Y 2013 Earnings Call

Company Participants

- Eduardo Noronha, Chief Operating Officer
- Wilson Olivieri, Chief Financial Officer and Investor Relations

Other Participants

- Carlos Macedo, Analyst
- Josh Milberg, Analyst
- Matthew Pascale, Analyst
- Rafael Frade, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Qualicorp's Conference Call to discuss the results of the Fourth Quarter of 2013. We have with us today Mr. Wilson Olivieri, the Investor Relations VP, Mr. Eduardo Noronha, the COO and Ms. Natalia Lacava, the Superintendent of Investor Relations.

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 would now like to turn the floor over to Mr. Eduardo Noronha, who will start the conference. Mr. Noronha, you may proceed.

Eduardo Noronha {BIO 15227354 <GO>}

Okay. Operator, thank you. Good morning everyone. Once more, I would like to thank you all for participating on our fourth quarter of 2013 and full year earnings release call. We have here Mr. Renato Velloso and Alex Oreiro that just joined us in the last week and they are here with us today.

The year of 2013 was very challenging year in both internal and external aspects along with macroeconomic conditions. I would like to say that we are very proud of the results we reached not only because of the consolidated number, but also due to the evolution we had in every single quarter of 2013. The results reinforced our conviction that we are in the right path and a good plans, which we have been implementing with lots of discipline.

We faced challenges in EBITDA, price adjustments, churn and sales suspension. And internally speaking, we have the integration process of Padrao and Aliancas companies acquired in the second half of 2012, the implementation of new management tools -- tools have matrix management of expenses, remodeling of the profit sharing plan, organizational restructure change, development of new IT platform, collection of late payments and et cetera. In this environment, we are able to focus on managing all these variables and even so improve the company's performance. Wilson will present you in details as usual, but I would like to highlight some of them. We reached the best EBITDA margin since IPO growing 300 basis points compared to the last year even considering some ultra [ph] positive effects, we did 200 basis points over 2012 margin.

Our net revenues grew 30.3% and the total expenses increased by 21.6%, which allowed us to increase the adjusted EBITDA end 41.7%, which is a significant efficiency gain even investing in the consulting support and in the management team to improve this process.

In Affinity segment, we had net additions in health life of 107,000 lives slightly lower than our initial expectation, but compensated by the price adjustment. The average monthly gross sales were higher than 35,000 lives in the higher end of our expectation for the year, which were from 30 to 35,000 lives. Recovers of bad debt in the fourth quarter of 2013 was almost 50% higher than the third quarter and three times higher than the history before we started our collection initiatives.

In the Corporate segment in 2013, we focus on the profitability of our portfolio making, which allowed us to stable figures regarding the number of lives, but with 11.6% growth in revenue when compared fourth quarter of 2013 to fourth quarter of 2012. In other words, we have implemented in all business lines, the improvement sorry. In other words, we improve it -- we had improvement in all business lines, which make us more confident to face the challenge of this year. Here you will also notice in the following remarks that we will bring some news about dividend policy and approvals on ADR launch, which will also reflect in the results not only this year, but also for the coming years.

Now, I would turn the word over to Mr. Wilson Olivieri to detail our results this quarter and before the Q&A session, I will share with you my closing remarks. Wilson, please.

Wilson Olivieri {BIO 17325685 <GO>}

Thank you very much, Eduardo. Thank you all for being here with us today in this morning and hopefully going to get the best part of the next hour. I'd also like to formally welcome our two new friends here with us on the call Renato and Alex welcome to the team and you are now part of this group of people that you are talking today. So if you could please bear with me on the presentation that we have shared with you through the Internet.

So, starting page number three, I think Eduardo already gave a pretty good briefing of how our main indicators performed in 2013. So please if you could go to page number four basically what we see here is that we have reached almost 4.6 million lives in the total portfolio of the company for a CAGR of more than 15%, if you consider since fourth quarter 2010 of course that includes some of our acquisitions. So, it shows the pattern of the growth in total number of lives especially if you look at the Affinity, we are pretty close I think probably this year of 2013, we've had hoped that we will reach the point of the mark of 2 million beneficiaries there. So, this is just a graph demonstration.

If you could please move to page number five, then we have a more detailed description of how our number of lives performed. So, I think a few numbers to highlight here. If you look at our gross adds number for the fourth quarter that are little more than 100,000 lives for the year -- for the quarter that represented a growth of like 22% if you compared to the same period last year bringing a total portfolio of Affinity health lives to almost 1.4 million lives representing growth of 8.5% versus same period last year.

And as you'll know, this represent-- this is the core of our business representing 92% of our net revenues as we'll see shortly in another schedule. So, that almost 4.6 million lives that I mentioned to you showed an increase of a little more than 5% for this year when compared to prior year. And if you had -- and it's not on this presentation, but If you look at our earnings release, you will probably saw an additional information that we've added to share with you referring to the regional performance in terms of our portfolio there. So, I think it is an interesting schedule to look at that shows how our regional sales are performing and how we are developing on a regional basis.

Page number six, we start actually looking at the P&L. So, we see net revenues at R$333 million for the quarter growing almost 29% compared to the same period last year. But most importantly, it shows growth of 30% when you compare this indicator with the same -- with the last year 2012. And as I mentioned to you in terms of revenue the -- just the Affinity segment in the fourth quarter represented 310 million of the 333 total, which is 92% in line with the total year of the total revenue generated. Growth here is very interesting.

Another point that I -- is interesting to highlight on this schedule is if you look at the total revenue of 2013 for Corporate and Others so as you can see there we are getting pretty close to a business of R$100, which adds a lot more in terms of number of lives then it does in terms of revenue, but as you all know it is very important to our business model.

In page number seven, if we look the cost of service details I think the most important comment here is regarding the growth for the total year. So we have increased our total expenses on those lines by 24%. This as you know are mostly variable expenses. So, having said that for a growth of revenue of 30% it shows how we're able to manage those expense lines in terms of increasing productivity in the structure [ph] in such a way that our gross profit for this quarter actually increased to 75% of net revenue.

Switching now to page number eight, in the administrative expenses, we see here two lines that I think are important to mention. Number one, in personnel expenses, you will probably notice there an increase versus prior quarter of like 24% and the majority of that change refers to the profit sharing program of the company. If you remember, during most of 2013, we were sharing with you gentlemen the expectation of how our margin should increase and we were targeting to levels of a 100 to 150 basis points of growth.

So, the numbers here that we are showing today are showing a fairly higher increase than that mark. So, therefore the executives and the teams in Qualicorp was entitled to a higher share on this program and the profit sharing the reason, why we hit the most of the -- the adjustment, we hit all of our fourth quarter.

If you look at the third party services as well, you'll see an increase of 35% and the majority of this increase are coming from consulting companies that we have engaged to help us on the collection prices. So, some of the R$3.7 million that is collected that helped our PDA this quarter actually part of it is paid as consulting fee to the collection companies that we engaged in supporting this on that. Bottom line, all-in [ph] it shows that our total growth in fourth quarter '13 versus fourth quarter '12 for the administrative expenses was about 19.3% considering these two major effects that I think are important to highlight.

Moving to page number nine on our selling expenses, a couple of points here to highlight. Number one publicity and advertising, as you can see in the fourth quarter reached almost R$11 million, but if look on that very same line on a total year basis at a R$35.7 million. It shows that our growth on that line versus last year was only 11.5%. So, this is another situation, where we leverage our costs. This is not even fixed or variable. This is what we call discretionary costs and have this pushed on the fourth quarter of the year it goes pretty much in line with the history of the company, where we push a little bit of marketing initiatives in the fourth quarter so we can start early in the next year with a better sales development.

Finally, in this graph, as you can see total all-in has grown only 21.8%. These are mostly variable expenses even considering sales growth at a higher pace than that.

In page number 10, the bad debt or if you will uncollectable receivables has shown a pretty stable performance especially versus prior quarter -- the last quarter of last year. But it is important to emphasize that we -- as we described on the release, we have accounted for this quarter for R$3.7 million of write-off on our accounts receivable from receivables that we expected to receive from prior periods, but they were not collectible anymore. So, if you were to exclude that adjustment, our PDA as a percentage of net revenue would be 7.2% showing some improvements on the collection process especially if you look on the second chart slide -- second line of the information here on this slide, where you see coincidentally number 3.7 is the same, but it's another subject.

We were able to collect R$3.7 million additional, which was growth or the same indicator versus last quarter of 47%.

If you are on page number 10 on operating income and expenses, as you can see this is probably where we have a few adjustments that we had to explain. So, we starting on the expenses related to contingencies the R$10.4 million that you see there. The majority there, which is R$6.7 million is referred to the following. When we acquired Alianca, Alianca had their operations in the capital of the country, which called Brasilia and they were invoicing some of the revenue out of another city that had some tax benefit. So, once we acquired the company we started accruing for that difference assuming that this would be a possible contingency to the company.

Earlier this year was not late last year, earlier this year, we've had received signs of the capital of the city the country called Brasilia that they would approve a movement, where we would switch all of our invoicing process from this other city to Brasilia at the same rate that we are currently paying. So having said that, that allowed us to change the qualification of the contingency bringing that to a situation, where we could we were allowed by the lawyers and the auditors to reverse that contingency. So, that accounts for R$6.7 million worth of tax reversal in contingency for 2013 for Alianca.

Moving to the second line with this the same slide called constitution of tax credits on subsidiary the R$6.7 million that refers to taxes that Qualicorp was paying of severance packages of employees that left the company, which according to a consulting company and a group of lawyers we hired we are not necessarily to pay. So we were able to create a case put it out to the court and we've received an authorization from the lawyers and the auditors to actually go after that amount. So, we truly have a R$6.7 million worth of payroll taxes that has been considered in the fourth quarter that will be receivable to -- for the company.

And finally and not the least, the R$4.3 million in operational losses, which is happened to be a gain at this quarter. It was first the relationship and the conciliation of balances that we carry on a monthly basis with our operations -- operators so certain quarters we had debit in that account, certain quarters we had a credit in that account, but the most important thing is this happens all the time. It's part of the operation of the company. The reason why when we suggested on our earnings release that we should probably not consider recurring only the tax issue from Alianca and severance gains on payroll taxes. We do not suggest to exclude that amount, because we consider that to be operational. So that's a fairly quick summary of why we had other recurring expenses coming out of the R$20 million credit this quarter.

Moving to page number 11 in terms of financial income and expenses. As you can see the income from short-term investments, we saw a fairly interesting growth in fourth quarter '13 when compared to the same quarter last year mostly due to two factors. First, we will carry a larger balance of cash throughout this period. And secondly and as important the Brazilian government has increased interest rates, which actually help us on that line.

In terms of interest expenses all we have on our balance sheet currently are interested accruing on the debentures that we have payable, which should be over by next year. But the most important adjustment in this slide that I think it has to be detailed refer to the monetary adjustment from call option especially at Alianca. So, considering the evaluations that we had in the third quarter, Alianca was targeting to an EBITDA for about R$47 million out of which we should pay 9.5 times for the evaluation. In the fourth quarter, we would assume additional inputs one the taxes I .just mentioned to you, which represented $R6.7 million.

And a couple of orders that were commissions that Alianca received for migrating a few number of lives from Unimed Centro-Oeste we call here that company actually went bankrupt and so we had to switch those lives from that operator to a few others in exchange to that, we receive additional commission from those operators.

And we also had one specific professional entity from Alianca; they had to go through the same process. They had another operator. They decided to switch. So, they both hinder our first quarter results on Alianca, on an average about R$5 million to R$6 million. So, if you consider these two events of migration of lives together with the ISL -- the tax issue that I mentioned to you that added about R$100 or so million to the evaluation of Alianca. The reason why we had to more internally adjust our results of this number you see here R$144 million for that side.

That means Alianca evaluation at this point of time, if you do the math, it's very easy. We are talking about a company that's currently worth about R$600 million in total.

So, moving to page number 12, a quick look at EBITDA. I think Eduardo already gave the most important highlight. All I would like to add here is that we are looking at EBITDA for 2013 adjusted of R$450 million, so we are almost at a R$0.5 billion point representing margins of 37.6% out of which if we exclude what we considered to be extraordinary items here we would still be generating approximately 200 basis points versus prior year, a little bit higher than the indicator that we have given in the market in -- during the year.

Getting close to that, if we look at the adjusted earnings again here we see starting out of our net income reported of negative its R$41.2 million. If we were to adjust by the monetary and some non-cash item on the call option, we'd be looking at a potential adjusted earnings of almost R$108 million that would be on a per share basis at R$0.39 per share. It's still another analysis that we added this quarter to the system. If you look at the total cash earning analysis, you'd be looking at a potential cash earning of like R$160 million generating R$0.68 per share in terms of -- that -- this slide actually shows how strong is the cash generation capacity of this company today.

Moving now to the -- to page number 14 in line with what we've been telling the market. We have invested in CapEx outside of acquisitions or others R$51 million this year, most of it almost R$36 million coming from investments on our IT platform and the remaining R$15 million the majority of it refers to initial investment that we have started on our new headquarters, which should -- we should be moving somewhere this quarter -- second quarter 2014 to a facility, where we're going to have all of the employees working together no longer in two different buildings separated so we expect to generate a few efficiencies out of that move.

Still in page number 14, if you look at the capital structure, the most important point here is the fact that we have reduced especially due to our cash generation facility, our net debt by almost 16% to a current R$373 million level.

Page number 15 and the last one on this presentation, we added to our investor community a calculation regarding return on invested capital, which we believe shows very well to all of our investors that how productive our acquisitions have been performing especially when we put some of them in the intangible line. So, we have increased on the fourth quarter '13 ROIC to a level of 28.1% this time considering that in the last quarter this -- last year the same quarter, we are looking at almost a 26% on that indicator. So, to finalize my session on this call, I would like to add a couple of comments aside the fact that we had the two new executives here with us today. The comment number one refers to the new benefit administration company that we received all of the approvals from the regulatory agency ANS. So, we are now officially operating out of our new company called Clube de Saude, where we're going to offer products at cheaper price for C and D class customers and that we will also be a great tool to retain customers that would be willing to catch on us looking for cheaper products.

We have also got two approvals from our Board during this last quarter. Approval number one referring to the launch of an ADR program in U.S. We are now in the process of waiting for the regulating organizations to give us the final approval, which should happen within the next 30 to 45 days. Once that received, we would be ready to launch ADRs in New York shortly.

And finally and probably one of the most important points of this call, we have also approved with our Board and I remember to have had this discussion with some of you on the call individually. We will -- from now on payout dividend at a minimum of 50% of our accounting profit. Regarding the fact that we should keep on our balance -- cash balance a minimum of 10% of our total revenue estimated for the year. So as I shared with you with in the other opportunity in 2014 due to the payments we are doing for Alianca and for the debentures in August so cash should be a limitation factor for that. So, if we had any dividends payable in '14 it would be mostly relevant, but and it's definitely a very important issue for us to look at in 2015.

So having said that, I'll give the word back to Eduadro for his final remarks before the Q&A session. Thank you.

Eduardo Noronha {BIO 15227354 <GO>}

Okay. Thank you Wilson. Before we move to the Q&A section, I would like to share some of our expectation for this year and take a chance to answer some questions that we have received since last night. Talking about gross sales in Affinity segment, we expect a gross sales around 40,000 lives per month and net additions in half Affinity is expected to grow around 8% to 9% of our portfolio this year. We expected to improve EBITDA margin by 100 basis points over 2013 and I'd like to highlight that 2013 without the punctual effects are 36 -- it's 36.5%, it's a new level of EBITDA margin of our company.

We will resume growth in the Corporate segment, the reason -- the reason why we brought Renato Velloso to the team, who have a strong background in this segment. We are implementing the ZBB, zero-based budget in 2014 as we are planning to implement, which should boost even further our results through the optimization of resource and focus on our core activities. And we launched our first three new programs this year. We started with more than 8,000 candidate -- candidates registered and four months later in the process, we approved seven high potential new professionals, which are aligned to -- aligned with the (inaudible) culture, we want to enforce within Qualicorp.

And lastly on (inaudible) our institutional authority, we presented in the end of December all documents that was required and we believe that there are chance to having our case judged in the next quarter, in the second quarter of 2014.

I'd like to thank you all for participating. Let's move on to the Q&A section.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) Our first question comes today from Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good afternoon, gentlemen. I have a couple of questions both related to growth and expectation to some degree. The first question is actually looking back total lives or net lives and they are certainly greater than half a percent in 2013. Could you give us some color on what was actually organic growth in the regions that you already had a presence? I know, Wilson you mentioned the graph or the table in the release that's actually very useful? How much of that growth came from the existing businesses or existing locations, where you already serve and that was driven by your expansion into these other regions particularly in the South of Brazil and regions outside of say, Rio and Sao Paulo here in the Southeast. And what are your expectations for 2014 given that you once again you're guiding for that 8% to 9% growth in the number of lives?

And the second question is, if you give us some color in the first quarter given that we're 10 days away now from the end of the quarter. If the trends that you saw in the fourth quarter are now carrying forward given that also it appears that the Brazilian economy continues to be somewhat sluggish?

A - Wilson Olivieri {BIO 17325685 <GO>}

Well, Carlos thank you very much for being here with us in the call. Thank you for the question. So, as we've probably mentioned in page number four of the earnings release for the ones that had access to that. It shows clearly how our performance is behaving when you consider 2013 versus 2012 so I think we see the trend that we expect to happen geographically speaking. In other words, you will see that participation of region Sao Paulo and Rio coming down to '12 from '13 over '12 from 77% of the total to 70%.

And we see also this change being absorbed by other regions like as you can see the South region, where we had not in '12. It already represented 2.5% only in one year so imagine the potential that we see there on that region. We also see of the Southeast, where you see it going from 1.2% participation to 3.6%. So, these are definitely by far, the two most interesting regions that we have to develop.

But there is one comment here that is very important it does not reflect a change that we expect for this year, which is in the Northeast region, where it actually dropped from 10.6% participation to 9.2%. And the main reason why that happened is for the ones that know Brazil, we know the Northeast region is where we have the largest majority of C and D class customers, and I don't think we had good products for them during this year.

Now with the launch with our -- of new Clube de Saude benefit administration company, we expect to incentivize sales on those regions. So, you will should be able to see in the next report Northeast growing further than what you see in this schedule. But in general if you consider the ramification in terms of geographic expansion coupled with a few other strategies or distribution channels that we are implementing naming franchisee systems, which we are final year on this segment in implementing. And developing and further investing in other channels such as telemarketing and Internet. All of this together gives us a fair amount of comfort in terms of the expectations we are sharing with you that not only I just mentioned. So, I hope, I had answered your questions on those.

Q - Carlos Macedo {BIO 15158925 <GO>}

Yeah, absolutely. On that just -- I mean wouldn't given the Clube de Saude and your presence in all these other markets that's growing. I mean -- I'm almost reading that you are being conservative with your estimate of 8% to 9% in terms of growth in Affinity lives. Is there the possibility that we get -- that we get -- is there upside risk to that number? And would it come from the new businesses or from organic growth within the existing places where you already do business?

A - Wilson Olivieri {BIO 17325685 <GO>}

Well for 2014, we expect this growth to come from the business we already have. We would not have any new business. But one of the things that we are sharing with our investors all the time is we have to be a little cautious for this year 2014 in Brazil especially because we're talking about a year that has two major events with no President happening together, which means the Soccer World Cup that as you all know.

Just to give you a quick perspective, we are trying to figure strategies regionalize for how we're going to attack the market according to holidays and soccer day -- days, where soccer games will happen and there are still series in this country that have not decided if they are going to have a holiday or if they are going to just escape people from working. So imagine this is the environment where we are working. So 2014 will surely be a very challenging year.

And other reason why we should be careful on our projections for those indicators is that a health inflation in Brazil is too pressuring the system quite a bit. So if you remember in the last couple of years, we had already passed through a double-digit price adjustment and we do not expect 2014 to be different than this last couple of years. There are actually chances of the price adjustment to be even higher than that, which would probably on a short-term be good for our results as we had like third quarter last year.

But in the medium to long-term, it would hurt our churn, while even with all of the programs that I have implemented if we give price increase on a double-digit basis again we should be careful on those projections. So that's why we are looking at this growth similar to what we've experienced '13 versus '12 so we expect '14 versus '13 to be about the same, but on a more challenging scenario in both indicators.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you. And now Wilson just quickly if you could give us is that the first quarter coming along similar to the fourth, is there something that you can talk about?

A - Wilson Olivieri {BIO 17325685 <GO>}

Absolutely. We should see fourth quarter being pretty much sorry, but we should see first quarter 2014 sorry did I say that being pretty much in line with our expectations. So, we do have a seasonal effect in the quarter as every year because you have vacation time so you don't find the brokers to sell or the brokers sometimes don't find the customers so that's very normal. And so considering the fact that we should also see a better performance of our churn, you should expect net adds around the same as you saw in fourth quarter given or taken a couple of lives -- a couple of thousand lives here and there, but that's how we see top line.

In terms of bottom line, we are pretty much in line with our budget and with our expectations. So, we are hopeful to be able to show interesting results this quarter in terms of in line with the margin expansion that we are sharing with you in the market.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you so much.

Operator

Thank you. Our next question is from Rafael Frade with Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi, good afternoon, everyone. I want to discuss a little bit on delinquents I would like to understand what was this write-off -- this one-off write-off that you had in the quarter. In addition, if you could walk through the change that happened in Rio de Janeiro and in the way that it's accounting that in Rio de Janeiro and the impacts on that?

And finally, when we in the Portuguese conference call and now also you mentioned a 100 bps improved in margin for 2014. I understand that this does not consider any change in delinquents. So if you could give us some idea of how you are seeing delinquents evolving during the year?

And second question in another subject would be a follow-up on question in the Portuguese conference call about the new sales fee you mentioned that there were some specific revenues coming from the integration of some portfolios. But even if we exclude that this line had a huge increase even if you look for the -- in the entire year. So, if you could help us sort of understand how this could evolve during 2013, improve in 2014, I think that most people will look for this line as a -- as revenues in relation to gross adds. I would like to understand if the level presented in the fourth quarter is a new level or what would be the appropriate level to work for 2014?

A - Wilson Olivieri {BIO 17325685 <GO>}

Okay. Rafael, thank you very much for being here with us. Thank you for the questions. So, I'll try to answer lot of them keep controlling me, if I miss anyone you jump in. So, starting on delinquency, the R$3.7 million of adjustment. Just to have an idea, we have situations with some of our main area there, but we have situations where some customers of Qualicorp they go to court for instance, when they receive a price adjustment for age reasons.

So, a guy just turned 59%, every guy that turns 59 -- I mean, 59-years-old sorry as I mentioned we've got to talk you is about other thing is a mess. So when anybody turns 59-years-old, that's the last age, where Brazilians receive price adjustment. So, let's say, he gets a price adjustment of 20%. For some reasons, he feels that not -- that's not fair, he goes to court and judges in Brazil tend to be very favorable to individuals. So, the judge says, okay, I will not allow the operator to impose that adjustment to you. So, then we have a situation, where a guy was paying R$100 per month, he was supposed to pay R$120 per month and so therefore the judge says, this gentlemen will pay only R$100 per month.

So, we have a discussion with the operators on that front, where they would try charge for us on the R$120 basis and we will try to discuss with them that we have a situation, where the judge is imposing that on us. So, there are certain situations, where the case or and that's the true negotiations, it's not a court decision between us and the operators. There are situations where we win the case and there are situations, where the operators impose and they say, okay price -- final price is your responsibility. So, therefore the judge is telling you not to charge them this extra R$20, it's your promise not mine. So, only that has built on our balance sheet a receivable of R$3.7 million that until last quarter we thought they would be receivable.

We have our legal department and operation guys discussing with some of our operators and we've concluded that out of this balance R$3.7 million are no longer receivable. So, therefore we decided, as you all know, we have a very conservative accounting procedure. So, we decided to write-off that balance so this is exactly what this R$3.7 million is. So, that's why they go against bad debt because this is the line we accrue the debit. Was it clear?

Q - Rafael Frade {BIO 16621076 <GO>}

Yeah, it's clear.

A - Wilson Olivieri {BIO 17325685 <GO>}

Okay. So, second is and the changes on the collection rule that we had in Rio. We had a fairly large amount of lives in Rio de Janeiro, where instead of having -- giving them a 30 days periods for collection, we were giving them 60 days. So, in November we'll cut them down to 30 days all of them. So, we had built into this numbers an additional 2,500 lives that we believed it's not a scientific number, that's why we are not disclosing that on the package. But we've estimated that it's about 25,000 lives during the quarter that did not that were an extra churn that we generated because we credit [ph] people from 60 days churn to 30 days churn. So that's supposed to be a one-time adjustment so you should not see those on our reports anymore. That's --

Q - Rafael Frade {BIO 16621076 <GO>}

Sorry Wilson just about that -- so is that just already happened in the fourth quarter or should happen in the first quarter?

A - Wilson Olivieri {BIO 17325685 <GO>}

That is correct it's already built into the fourth quarter numbers.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay.

A - Wilson Olivieri {BIO 17325685 <GO>}

Okay. And the other question was the change in the -- of the new sales, yes that's -- I couldn't understand why I wrote like that. So --

Q - Rafael Frade {BIO 16621076 <GO>}

Sorry, Wilson.

A - Wilson Olivieri {BIO 17325685 <GO>}

Yeah.

Q - Rafael Frade {BIO 16621076 <GO>}

Just on the delinquents there last question would be the perspective for 2014?

A - Wilson Olivieri {BIO 17325685 <GO>}

Right. So the perspective in delinquents for 2014, I'll share with you exactly what we're doing here internally. As I mentioned to you, the World Cup and the Presidential Elections on a very challenging scenario in Brazil. Our -- we are still waiting to see what the final effect those events will cause on our numbers.

So having said that, even with all of the collection performance that we had experienced in the past two quarters even with all of the actions we still have to implement, we are looking at a percent -- as a bad debt as a percentage of net revenue in line with 2013. So let's say for the sake of conservativeness we're assuming that we still face an 8% bad debt accrual as a percent of net revenue even with all of our efforts. So, our effort should be strong enough to compensate potential increases that we will experience on that line.

So, as the quarters go by, if we feel the economy is behaving different than what we expect or if we could have some relief, we will share with you guys on those fronts. So our guidance or our expectation for 2014 in terms of the 100 basis points additional margin that we expect, they should be considering bad debt on the same level as last year. And they should also consider the fact that we are, as you all know, in the middle of the implementation of a new IT system. And every time we do that, we had two major effects. Number one, every single money that I was investing on the new technology once I start testing that operationally speaking due to CPC and IFRS, I have to account for those as expenses immediately so they are no longer CapEx, they turn out to be expenses that's number one. And number two, as every time you implement a new system in any segment of the industry, you had to have what we call the parallel movement meaning that I'm going to have a team working on the old system and a team working on the new system in parallel until we get very comfort with the new system. So, the addition of 100 basis points that we have shared with you all, they contemplate an 8% business and a compensation of another lines for those expense increase that we expect to happen this year. Okay.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay.

A - Wilson Olivieri {BIO 17325685 <GO>}

So and then last question that I noted here in the new sales fee, I'll give you the breakdown that we currently have. This new sales fees mostly coming from Alianca and you had approximately, as I mentioned in the call anywhere between R$5 million to R$6 million coming from commissions we received for migrating lives from one operator to another, one because the operator, which was Unimed Centro-Oeste broke down and another one, because a lot of our customers decided to change.

So, those were additional commission that we received for those migrations, which we do not consider to be recurring because they don't happen all the time, but in the full year of experience like 2014, there could be chances, where others like that would happen. But we don't include that on our budget so that's why we would recommend when you do your projections not to include those.

We also have built into that number that gives you about 6 million of the variance. We also have built into that number R$1.2 million worth of revenue from Alianca, from periods of -- from months of 2012. So I'd like to highlight the following. The reason, why we did not disclose -- we did not disclose the number in our package because it is not considered to be a part of the EBITDA based to value Alianca.

In other words, when I calculated EBITDA for Alianca, excluded this effect of R$1.2 million because they did not belong to the 2013 year, they only belong to 2012. And that refers to revenues that we will discuss it with Alianca during the first months of the acquisition they should belong to Qualicorp or not. And finally, we conclude during this final negotiations that those revenues were from Qualicorp so there is another 1.2 million. The remaining variance that you should see anywhere between R$2 million to R$2.5 million refers to timing differences that we have gone through that in the past in terms of mainly commissions of new sales that refer sometime we are able to anticipate some of those new sales fees with our operators, sometimes they get delayed on time so you'll see that's the normal flow of the business on those line. So, that should explain the full variance for the quarter on that line.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. That's perfect, Will. Thank you.

A - Wilson Olivieri {BIO 17325685 <GO>}

You're very welcome my friend. Thank you.

Operator

Our next question comes from Matthew Pascale with ShearLink.

Q - Matthew Pascale {BIO 17304710 <GO>}

Hey, Wilson, how are you?

A - Wilson Olivieri {BIO 17325685 <GO>}

Hey, Matthew, very well. Thank you.

Q - Matthew Pascale {BIO 17304710 <GO>}

Just had a quick question on Alianca. At the current valuation for Alianca, how much is Qualicorp going to need to pay out of pocket in Q2 or Q3 this year for the remaining piece that you guys already done? That's my first question.

A - Wilson Olivieri {BIO 17325685 <GO>}

Sure. The basic pay -- the payment should be -- should happen first week of April and we expect to write a check of approximately R$260 million.

Q - Matthew Pascale {BIO 17304710 <GO>}

Okay, great. My second question is on page 18 of your earnings release you guys disclosed around 400 million of cash flow from operations in 2013 and about 50 million of CapEx, of about 350 million of free cash flow, I think if you divide that by your shares it's about $1 or R$1.30 of free cash flow per share. Is that the rate base that we should expect free cash flow to grow from going forward or are there special items in that?

A - Wilson Olivieri {BIO 17325685 <GO>}

Well, I think expect for the items we discussed there are generated operationally speaking. In terms of cash, we don't -- and again knowing what we know in terms of the payments for the debenture and the remaining payment for Alianca, we should not expect any variables that should affect much the future of those indicators.

Q - Matthew Pascale {BIO 17304710 <GO>}

Okay. So that should grow kind of in line with EBITDA then?

A - Wilson Olivieri {BIO 17325685 <GO>}

I would say so, yes.

Q - Matthew Pascale {BIO 17304710 <GO>}

Okay. Thanks, Wilson.

A - Wilson Olivieri {BIO 17325685 <GO>}

Thank you very much my friend. Take good care of yourself.

Q - Matthew Pascale {BIO 17304710 <GO>}

Okay.

Operator

(Operator Instructions) Our next question comes from Josh Milberg with Deutsche Bank.

Q - Josh Milberg {BIO 2004065 <GO>}

Good afternoon, everybody. Wilson, my question relates to the point that you made that there hasn't been any let up in health inflation and that this could mean even higher increase in 2014 than in 2013. Could you just provide some perspective on what factors explain this when the economy has been so sluggish? And then also related to that, can you just let us know what trend we might expect in 2014 as far as people migrating to lower priced plans just trying to get a sense of, if in fact we have a similar or higher price adjustment this year. What kind of evolution we could see of the ticket, the Affinity ticket?

A - Wilson Olivieri {BIO 17325685 <GO>}

Wonderful. Thank you, Josh for the question and thank you for being here with us. So, in terms of inflation what we have it's not very much different than what we had experienced in the last couple of years. It is a combination of a price adjustment that the whole network providers -- as you know again in Brazil everybody adjust their prices at least once a year, some people would adjust it even more than that.

And second and as important is the frequency of the usage of the system. So, as we all know in healthcare, every time you have a new technology, this new technology does not replace the old technology actually comes on top of it. So, if you were to go to a doctor, who is like 10 years ago with a headache, they would look into your eyes and they would say take just an aspirin. So five years ago, he would give you an X-ray. So today, he gives you the X-ray and tomography. So, these all adds up to the cost of health. And to be honest with you, this is not only a problem that we're facing in Brazil, but that's a worldwide problem. New technology something that has -- it always comes as an addition, it never replace the old technology, Brazil is not different.

Aside that, we also see here in Brazil, as you all know, a need of improving controls on the usage of this process. We know by fact there is in Brazil, a fair amount of inefficiency and fraud on the usage of the system. So, one of the reasons why we believe actually and I never talk to them on that, but the UnitedHealth saw an opportunity in this country and they acquired a mill about a -- little more than a year ago, because it's clear that if you have improved your controls in terms of efficiency and fraud, you should definitely be able to extract gains out of this costs in Brazil.

The fact that we have these two major events drives us to believe that the government will be too busy doing other things World Cup and Presidential Elections so we don't see them actually touching this matter this year so that's why our expectations for this year are to have potentially a higher price adjustment than what we saw last year.

In 2015, however, we see with new President, whoever that is the same one or another one that is the major issue that the government is facing because the same problem we have in the private sector, the government has on the public sector and they don't have enough budget to treat everyone. So it's definitely going to be a joint action between private and public in terms of finding opportunities to reduce medical costs in this country. So, that's been an overall market basis this is how we see the market today. In terms of people migrating, I can only project numbers if I look in the history. So, looking at the history and looking at the past, we've noticed that about 30% of the churn people that we currently have they go to lower priced products as -- if you remember, another third go to corporate products, other third goes to public sector.

So, if we consider 30% of the -- those people that we could retain somewhere, let's say like half of it, who will be departing today and at least I would say 5,000 additional new lives to the system. So, selling cheaper product to cheaper to C and D class will definitely increase churn, but it will allow us to retain customers that would be downgrading. So, I don't have any reasons to believe that this 30% is being fairly flat throughout the last few quarters. So we have no reason to believe that should increase. So, I would say we would be able to access 30% of our churn and hopefully if we can retain at least half of it, it would be a good point.

Q - Josh Milberg {BIO 2004065 <GO>}

Okay, great perspective. I appreciate it.

A - Wilson Olivieri {BIO 17325685 <GO>}

Thank you, Josh.

Operator

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

A - Wilson Olivieri {BIO 17325685 <GO>}

So, once more thank you all very much for being with us. As usual, our IR team will be available for further questions and compliment. I would only ask for you all to be a little patient, we will talk to everyone. There is a pretty big demand. So, in 24 to 48 hours, we expect to be able to talk to everyone. So, thank you very much and talk to you next time. Thank you.

Operator

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