

## Q1 2016 Earnings Call

### Company Participants

- Grace Cury de Almeida Gonçalves Tourinho
- Mauricio Ceschin
- Natália Lacava
- Unverified Participant

### Other Participants

- Joseph Giordano
- Rafael Frade
- Rodrigo Gastim

## MANAGEMENT DISCUSSION SECTION

### Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Qualicorp's Conference Call to discuss the results of the first quarter of 2016. We have with us today Mr. José Seripieri Filho, CEO of Qualicorp's Group; Mr. Mauricio Ceschin, CEO of CRC/Gama Companies; Ms. Grace Tourinho, the CFO and IRO; and Ms. Natália Lacava, the Investor Relations Superintendent.

This event will be recorded and participants will be in a listen-only mode during the company's presentation. After which, we will begin a question-and-answer session with further instructions will be given.

I would now like to hand the floor over to Ms. Lacava who will start the conference call. Ms. Lacava, you may proceed.

### Natália Lacava

Thank you. Welcome, everyone, to our first quarter 2016 results. I will turn the floor over to Grace to make the opening remarks. And then I'll go ahead to discuss in more detail our numbers. Grace, please.

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

Good morning, everyone. And thank you for your attendance. We have consistently tried to generate value every quarter even in adverse economic scenario. This quarter, we were able to complete a great part of the tax planning achieved, details will be provided

by Natália later. We also managed to postpone the (1:42) from March to June 2016. We may recall, (1:51) is steadily published on March 21, which would change these types of rate from 4.65% to 9.25%. After (2:05), we related the potential - a potential price reduction via these two reductions. These rates could be close to 7.5%, but we are still committed on try to minimize (2:21) in our results.

About the dividends, we are going to designate the payment to May 25. It's important to have seen our conviction to keep improving our process, forecasting on customer care, better debit control, and (2:41) our cost matures.

Now, I will turn the floor back to Ms. Natália. Natália, please.

## Natália Lacava

Okay. So, let's move to page number three, where we have our remaining indicators. On this slide, I'm just going to call attention to our growth in our net revenues. So, we grew 13% year-over-year, reaching BRL 455 million. Here, I think it's worth mentioning the fact that even having a challenging scenario in 2015 losing a piece of our portfolio throughout the year, we're still able to grow our revenues by double-digit rate. We were able to keep our sales at very high levels in very high NPZ products which allowed us to keep on growing revenues and showing the resilience of our business model.

In this line here as well, we had the benefit of the service tax reduction, which impacted us from February onwards, so two months in the quarter. In terms of EBITDA, we have also grew 13%, reaching over 41% margin, which is a very high level in our view considering the challenges of higher delinquency rate and reflect the reductions we have been doing in our cost, and all the assertive strategies to keep our admin expenses under control.

Moving to page number four, where we discussed our net adds. I'm going to focus here on the medical piece, where 90% of our revenues come from. We had sales growing 7% year-over-year. I wanted to (4:18) attention to this number, because it's important to tell to our investors that even with all these scenario, we are still selling, we are still growing sales, which means - which shows the capacity of distribution, the capacity of our company, and how defensive our business is, because people are really worried about the private healthcare solutions in Brazil.

In terms of churn, even though you see a deterioration comparing to last year, you saw a reduction versus last quarter, we reduced it more than 10% comparing to fourth quarter last year, even excluding the extraordinary cancellations. And that ended up with a positive net adds of 175. We also highlight a loss of 4,000 this quarter related to a portfolio that we lost, an insurance company that decided to leave some regions of Brazil. If I were to exclude that effect, our net adds would be over 4,000 positive net adds. So, here I think the message is, the scenario is not easy, but we are managing to keep our portfolio flat and still deliver growth in our numbers for our investors.

Moving to slide number five, where we discuss our net revenue. Net revenues grew 13% as I mentioned before. Here just highlighting the fact that the sales we are doing, even

though we still have contribution from our lower income provider (5:53), the health club, we are also selling a lot (5:58), which means that our ticket is still growing year-over-year comparing to 2015. So, that's the reason why our revenues are still growing double-digit rate.

Regarding slide number six, where we discuss our call, here I want to mention basically two things. The first one on personnel expenses, so you guys remember that we made a restructuring in last December, where we dismissed more than 130 employees, and that reduction have caused our personnel expenses to significantly reduce, you see a 12% reduction quarter-over-quarter and that's related to this restructuring (6:46). And that's the number that we expect to keep on going forward, once there is not other effects in this number during this quarter.

I also wanted to highlight a strategy that we have put together in terms of printing and logistics cost. We have changed the way we print materials proposes for sales. I call here adjusting time, let's say - let's put this way, strategy where we don't print anymore and we don't stock anymore, there's no inventory anymore. So, now the system we have implemented, the proposes are printed in the exactly amount our sales needs and exactly the logistic expenses, exactly the ones that are really required. So, that reduced a lot of wasting we had in terms of proposes and logistics and printing cost.

One of the reasons why our gross margin is still increasing and we have reached almost 75% gross margin during this quarter.

Moving to slide number seven, where we discuss our admin expenses. Here consonantly we have been managing this line very closely, you see only 1.5% - 1.8% increase year-over-year in this line reflection of a very, very restrict control in third party services, also personnel expenses and this reflects the austere strategies we have been putting to not allow admin expenses to consume our cost and also to be a driver of margin expansion.

Moving to slide number eight, where we discuss commercial expenses here just want to make an initial observation. Commercial expenses is a line that we manage on a consolidated basis. Sometimes we decide to give more focus on campaigns, sometimes we give more focus on publicity, so that's the reason why you see some ups and downs when you compare all the lines. During this quarter specifically we put a lot of attention to the campaigns, where there is more direct - directly impact on sales, so the one of the reasons why our sales have been holding quite well is because we have been focusing our expenditures on strategies that have a more direct effect on sales. But all in, if you look to the performance of our sales expenses on a consolidated basis, it grew 17.7%, which is in line with growth in sales plus the growth in ticket. So it's completely within the range that we imagined that we could expand in commercial export (9:43).

Moving to slide number nine, where we discuss our bad debt. This is the line that you see a more relevant increase considering the macro condition, it's natural, we - it doesn't come at a surprise to us the 6.6% bad debt ratio, it's actually a reduction comparing to the fourth quarter results. It's higher than last year where we reached 5.3%, however within the range at a very controlled level and we don't believe that we're going to have

surprises on bad debt this year even though we already expect a consumption of margin on this line.

Regarding the other revenues and expenses, I don't think there is much to say here, it came in at only BRL 1 million. So, this is aligned, and sometimes it's positive, sometimes it's negative, it's part of the business and there is not much here to comment on this line specifically.

Moving to slide number 10 where we discuss the financial expenses and interests. The only highlight I would make is the reduction of our interest considering the capital reduction that we have done last year. So, we have a lower amount of cash balance and also to the fact that there is expenses related to the debentures changed from the holding to the subsidiary. So, there were some financial expenditures that we have boosted our other financial expenses. But all in, it's not much different than what we have always posted in terms of financial results.

Moving to slide number 11 where we discuss EBITDA. So, after all the initiatives, the strategies, keeping sales high, controlling cost, we were able to reach BRL 188 million in EBITDA, a 41.4% margin. So, over 41% margin which is flat year-over-year, considering that we have increased the bad debt and putting more efforts on commercial sales, maintaining the margin flat means a lot, means that we have cut admin expenses, means that we have managed a lot of our cost structures so for us it's a great achievement reaching over 41% margin during this quarter.

Moving to slide number 12, where we discuss net income. As we mentioned in our last quarter results, we had a lot of fiscal initiatives that Grace has described a bit deeply in our last quarter results and this quarter we reported the goodwill effect which in the amount of R\$138 million and that's the reason why our net profit boosted to R\$198 million. That's accounting income and that's an important driver for us here in the company once it's the number that we account when we think about dividend payments.

Moving to slide number 13, where we talk about CapEx, here we have a regular CapEx on IT once we are implementing new systems. We also had CapEx related to changing three subsidiaries to (13:18) in order to have tax incentives, and also the exclusivity on our association call - the medical association which we consider to be very relevant for the company once it's a very large association we renew it, the exclusivity with them in the amount of R\$4.5 which are going to be paid in four years.

Lastly, moving to our cash flow here once again, generating almost BRL 100 million in operating cash flow. This quarter, as everybody knows is seasonally lower quarter because we have the payment of interest, plus the payment of our bonus. So, from working capital proposals, it's a cash consumption quarter, but even though, we have generated BRL 64 million after CapEx. So, this reaffirms the strategy of the company to keep on delivering cash and increasing the return to our shareholders.

So, with that, I conclude my presentation on the numbers. And now, I'll turn the floor over to Mauricio Ceschin, who will make some remarks. Please, Mauricio.

## Mauricio Ceschin {BIO 18750717 <GO>}

Thank you, Natália. Good morning, everybody. Just would like to add some comments about the announcement made by the company yesterday. I really believe and I'm committed, I can assure you to the CRC/Gama project. It's a challenge that motivates me. It requires attention, focus and education.

As you know, I believe that the way out for the healthcare sector depends on active health management process, and CRC/Gama has all tools to succeed in this endeavor. My professional experience working side-by-side with payers, the providers, operators, regulators, and the benefit administrator, as well as my medical background, just reinforce my belief in the sector transformation need on which its sustainability is under or it's being tested. And the CRC/Gama offers me a great opportunity to put this knowledge into practice.

I'd like to add also that Qualicorp benefited in Australia and broker is robust, a strong result, solid business model and with the Board of Directors now led by Junior and Alberto Bulus, that has full capacity to continue delivering results. I will certainly continue to contribute to the company. I'm still attending all executive meetings and therefore this change allows me to focus on a relevant project that I hope it can contribute with the future of the health segment here in Brazil. Thank you all.

## Unverified Participant

Hello. This is Junior, as my English it is not so good, I will prefer the people here to – I mean, to repeat the exactly speech that I did of course in Portuguese one hour ago in our other conference, I mean call. Who is going to do this.

## Natália Lacava

So, I'm going to be doing a literally translation of what Junior said in the Portuguese call. So, we had exactly the same message for all of our shareholders. There is not much to add beyond what Mauricio has already spoken. Recently when Mauricio returned to Qualicorp, our focus was in the medical area. But he ended up managing the company as a whole. Brilliant, by the way.

Now at this point, I have no criticism to the management that he carry out. What happens is that in the current challenging Brazilian economic scenario, we are returning to the regions of the company, where we have to focus on two main points. Number one, sales and number, two after sales post sales. This means, that we have to sell, in one hand and we have to retain members on the other hand. This will generate a positive churn and a consequently positive net adds. That's my main focus, once I came from the sales area. The company is very well structured on the administrative and operational side, especially in the financial point of view, with a brilliant management team, which Mauricio has built up and that remains completely unchanged it.

FINAL

Bloomberg Transcript

Alberto Bulus leads the regional Rio de Janeiro Director position to take a Commercial Vice President role to help me at this new challenge with the company. Alberto is with me since the inception of this company, and our main focus again are going to be sales and after sales. While Mauricio will be fully dedicated to manage CRC/Gama company, focusing on the main point of the business, which is making affordable solutions for Brazilians to buy private insurance.

For over two years, we have been investing in CRC/Gama, as we believe this is the medical management tool, which in partnership with our providers, insurance company should reduce claims, cost, so that we can get more competitive in terms of prices and we can keep on increasing our membership base.

If, we have lower prices, if we have more affordable prices, we will deliver higher sales and better retention rates. So that was the objective of the changes.

With that, so this was the speech of Junior in the Portuguese call. With that we conclude our initial presentation and we turn the floor over to questions and answers section. Thank you.

## Unverified Participant

Thank you.

## Q&A

### Operator

Thank you. We will now start the question-and-answer session. We have a question from Joseph Giordano from JP Morgan. Please go ahead.

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

So, hi. Good morning everyone. Thanks for taking my question. My first question would be more on the net additions front. We see a very good drop in the addition space. So I really wanted to understand how we were seeing this space in the second Q, so maybe you got like a new professional association that is helping on this front. Also we have no, let's say, one-off impact from operators canceling plans. So I really wanted to understand what we saw particularly in the month of April if the pace of like 30,000, 17,000 (20:52) lives a month was maintained. And second thing is I think that's more like to Mauricio this question is. That's a very interesting thing on controlling the medical costs better. So I really wanted to understand what's like the whole model or maybe the company you are taking as an example, let's say, an option healthcare (21:15) so just understand what's like the direction that those operations that Qualicorp should go. Thank you.

### A - Natália Lacava

Thank you, Joseph. So I'm going to start with the first question. So, seasonally the second quarter is a better quarter in terms of net adds comparing to the first quarter. So, we do

expect to be a little bit better. It's still hard to quantify, but we expect to be better. Another important thing is that, January, February are very weak months in terms of sales because of vacation and kind of - so April was indeed a better month comparing to the months of January and February. So, we do expect a better quarter, but I think it's early to quantify the second quarter yet. And regarding the second question, I'm going to ask Mauricio.

#### **A - Mauricio Ceschin** {BIO 18750717 <GO>}

Right. Hi Joseph, let me tell you what intend is to bring to the TPA and CRC/Gama has a strong action and looks like as TPA, and to bring to our partners (6:22) or insurance companies, and new models of network providers in a sense of managing cost and managing the health segment with proper tools so that we can develop new products with best and excellent cost control and that deliver a care in a sense that we partnership not alone but in partnership with our current clients and develop new clients, we can try to bring some new products with new models of care in care management, so that we can reach new costs and new prices in this product that can address the market that it cannot afford paying more readjustment around annual readjustment in the levels that we see in the market. So, our goal is trying to bring something new to the market in terms of health management, okay?

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

Right, perfect. Thank you.

#### **Operator**

And our next question is from Rodrigo Gastim from BTG Pactual. Please go ahead.

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

Hi, thanks. Good morning, everyone. Two questions from my side today. The first one I just want to better understand how the 2854:98() the lower income operation is helping growth so far, I mean how much of growth that already comes from this operation. And if you could provide us more details on the event of NPV differences of this group, how would you contract when compared to other Qualicorp conference would also be very good? And my second question is on the PDA side. Are we starting to see an expected deterioration in Q1, but I just would like to better understand which would be - what would be the level of PDA expenses in 2016? That's pretty much. Thanks very much.

#### **A - Natália Lacava**

Hello, Rodrigo. Natália is speaking here. Regarding health club, it has been an important driver for to support our drugs add. It didn't change much from the last time that we have spoken. So, health clubs do contribute close to 15% of our monthly performance, not much different than what it has been doing in 2015.

In terms of NPV, it's a cheaper plan. So, the contribution in the - the amount of contribution per life is lower, but the internal rate of return is similar because we do have tools here to manage a lower cost to provide cheaper services. And so we have

structured the product doing one side, the cheaper, but in the other side, adjust our cost structure to comply with that product. So, the contribution in the amount is a little bit lower of course, because the ticket is lower, but the internal rate of return is now lower. So, that's the first question.

Regarding the second question, for the full year, I'm going to ask grace to correct me if I'm wrong, but we expect that debt to increase in 2016 by between 100 bps to 150 bps year-over-year. Yeah, it's right. So, that's the guidance.

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

That's very clear. Thanks very much, Natália.

## Operator

And our next question is from Rafael Frade from Bradesco. Please go ahead.

**Q - Rafael Frade** {BIO 16621076 <GO>}

Hi. Good morning all. I'd like to just get some color about how are you working for the process of the rate adjustments in price to be taken in June, and less couple of years you have been working on. New products increased co-payments and additional alternatives to be able to give options for our clients that cannot afford for the price readjustments. So, if you could give us an update about this, how you are, what you learned from the lessons that's now maybe you could have a better prospect this year, it would be great?

**A - Natália Lacava**

Hi, Rafael, Natália speaking. So, there's not much things different. We have only evolved from what we did last year. So, we still have the Group A options, we have also negotiated with the insurances, alternative options. So, in between process, we could have alternatives in prices. So, there's not much different things compared to last year, but of course that we have learned, we have get better, our churn department is more experienced on that scenario. So, I don't think there is any news or any new product for this year, but the strategies are the same, the work is a continuous work and every day, we improve our retention area and we set the targets higher.

So, we're going to work exactly the same way we worked last year and we hope that we can succeed in exactly how we performed last year.

**Q - Rafael Frade** {BIO 16621076 <GO>}

Okay. That's great. Thanks a lot, guys.

## Operator

And this will conclude our question-and-answer session. I would now like to turn the call back to Ms. Natália Lacava, Investor Relations Superintendent.



## A - Natália Lacava

Thank you all for your participation. As always, Gabriel, Natali and me are available if you have further questions, let us know and don't hesitate to give us a call. Thank you once again and have a good day.

## Operator

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

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

FINAL

Bloomberg Transcript