuals.

In the line of others, as we usually say (19:36) of three different items. And obviously, we can't (29:42) control with them 100% in operations. And so when they terminate, that's when we are going to book or with the change in probability of losses will continue. Those have been very much on the evolution of each contingency, operational gains and losses.

They are very one-off, really, specific, and (20:11) we can compare. So again lines that we're still looking at with great attention, but there may be variations. In terms of importance to highlight to all of you, that maybe two days ago, Normative Resolution 412/2016 was enacted, which mandates the company to make effective immediately the plan as the customer asks. In this manner, the company is supposed to immediately cancel the customers who so request, which may lead to a reduction in the revenue but also reduces expenses because we are able to adjust the revenues (21:00). But also health plans, and this may contribute to a reduction in (21:09).

Now going to financial expenses and revenues. Once again the very objective, supplies remain flat. As a reminder, the \$8.5 million of monetary collection refer to the 25% remaining, it's not the purchase of (21:40) amount and we booked it in our balance sheet at BRL 240 million. In the first quarter of 2017, I also highlight the payment of the previous quarter and also the payment - and the payout of dividend that's going to take place May, which corresponds to 100% of our profit in 2016.

Now going to slide number 11, EBITDA. We had a gain of BRL 37 million in EBITDA compared to Q4 2016 as a result of intense work, constant reduction of expenses in all lines and also management of default. And we are much closer to our customers. Because it's useless to (22:36) customers especially one that's still not very big company. I forced them to pay, create a (22:46) with Qualicorp and the customers - so we pay taxes and then as a consequence afterwards, we have constantly recovered that money through the company.

Once again, even though the margin is very positive, we cannot consider it as the margin of 2017, and in expenses, especially sales expenses which because of seasonality and on the incurred as of the second quarter of 2017. If we were recurring, we would be

delivering in the first quarter which is a positive quarter, seasonal (23:37) margin is usually better about 44%. Again conversely, we are not going to have expenses for terminations amounting to BRL 7.5 million, not to mention that we're also working and we will continue to work in future quarters (24:01).

Now moving to slide 12, net income. Our net income is smaller than the previous year by 44%. So, when we take out the tax effect, net income increased by 84%, which is the company to continue being a great generator of cash and a good payer of dividend.

Another important point here is something you always asked me, with regards to tax rate. The tax rate in Q1 2017 is very positive about 28%, which is an evidence of the result of the continuing work that we have been making to increase the company's tax efficiency. However, if we were to take out a one-off positive effect of this quarter, we would deliver a rate closer to 36%. So once again continuous work.

I'm not yet happy with this. We are still working on this. This is much finer work, much more one-off, but the important thing is for you to (25:29) evolution. Just as a reminder, it was as high as 50% some time ago. Obviously (25:39) an organizational structure of the company, with companies are regulated by AMS, broker houses and (25:51) with different regulators, which means it's slightly difficult for us to have a more efficient tax rate. But we are working in terms of what we are able to deliver every quarter.

Now, on slide 13, CapEx. There were no significant investments, just the BRL 16 million is the (26:23) and the acquisition that we made in the fourth quarter 2016. And the acquisition of Uniconsult as I had reported last call, which will become effective in the second quarter after it's (26:38) by ANS. The main highlight here is a reduction of more than 50% in our net debt based on a strong generation of operational cash.

Now, on slide number 14, once again, you can see really great generation of BRL 238 million and the ROI scheme even though it's not in the presentation, (27:09) we actually need here to really reach more than 45% once again to see the consequence of maturity of investment that are being made in the company.

So, once again, I have finished my presentation, and I would like to open for questions-and-answers. Please feel free to ask any questions you may want so that everything is very clear to you. Thank you.

## Q&A

### Operator

Thank you. We're now going to start a questions-and-answers session. Our first question comes from Joseph Giordano from JPMorgan. Mr. Giordano?

**Q - Joseph Giordano** {BIO 17751061 <GO>}

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Good morning, everyone, and thank you for taking my question. Two very short questions. (28:42) affect in Q1 as you said which affected the sales of new plans. What have you been seeing considering that we are in mid-May in terms of new things. It keeps getting any better or is it still difficult because of macro?

My second question regards in your marketing budget. (29:07) discretionary expenses. How should we work with the expenses along the years? Also to understand seasonality and how this may affect margins along the years.

And number three, what are you seeing in terms of medical inflation? What was daily average transfer in terms of the prices of health in terms of the pricing of health plans?

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

Thank you for your questions. With regards to your first question, about our sales, we are very much in line with the previous year. But obviously it's not easy to tell. We (29:52) to see any improvement in the market, in terms of the money that is circulating. And once that happens, we saw (30:03) in the company. But our sales are very much compared to the previous year.

With regards to marketing, we have changed our strategy over the past three months and our strategy was very much in global, we had very expensive advertising campaign and it was very much focused on the internet and - then has been in producing its effects and in its results.

So we hope that we will continue at this level of cost that is lower. But we're monitoring our sales, but the quality of the leads that are being generated and whenever necessary. But for now, I don't think this will be necessary in the next quarter or a quarter after that. So with regards to inflation, honestly, we receive some average of last year of about BRL 22.5 million, and this might be slightly lower. But still in around two digits. And we are prepared for whatever happens. We want to control it as much as possible. But we are working on this.

**Q - Joseph Giordano** {BIO 17751061 <GO>}

Thank you very much, Grace.

**Operator**

Our next question comes from Mr. Calvi from Itaú BBA.

**Q - Marco Calvi** {BIO 19854632 <GO>}

Hello. Good morning. My question regards PCI, you say that the organic sector (32:13) severance account. Could you share with us what exactly was the effect and how recurring is the significant drop that you showed on this line?

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Second question is a reduction in favorable expenses. You said that you were not spending (32:33) with internal brokers on a smaller-scale volume. Could you share more details on how much is reduction because of less sales, and how much of the reduction is because you'll have fewer brokers? Second question regards CapEx. In terms of assignment of (32:59), if we project the Qualicorp will not acquire any portfolio, (33:13) close to zero?

### A - Operator

With regards to the reduction of FGTS 5 to 10 million, I don't have a precise number. I can give it to you afterwards. But it was something like that. And the second question regards the reduction of commercial expenses. The reduction - just a minute, minus 14% in sales, also that this is also a consequence. I don't have here with me now a precise number. And CapEx, if we do not make any new acquisitions, which I hope happens and we are working through that. But I cannot announce anything. We may consider this line as zero, close to zero. So as a reminder, you may consult it will be in the following quarter, next quarter.

### Q - Marco Calvi {BIO 19854632 <GO>}

Just one last question. With the Normative Resolution 420, effectively that will produce an effect as of the second quarter in the company's performance. Can we see a structural effect in the drop of PCI because of the resolution? Does it make any sense to think like us?

### A - Operator

Yes, it does. It makes sense. This is something we will be seeking, however still very recent, it has only just been approved. We have been working on this and we are closer to our customers and we can feel when it's impossible for them today. It's usually needless to build them because they just can't pay. And they can't afford it. They just don't have the money that they should sell us up to the 20th of the month so that we could cancel the plan with the healthcare and they wouldn't have an expense that they should pay. And this January, provision for bad debt, especially when they have difficulties to pay. And this ended up creating the greatest game for the company is not too unfriendly with customers.

We want to be seen as someone helping them. We have rooms, otherwise (36:34) very bad. So reflected now we are obliged to cancel. This avoids us having more provision for bad debt in the company.

### Q - Marco Calvi {BIO 19854632 <GO>}

Thank you.

### Operator

Our next question comes from Mr. Rodrigo Gastim from BTG Pactual.

### Q - Rodrigo Gastim {BIO 19694950 <GO>}



I have a question about the health plan (37:11) accounts for greater and greater share, annual basis. How much does it account for in your net and gross numbers and also profitability of this product (37:26)?

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

Excellent question, Rodrigo. Thank you very much. So actually the health club today accounts for 10% of our portfolio. It has been growing especially because it has a better ticket. So in the second quarter, I was not going to say anything about this. But since you asked, I will say. So in the past, this was done externally. It was outsourced. There was a third-party who did the back-office functions. With this change, we have in-source these operations. And since they're being done in-house, it's going to be slightly more profitable than it was again in our financials. So this will improve even better (38:29). In Affinity, we work with positive margins. I don't have the details about these margins (38:38) a transition, but the idea is to incorporate it into Qualicorp to enforce it.

**Q - Rodrigo Gastim** {BIO 19694950 <GO>}

Thank you, Grace.

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

Thank you very much for your questions.

**Operator**

Our next question comes from Mr. Bastos from Credit Suisse. Mr. Bastos, please.

**Q - Leandro Bastos** {BIO 21416405 <GO>}

Good morning, everyone. Thank you for taking my questions. I have two questions. The first one is about sales, tickets and how it is compared to the average ticket of the portfolio. The other thing is your expenses and royalties this quarter, do you see any increase in that along the year? Thank you.

**A - Operator**

Leandro, thank you for your question. In fact, our sales tickets is better, our inventory is about BRL 600 on average. And now let's say (39:50) BRL 400. And with regards to royalties, it's a great opportunity in the company. It's really a great opportunity. We have been working on really to probably to improvements in the future quarters, but it's too early for us to celebrate. On (40:17) on any reduction is this line, but this is a line which is clearly more and more important in the company.

We will be able to see these results next year, not yet this year because there is a granular effect of negotiation with all entities. Have I answered your questions? Is it clear?

**Q - Leandro Bastos** {BIO 21416405 <GO>}

Yes. Thank you very much.

## Operator

Our next question comes from Leonardo Anguiano from Santander. Please proceed, Leonardo.

### Q - Leonardo Anguiano {BIO 17330967 <GO>}

How many months suffered the impact of the head count reduction?

### A - Operator

In the second - more on the second quarter, the savings that are yet to come in future quarters, and there might be to an increasing sales in the second quarter. We might have a negative effect in commercial expenses. Could you have more savings in EBITDA margins towards the rest of the year or at the level in the first quarter?

Leonardo, thank you for your questions. It's difficult to answer to you right now because not all areas in the company did that. Most of them is in March. So, GA was on February 1. Then there was something's being done now with regards to reduction in which we're seeing our head count. And so it's difficult for me to tell you in fact. With regards to the reduction in head count, the main effect will be seen in the next quarter.

Your second question regarding savings versus commissions that are likely to go up. I'm really hoping that the economy recovery as they can sell more, grow and that I save more commission. Everyone knows that once we sell, the margins go down, but it's a onetime drop in margins. I believe that if we are on those levels and we will need - I'm really hoping for our salespeople to be successful and with the savings that we are having, (43:20) to go up, I'm really hoping that has happened.

If there are no further questions, I would like to turn the conference over to Ms. Grace Cury for her closing remarks.

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

Thank you, all, very much for telling me to work more intensely. Thank you very much for your trust. I think that it was difficult for us to explain why doesn't the stock pick up again, and this is very positive and leaves us - increases our responsibility in terms of continuous delivery. Thank you, all, very much, and thank you very much for your trust.

And we are available to any questions you may want to ask or any explanations you may want, if anything was not so clear in this call. Even though Natália is not here physically with us, she's very happy that we are reporting these results, which I think are the result of a long (44:40-44:58)

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