Q3 2014 Earnings Call

Company Participants

- Alex Fernandes Oreiro, Chief Financial Officer
- Wilson Olivieri, Investor Relations Officer

Other Participants

- Bruno Giardino, Analyst
- Rafael Frade, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Qualicorp's conference call to discuss the results of the third quarter 2014. We have with us today the IR Team, Mr. Wilson Olivieri, the IRO; and Mr. Alex Oreiro, the CFO. This event will be recorded and participants will be in a listen-only mode during the Company's presentation. After which we will begin the question-and-answer session, when further instructions will be given. (Operator Instructions).

I will now turn the floor over to Mr. Wilson Olivieri, who will start the conference. Mr. Olivieri, you may begin.

Wilson Olivieri {BIO 17325685 <GO>}

Thank you very much, operator. Thank you all for being here with us today on our third quarter 2014 earnings release call. It is a pleasure being here with all of you again. Typically, what I would do, I'll pass the word to Alex, so he would make the introductions. But, this time, I'd like to make a couple of announcements first.

So, first is, this is, as you'll see and probably you have read before, this is a very intensive quarter to us here at Qualicorp. I think the amount of activities and new things that we've experienced in the last three months are probably more than a few companies who have experienced in years. So, in order for us to be here today with all the profit results and everything, I'd like to thank the financial team, Alex and his team, the accounting guys, the controllership planning, they were all very helpful during this period of time. People at Deloitte, they were also very helpful, so we could be here today. And I could not present information, IR team that is here today as well.

Aside that, I'm not going through if you are all familiar that, Natalia, which is our IR is not here with us today. She actually gave birth to a beautiful daughter, and she is right now at home. And so, if you didn't know that, we're just telling you officially now. She is going to be away for few months. But, that's one of the reasons why she is not here today.

And finally before passing the word to Alex, I'd like to just briefly mention to you a few things that I believe are very important to keep on the back of your mind during all of this phone call.

Here in Brazil, we've been going through a very difficult and rough macroeconomic and social political environments. And so, all of the numbers, and all of the data that we're going to be sharing with you today are all we have to consider that under that macroeconomic scenario. (Technical Difficulty) government actually published last week of the -- prior to the last that our new expectations for GDP growth for this year are down to 0.3%, so -- and we still have a couple of months to go in the year, so as I've heard from other investors, we still have time to -- government still has time to review that, and hopefully keeping that at 0.3 and not bring it further down.

This quarter is a very important quarter also because we experienced the highest level of price adjustments on part of our portfolio since the inception of the Company, 17% being the highest level of price adjustment, which will also affect the results for us this quarter. Also, as you all know, we had the first full quarter of management of our new CEO, Mauricio. And so, some of the results going to be showing are already under his management period.

This is also going to be the first quarter that we will report a full effect of the tax reduction we received from the government on PIS/Cofins and all of its retroactive and all of the current effects on the results.

If that was not enough, we also acquired -- we had two major acquisitions this quarter. Number one, we acquired an additional 15% of Alianca, meaning that we currently own 75% of the business now. And another thing is that Heath Solutions Unit, we acquired two units of Tempo. They're called CRC and Gama, that are also affecting our results.

And the last and not least, we've also engaged into a debenture facility with Itau Bank of about BRL300 million. So, all-in, this is a very active and full-of-action quarter, which will be reflected on all the numbers we'll be seeing.

So, before moving forward, I'd like to give the word to Alex, so he would give us some introduction. Alex, please.

Alex Fernandes Oreiro

Thank you, Wilson. Thank you all of you to be with us here this afternoon. Let's go through some of the operational and financial highlights. Our total portfolio beneficiaries of approximately 5.2 million lives, include affinity, corporate and other segments, grew 13.4% in this quarter. And we can describe this divided on our portfolio of beneficiaries in the

Corporate and Other Segments grew 20.4% with 3.3 million lives, mainly due to the acquisition of Unidade Saude Solucoes from Gama and CRC. Another part our portfolio of beneficiaries in the Affinity segment grew 2.8% in this quarter to 1.9 million lives, mostly due to the health portfolio, which grew 7.2%.

Talking about the net revenues, we had a growth of 22.5% in this quarter, reaching BRL391 million, as a result basically of the 17 average price adjustment in part of our portfolio. And a small part of this comes from the PIS/Cofins adjustment in the tax. Our recurring adjustment EBITDA grew 26.9% in this quarter, close to the quarter at 157.1 million, reaching a margin of 40.2%. In this margin, it includes the 3 million of expenses with UHS acquisition.

We closed the third quarter with net earnings reported in the Audited Reports of BRL69 million, which compares to the 18 million in the third quarter on 2013. This adjustment is basically from the retroactive PIS/Cofins fully compensate the monetary adjustments for the acquisition of Alianca. And it's important to report to you that this movement follow the strategy of the Company to prepare the Company for distribution of dividend in the end of this year. If you check in our net earnings accumulate at the balance sheet, we have BRL105 million reported this quarter. And this goes with the strategy that Wilson came talking to you guys in last month.

Wilson?

Wilson Olivieri {BIO 17325685 <GO>}

So, thank you very much Alex. And if -- I would assume you probably have accessed our presentation at the website. So, I would kindly ask you to please bear with me in page number two, where we have the highlights. I would like to start our conversation just as I mentioned to you, there has been a lot of activity. And one of the main challenges, I think, we faced here was, how could we possibly report our data on a consistent and good basis that everyone could compare with prior periods and everyone could put the right numbers into their models.

So one of the ways we've thought about it was building this chart, where we show four columns. The first column to the left, which is written ITR is actually the audited results that if you look at the report, the audited results reported, we have a revenue of BRL413 million for the quarter.

In fact, if you were to look at the other two columns on the right, built into that number, we have the retroactive effect of the tax reduction for the year of 2014. So that going from January through May 2014, which is BRL14.8 million. And we also have the effect of the consolidations of the Unity Heath Solutions that we acquired. So, if we were to exclude those in order to compare to prior quarters, we would have what we call the column recurring third quarter '14 data, where we believe to be that reflects the best recurring revenue for the Company, which is BRL391 million.

So, just keeping the same intelligence and looking at the bottom line, this is keeping some of the details here. We'd look it on a EBITDA basis, if we were to extract that number from the audited reports, we would have seen a BRL286 million of EBITDA with margin reaching almost 70%, which of course, is not a recurring margin for us. So, what we had built into that number is a total of BRL130 million of retroactive taxes that we credited this quarter. And the reason why you have 160 million allocated into the line called other operating income is that this refers to retroactive credit from 2010 all the way up to 2013. And the other 14.8 million, as I mentioned, refers to the 2014 retroactive data.

So, if we look at the results of the three units acquired from Tempo, we would see a loss of BRL1.7 million mostly coming from a fee that we are still paying to the Tempo regarding back office facilities that they are providing to us, which should be over by early next year. There would bring us to what we call a recurring third quarter '14 of EBITDA of BRL157 million with a margin of like 40.2%. Built into this 157 million, we also have what we did not exclude on this specific chart, but we mentioned on the note, we've incurred in a BRL6.3 million worth of costs regarding the Tempo acquisition, mostly due diligence costs, legal fees and auditing fees regarding to those, which are non-recurring.

So, if you have a model that you are projecting future data, we would recommend you to reduce BRL6.3 million from your general and administrative expenses. If we were to reduce that number out of this schedule as well, we would be looking at a potential EBITDA of BRL163 million with margins reaching almost a 42% level.

So, having come through that introduction, I would kindly ask you to move to page number four, which called portfolio evolution, where we have the number of beneficiaries on our left-hand side, which in the first time on the history of the Company, we have surpassed the mark of a 5 million lives of beneficiaries. So, as you can see, with the acquisition of CRC, Gama, we have added gross amount of 743,000 new lives to the system with our current organic growth brought us to a level or number of lives cared by Qualicorp of 5.2 million lives. So, this is a very important quarter to us on that specific indicator, because 5 million lives is a very interesting benchmark to surpass which we currently have done that this quarter.

So, all-in, we have been growing on the period that we've shown this quarter since third quarter '11 at a compounded annual rate of 12% and by a big coincidence with this acquisition, the growth in the corporate and other segment of 12% being pretty much in line of the growth we see in the Affinity line of 12%. With that acquisition, the pie chart in the right that's kind of unbalanced a little bit. Usually we would see like 51% Corporate and Others in lives versus 49%. With that acquisition, in number of lives, Corporate and Others now represent 64% of our portfolio while Affinity is representing 36%.

So, moving to the next page, that's called evolution continuation. We see our number of lives in a little bit more detail. A couple of points I would like to highlight on this pretty clouded slide here. Number one, on the gross adds point, with a gross addition of almost 111,000 lives for the quarter, that means, we sold about 37,000 lives per month on average this quarter, which is pretty much in line with what we had sold last year at the same quarter, considering the fact that we had a price adjustment of 17% and considering the fact that we're going through a very difficult macroeconomic environment in Brazil, we feel that number to be very positive. Although it is not as high as we'd expected early this year, but it's still very positive selling 37,000 lives in a quarter like that, it's not an easy task. And I think our sales force is pretty good in that.

In terms of churn, considering the economic moment and considering the 17% price adjustment, we were expecting that indicated to be higher than 100,000 for this quarter. We had some sensitivity here, where we're reaching almost 110,000. So, assuming it closed at 96,000, which is about an average of 32,000 per month, we feel there was a very good result, especially if you compare to last year, as you can see here, it was almost 86,000 lives canceled the same quarter last year. So, our growth for this size of a price adjustment we had was only 12% versus that period.

I would not recommend us to look at the comparison of the second quarter, because second quarter was unusually low due to specific effects on that quarter. So I think, looking versus last year same quarter, we were exactly at the same price adjustment level, considering the last quarter price adjustment was at 14%. So, that had allowed us to come up with gross adds for this -- for net adds for this quarter of a 14,300 lives which was a little bit higher than we expected on the most recent weeks, because (technical difficulty) of the combination of gross adds in churn.

A couple of other comments of this slide, especially on corporate, as you can see comparing to last quarter to the same quarter last year, we've experienced a reduction of almost 18% as much as we did a reduction on the small and medium enterprises in terms of number of lives. And this is a result of two things. Number one, a reclassification of -- level of small and medium enterprises. With the arrival of our new Corporate Director, Renato, we've decided to cut off our number of lives to be treated by the small and medium enterprise grew up to 299 lives. So, that means, from this quarter onwards, every single company that we deal with more than 300 lives will be relating with our corporate sales team. And the number of -- the companies with less than 299 lives will be dealing with our small and medium enterprise team.

So having said that, the reclassification level was about 33,000 lives. So, most of the drop comes from corporate lives, which refers to a few corporate customers that we had with a fair amount of lives that did not renewed the contracts with Qualicorp. They made decisions going with agent or the brokers, some of them even doing that directly.

So, moving to the next page, with I believe is page number six. Taking a closer look at the net revenue lives, as you can see, again, the reconciliation is starting at BRL413 million reported. Our recurring revenue is BRL391 million; out of which, 93% is coming from the Affinity segment and 7% is coming from Corporate and Others. So, even with a reduction in number of lives in Corporate and Others, we still experienced a growth of 7% versus last year, which is an interesting growth not compare of course to the 24% growth on the Affinity, but it's still an interesting level of revenue for us this year in Corporate.

In page number eight, cost of services, yeah, that's the right one. We experienced here growth in total recurring data of Qualicorp of 22.7%, so a little lower than the level of growth in Affinity with a total of BRL99.3 million. I think, there is a couple of items that are important to mention. Occupancy expenses, mostly coming from reclassification of the full balance that we had, only in the general and administrative expenses in the last quarter. So, we have reclassified and you'll see the same effect in all of the other data, all the other lines.

And the most important in others that we have seen here a growth of almost 100% going through from last year to almost BRL12 million, that's coming mostly from lawsuit agreements that we've experienced during this last quarter regarding several different kind of lawsuits that you would look at civil side, labor side, that affects that -- I think we've reduced significantly the amount of lawsuits, but in exchange for that, we paid out a few of those. And on the BRL3.8 million you see from the Health Unit's Solution most of those are coming from personnel expenses.

And last highlight I would like to make on this slide here is that, even though we had experienced all of those in the third quarter this year, we've leveraged a little bit our operating margin going from 73.9% last quarter to 74.8% this quarter. So, leveraging about 70 bps on that margin.

Next page, on the administrative expenses, a few things that are interesting to highlight, especially personnel expenses, you see a fairly significant growth when you compare to prior year same quarter last year. So, this is coming from additional executives that we've hired, the new CEO, a couple of new Directors and most importantly a salary increase is that part of our employees were subject to what we call (inaudible). There is an annual salary adjustment and most of those happen in August for us. So this is what affected that line.

On the third part, services line, you see that growing to BRL22 million, built into that amount as I mentioned to you earlier, we have this BRL6.3 million of Tempo expenses in there, which we recommend for you to exclude if you have a model projecting the future. Occupancy expenses have been reduced, if you compare versus prior quarter. For the reasons I mentioned to you earlier, we have actually reclassified all of those data -- all of those amounts throughout all of the lines.

And then today, if you look at the graph in the bottom, we have leveraged somehow our administrative expenses as a percentage of the net revenue. Once the prior quarter, that represents a 27.3% of our revenue in currencies representing 25%.

Taking a closer look on our selling expenses, as you can see, comparing especially to previous quarter and last year, we have not seen many changes except on the occupancy expenses, where I mentioned you have increased versus prior quarter due to reversification. But, in terms of third-party commission, sales campaign, we've been very much in line with last quarter, which makes a lot of sense. Once our gross adds for this quarter, we're pretty much the same as the gross adds we've experienced last quarter.

In page number 11, I think, on the bad debt and uncollectible receivables here, I think, we had a great start of our quarter in my opinion. This is where, I think, our greatest results were achieved as you can see here, the BRL21 million of uncollectible receivables that represents a 5.4% of our net revenue are lower even on our best sensitivity analysis inside, these results were a good surprise to us at flow-through of our results. If you look for instance, our gross bad debt for Qualicorp would have been BRL27 million, if I had not recovered BRL6.2 million worth of debt pays from the past is still that gross amount would have been lower than 7%. We would be very difficult to imagine in a difficult quarter for the reasons already mentioned to you for a 17% price adjustment. So, it was a great achievement, of course result of a lot of efforts that we have here, collection agencies is still working at full speed.

We also have more people calling us in terms of -- instead of having them stop paying, and we have our sales force better educated in terms of asking our customers to call, which gives us the opportunities to retain some of those customers. So, all of those trials that we keep talking to you over the past few quarters are really paying out with these results.

In the same page, if you look at the other operating income schedule, in terms of what we call the recurring fees for Qualicorp, we had not seen major changes that are worth mentioning, but that is one point shared that we looked at the first slide that I showed you, which is a constitution of the tax credit of BRL116 million, which is being part of the balance of that line called other operating income expenses, all related to benefits from 2010 to 2013, that as we showed earlier in the schedule, we recommend not to consider for your future projections.

Next page, in financial income and expenses, again, no major changes here to be highlighted, except at the line called monetary adjustment from call option, which is all coming from Alianca, you see here an impact of almost BRL99 million on our results, which are mostly coming from two things. One would be a normal adjustment because Alianca has been performing better than expected again.

So, even if we had not made an acquisition of 15% additional shares, we would still have been by that adjustment and the fact that we acquired those shares at a premium of about 20% have increased for this adjustment. But, as I showed on the previous slide is other operating expenses and income, the fact that we were able to recognize the BRL116 million in credit of balances of PIS/Cofins had mostly mitigated this debit that heated our P&L this time.

Getting close to-date a very quick reconciliation of our EBITDA. And I'd like to highlight here again, one of the most important points of our call which Alex already mentioned to you. But, as you can see here, our net income for this quarter all-in is a positive of BRL69 million. With everything else that we have done so far, we currently have accumulated gains on our balance sheet of BRL105 million. And as you will see shortly in a couple of slides later, we have on our cash balance, gross cash balance more than BRL400 million.

So, as we've been promising you for, I would say, at least two or three quarters in the past, we have put the company into legal and technical conditions of paying out dividends. We will fully submit those numbers on our next Board Meeting and hopefully we'll have some good and positive news to share with you on the next call or probably earlier. But, I think, we have reached here, since we became public in June 2011 for the first time technical conditions to pay out dividend. So, we are very proud to say that to you on this call.

And, if we flow through on that schedule, we would see exactly how we go from net income of BRL69 million with all of the adjustments we have already discussed, including the non-cash stock option lines and the reclassification of interest in late payments. We would reach the BRL286 million of EBITDA reported by our auditors which if you exclude the other adjustments we saw earlier, would bring us to what we call the recurring EBITDA, 157 million or 40% margin. Again, this considers the BRL6.3 million of acquisition of Tempo, which would have raised that to BRL163 million, margins close to 42%.

And the adjusted earnings schedule also reconciles the BRL69 million of net income to what we call the adjusted earnings. And adjusted earnings as you can see here, as easing out, would have been almost a BRL52 million, generating already a per share diluted earnings of around BRL0.18. If we were to exclude the regular of client relationship, goodwill and the portfolio amortization, we would still be seeing what we call a total cash earnings of around BRL107 million, which would represent cash earnings on a diluted basis of $0.38 per share. So, it's been a very interesting result that we had this quarter.

Finally, not the least, the latest schedule that talks about investment in CapEx, we have two things to highlight. Number one, this quarter we've invested another almost BRL15 million in CapEx mostly in IT, the BRL4 million that you see in other, I see some leftovers from our move to the new building mostly infrastructure of leasehold improvements, which are about to be over, so if reinvested almost BRL19 million in CapEx. Year-to-date so far, considering this year we have invested about BRL62 million in CapEx, mostly half and half in terms of IT and move of our offices.

And finally the capital restructuring as we mentioned earlier it reflects in here the debentures that we've engaged with bulk weight of BRL300 million, mostly to balance our index in terms of the special AMS for the benefit administration company. As you can see, here we show cash and cash equivalent available of BRL441 million even with that debt we still reduced our total net debt from BRL373 million early this year to a BRL286 million this quarter. So as you can see even by paying out Alianca, as you know, we wrote a check of BRL279 million in April and another one of BRL155 million this quarter. So we still have our net debt coming down early this year, mostly due to our capacity of generating cash operationally.

So having gone through all of this data, I'd like now to open for question-and-answer sessions. Thank you.

Questions And Answers

Operator

Thank you. (Operator Instructions) The first question is from Bruno Giardino of Santander. Please go ahead.

Q - Bruno Giardino {BIO 15974970 <GO>}

Hi, good afternoon everyone. Congratulations on the results. The first question, you still guide the market for potential delivering 40,000 lives, gross lives per month, potentially increasing to 45 next year, about considering the change in the economic situations of Brazil what is the level that the company could reach and what is the level, if you were an analysts you would consider in our earnings model for next year? That's the first question.

A - Wilson Olivieri {BIO 17325685 <GO>}

Bruno, thank you very much for being here with us. Thank you for the question. Yes, you're right. As I mentioned during the call with the average 37,000 lives per month that we have reached in the third quarter, mostly due to the general macroeconomics scenario that we experienced surely we won't be able to make 40,000 lives on average per month this year. So, our expectations for this year considering what we know so far in terms of gross adds and in terms of churn, would be close this year at around anywhere between 85,000 lives to 90,000 lives of net adds. That would represents a growth a little under 7% and if you look at the gross that side, that means, you would be missing our original target by about 10%.

So, for next year what we've been working on here is there is no sensitivity scenario that we work internally. That would drive us to a performance that would be lower than what we did previous in 2013. So if you were working on sensitivities, I would recommend you to go at least at an average of 36, 37 new lives per month. With the churn, which this year should be close anywhere around 21% to 22%.

If you want to be a little bit optimistic, which is what we are targeting here, and what we are pushing our sales force to do it, the same target that we had till 2014, we want to meet that target in 2015, which means if we can and the economic scenario allows us, we would love to reach out to anywhere like 40,000 lives per month. But, more important than all of this and we've been discussing that a lot with the market is the qualification of the sales. As I said on the Portuguese call, this is being our major targets here internally. And the biggest challenge will be to sell the right product to the right people in the right place.

In other words, we had a conclusion of a very important project that we put together here called NPV that stands for Net Present Value. And through that project, we were able to identify clearly, what are the products that brings the better benefits to Qualicorp, what are the regions where we can get better benefits, what are the main providers in the main professional association.

So, with all of that intelligence, we are targeting our sales target for next year. So, our sales people will have a specific products that they will be allowed to sell in a specific region. They will be either awarded or penalized if they don't follow that trend. And those projections will bring us a much more qualified level of sales which most likely have a much better performance in terms of early stage churn. So, if we can do, let me give you that perspective. 36,000 new lives per month, fully qualified. That means my churn could me much lower than not really expressed this month. I could 40,000 not so much qualified as a higher churn, get at the same net adds level costing a little bit more money.

So, this is the secret that we are currently discussing internally. We are going through the 2015 budget. And as I said to you the list that we expect from our sales force is a performance not less than what is experienced this year potentially with certain addition on a qualified basis.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay. That's very clear. Just to make sure I understood everything, in the scenario that you delivered 36,000 lives, fully qualify and with lower term potentially your operating margins will be higher, is this right?

A - Wilson Olivieri {BIO 17325685 <GO>}

Yeah, you're correct, (inaudible) but don't hit your margins immediately, because, as you know, qualified sales, imagine the following. We have 1.9 million lives on the portfolio that carries the majority of our revenue for next year, is that correct? So once I start adding new lives qualified, and I'm churning lives let's put that way not qualified, that in fact flows through the results on a slowly base. So, you would not have like a 100 basis points of gain just because I changed my structural in sales. But, I would be growing towards the right flow of sales that would allow me to take benefit on a medium-to-long-term, not on a short-term.

Q - Bruno Giardino {BIO 15974970 <GO>}

Understood. And just a second question, could you please give us the breakdown of the amount of lawsuits related to the collection of overdue receivables. This is the force that you did have made successfully on collecting these receivables?

A - Wilson Olivieri {BIO 17325685 <GO>}

Sure. The balance that we've experience on this quarter, the effect of the lawsuit is absolutely minimal. We had not experienced much, although very candidly this year we currently have a little more than 600 cases of lawsuits referring to our strategy of blacklisting. We have on the prior quarter, not this quarter but the quarter before, we have increased our contingencies on our result's by BRL1.8 million to cover for those.

So this is all we have so far, we have not paid much of those right now, what we have the increase you saw on the lawsuit balance year mostly refers to civil lawsuits regarding people that wants to be server, but they were not that we are caught on the action as a partner of the provider that we decided to cut down, things that could take forever and then we decided to slow down the process. So that's why we invested certain amount of money on that line, but it's not coming from lawsuits regarding bad debt yet.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay. So this 1.8 million would be an increase in the inventories of cases or is it the total amount that you have now for the 600 cases?

A - Wilson Olivieri {BIO 17325685 <GO>}

Yeah, the 1.6 was a reflection of the six allocations that was accounted for on the second quarter, not on the third quarter.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay.

A - Wilson Olivieri {BIO 17325685 <GO>}

Okay.

Q - Bruno Giardino {BIO 15974970 <GO>}

Thank you, Wilson. Have a good day.

A - Wilson Olivieri {BIO 17325685 <GO>}

Thank you.

Operator

Our next question is from (inaudible). Please go ahead.

Q - Unidentified Participant

Hi. Thanks for taking the question. I had two questions. First, I wasn't able to understand what you said on the re-classification of the occupancy expenses. Could you explain that a little bit more, please. I'm not -- I wasn't clear on what you said, I apologize.

And then, also on the personnel expenses, you had indicated that there is an annual salary adjustment. I'm trying to get an idea, is that annual salary adjustments (inaudible) occurs every year at this time and this is typically amounted the same percentage increase each year and how should we think about personnel expenses as a percentage of revenues going forward?

A - Wilson Olivieri {BIO 17325685 <GO>}

Okay, Brad. Thank you very much for being here with us. Thank you for the question. So, on the occupancy, it's very simple. We moved offices from old facility to a new facility in the last, I would say, six months, because we have a fair amount of people just (inaudible) more than 12,00 people have been moved. So, it takes a while. We can only move on weekends. So, it took a while until we could move them all.

So, once we had the expenses of the new offices starting heating our P&L, we did not know the area that each one of the different cost centers would be using. So, in the last quarter we allocated 100% of the expenses, occupancy expenses of the new building into general and administrative expenses. So now, during this quarter that we have allocated all of our employees, we know exactly which area each one of the cost centers us currently using. So, what we did is, we re-classified accumulated balances of the new building occupancy expenses through the specific responsibilities. So we took it out of general and administrative expenses and it will be on the different areas that are being allocated in the building. Is that clear?

Q - Unidentified Participant

I think I've got it. Yeah.

A - Wilson Olivieri {BIO 17325685 <GO>}

Okay. On the personnel expenses, the answer to your question is yes. In Brazil, because not only salaries to be honest with you, our revenues and our prices are also, everything is adjusted based on the current inflation index of the economy every 12 months. So, salaries have an adjustment, our prices are adjusted. The only difference here is, our prices are adjusted based on the medical inflation, which is in general higher than the general economy inflation. And salaries are adjusted in line with the general inflation.

So there is an idea for this year, our salaries and this one salary that you see adjusted in August that heated us this quarter, is only for a part of our employees. We have another part of our employees, they have their salaries adjusted in January. So that happens every year as everything in this country, rent and you name it, anything you want is adjusted every year by the inflation rate.

Q - Unidentified Participant

So, as a percent of revenues on the cost of services personal expenses would still -- we should model going forward somewhere between what 7% and 6.5% of total revenues, does that sound right or you are to able to give that kind of specific guidance?

A - Wilson Olivieri {BIO 17325685 <GO>}

No, it's still there, but if you are looking to put that into a model I would recommend you to keep the same percentage of revenue that we've experienced this quarter, you would not make a big mistake on those salary lines.

Q - Unidentified Participant

Okay, great. Thank you. I just had one more question. You had spoken a lot in the past when I'd spoken with the Investor Relations people about the geographic expansion that the company is undertaking and as a way to increase your membership and talking about some of the different approaches that you've taken to do this versus what you've done in the past. I was just wondering if you could give us a little bit of an update on how you've done so far with that and what type of progress and success you've had?

A - Wilson Olivieri {BIO 17325685 <GO>}

Well, thank you, that's a great question. We have two situations in terms of expanding geographically, we had the growth of the branches that we've opened late 2012, early-'13 and you're talking about four branches in the most important capitals of the country, such as Curitiba, Porto Alegre, Recife and Belo Horizonte. Just to have an idea, Belo Horizonte is the third largest healthcare market in the country and we had no activities there, what so ever that you were doing last year. So these branches are maturing and as they mature they contribute more and more with new lives into the system.

And just to have a reference, the two units that the two branches that we have, there are about six to seven years old by now, which is one in El Salvador, which is buyer and another one in Brasilia. They are both contributing at an average of about 3,000 lives each per month, so imagine if we can have this other four reaching out that level once they become mature. The reason I say mature is because due to our business model we don't just go to a new city and start selling 10,000 lives immediately. We need to negotiate to operators to offer more products to that specific region, we need to negotiate with a professional association. So we can have more professionals associated to our system. So, once you mature this new markets, we have capacity of producing more and more lives. So, this is one of the segments where we grow geographically.

The second is, we've opened this year five new franchises. It's an another way that we are expanding our business geographically. So, these franchises will be producing a fair amount of new lives for next year. And we do have expectations to open at least another five new franchise areas for next year aside of other projections. So, just making a long story short, if you look at the prior report that we -- the earnings release that we put together, three quarters ago -- I would say, four quarters ago, our participation of Sao Paulo and Rio into the sales group was about 77%. And last time, we reported, which was two quarters ago, that was already down to 70%.

So, that shows how effective our expansion geographically being in effect. We, just so you'll know and everyone in the call, we've stopped showing that detail on our releases, because we felt that was too much of a new strategic information. So, some of our competitors could take some good things out of that. So, we decided to stop showing that. But still, we're growing outside of Sao Paulo and Rio a little faster than we grow Sao Paulo and Rio.

Q - Unidentified Participant

Okay, great. And I just have one more question if I may, if you don't mind. I regard to the churn this quarter. I know that, you've changed around some of the way you deal with your brokers in your current broker relationships by trying to get a more quality sale. Is there any way to understand whether or not this is exacting your ability to add gross lives and whether or not it's increasing your churn as perhaps you maybe have eliminated some of your historical broker say, you depended on for your growth. Did, that question make sense?

A - Wilson Olivieri {BIO 17325685 <GO>}

Yes, it does. But, prior of answering that question, I would have to give you a background which is the following. The more we want to be qualified on our sales, that's our strategy, but here in this country, we cannot refuse selling medical plans to any one that wants to buy a medical plan. So, I'll give you an extreme of a very old gentleman. Let's say, 90 years old, that living in a CGI of a hospital. If he wants to buy a product from Qualicorp, even though he's not the best qualified customer, we need to sell him that. That's the regulation that we have. The only protection that the system has, we would be allowed to flag him for waiting period of 24 months regarding pre-existing diseases, that's the only protection this system brings. But, the system here in Brazil doesn't allow me to refuse selling anything. So, the qualifications that we put down in the market is more regarding our strategy in terms of where we want to sell more and of the kind of products we want to sell.

So, to your point, of course, if I -- there is a saying he in the market that's it, it is funny if it was not tragic but it says the following. The best way for you to sell medical plan, you know what it is, it said the emergency room of a hospital, because everybody there needs them a medical plan. Of course, that's not the best way for selling, it would sell a lot of plans on that facility, but that's not where we want to sell because we wanted to be qualified.

So the more I qualified my sale and the more I restrict the level of the addressable market, of course, I have some effect on our gross debt. But again the strategy that we have here is selling more and qualified, so it's a very big challenge, and this is the challenge that we are imposed to ourselves and to our sales team, selling qualified lies at a higher pace.

Q - Unidentified Participant

Okay, all right. Thank you very much, I appreciate your answers my question.

A - Wilson Olivieri {BIO 17325685 <GO>}

Well, you are very welcome, it is if there is anything that you have more questions just give us a call.

Operator

Our next question is from Rafael Frade from Bradesco. Please go ahead.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi, this is Rafael Frade. Just a follow-up, you mentioned that you are working with new products for the next year, to be able to sort of direct sales. I think that one product that we have been hearing rumors that maybe the America would come back to the Affinity market. I think that would be a product that would be very, very well if you're starting other places outside Sao Paulo and Rio. I would like to -- if could give an update on this specific product, if there is any negotiation on site.

And also, other potential products if you can give some details of which kind of other products would make sense and you would be working on two have for the next year?

A - Wilson Olivieri {BIO 17325685 <GO>}

Rafael, thank you for the question. And to be very candid with you, we are always looking for new products, new opportunities in new areas that we can offer to our customers. So you could potentially say that most of the time, we might be negotiating here and there with most of the providers that you can find in the market, but if I see an opportunity in Manaus, and I don't have coverage in Manaus. And I'd say, I'm here with the only choice we have in Manaus either a negotiate when you always with a local provider like we did with (inaudible) recently at the Northeast, which is one of the biggest providers in the Northeast, who we did not have relationship before. So I would not say that, we are not negotiating within anyone else, we are negotiating with several other providers, Intermagic [ph], there could do one of those. And if we can get into a reasonable agreement as we've got with all other providers that we currently have, why not selling Intermagic. What I can tell you was, in the past, that's public. We had Intermagic products in our portfolio and we stop selling because of the negotiation price adjustment at that time. We could not reaching an agreement. So, if we can reach a reasonable agreement with good products at good regions that we could sell, why not. So, that's how we behave.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. That's perfect. Thank you.

A - Wilson Olivieri {BIO 17325685 <GO>}

Thank you.

Operator

This concludes our question-and-answer session. I'd like to turn the conference back over to Mr. Wilson Olivieri, the IRO for any closing remarks.

A - Wilson Olivieri {BIO 17325685 <GO>}

So, thank you very much operator. Thank you all for being here with us for the patience of listening to our call. As usual, if you have any further question, myself, Gabriel and Jose will be available any time and we wish you guys to have a great weekend. Thank you very much.

Operator

The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.