

Q2 2015 Earnings Call

Company Participants

- Adolpho Cyriaco Nunes de Souza Neto, Chief Financial Officer and Head of Investor Relations
- Carlos Alberto Iwata Marinelli, Chief Executive Officer

Other Participants

- Unidentified Participant

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2015 Second Quarter Conference Call. Mr. Carlos Marinelli, CEO and Mr. Adolpho Souza Neto, CFO and Head of IR will present the results. This event is being recorded and all participants will be in a listen-only mode during the company's presentation.

After Grupo Fleury's remarks, there will be a question-and-answer session. At that time, further instructions will be given. (Operator Instructions). This event is also being broadcast live via webcast and may be accessed through Investor Relation website at www.fleury.com.br/ir, where the presentation is also available. Those following the presentation via the webcast may post their questions in advance on our website. They will be answered during the Q&A session as long as we have enough time.

Before proceeding, let me mention that forward statements are based on the belief and assumptions of Grupo Fleury management and on information currently available to the company. They involve risks and uncertainties, because they're related to future events, and therefore, depend on circumstances that may or may not occur. Investors and analysts should understand that macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Carlos Marinelli, CEO of Grupo Fleury, Mr. Carlos, you may begin your presentation.

Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Hello and good morning everyone. I appreciate the interest and presence of all of you in our second quarter 2015 earnings conference call. Despite the challenging economic

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environment in Brazil, Fleury Group has (inaudible) that results of evolution in its business for another quarter.

The execution of our strategy and the positioning of our brands in the premium and intermediate segments, which are relatively more resilient in an adjustment period of the economy, allow us being expansion and qualification of our financial and operational indicators.

As shown on a slide three of the presentation, our strategy is designed to recover the profitability of our operation has demonstrated its strength and consistency of results over the past two quarters and delivered an increase of 15.2% on our gross revenues in the second quarter year over year. When we compare the first half of 2015 with the first half of 2014, the increase reached 13.7%.

These results demonstrate the Group's ability to meet the demand for services in the segment in which we operate, premium and high intermediate including the capture of market share. Growth is a solid intention of Grupo Fleury and it's not only demonstrated by the evolution of our gross revenue line, but it also comes with an increasing qualification of our revenues. This qualification is not realized by the accelerated evolution of our net revenues in the profile of our accounts receivable. Net revenue improves 17.4% in the comparison between quarters year over year, a result of better value chain management from the delivery of our services, who is building with our main clients until it affected results. Accounts receivable established an increasing healthy profile in our portfolio. I will also detail and comment more about both indicators, net revenue and receivables profile ahead.

The growing profitability of our operation is an objective and grow of all management and inquiries of the Grupo Fleury in all business friends and geographies, where we operate. More important, it is to mention that there is a commitment supported by our values as a company and in strategic positioning to deliver the desired profitability in parallel with the reservation and increase of technical excellence and quality standards that have guided the Group's operation in the last 89 years.

In Grupo Fleury, we know that profitability and quality of care can and must go together, demonstration of this is achieving another quarter of growth evolution of EBITDA margin, evolution in net income and evolution in customer satisfaction indicators. Compared to the second quarter 2014, our NPS or Net Promoter Score indicator that defines how our customers are willing to recommend us to family and friends grew 5.5 percentage points to 71% in the second quarter of 2015.

In addition to that, the level of satisfaction of our customers increased 3.2%, rising to an average score of 8.94 in the group. Its qualitative indicators are combined by recurring improvements in the qualitative perception of our services obtained from surveys, we convert with the medical community confirms our sustainable and consistent execution of our services strategy in the premium and high intermediate segment in the markets where we operate.

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The attention of the organization and its employees show results focused management enables this scenario where our customers, the vision and patience demonstrated preservation and development of the quality of our services. At the same time, we can demonstrate the evolution of profitability indicators such as the 347 basis points growth of our EBITDA margin, which reached 20.5% of our net revenue and the growth level of 101.8% in our net income.

Moving now to slide four, I would like to highlight the important actions and recognition that we received in the second quarter of this year. In May Fleury rand opened the advanced diagnostic center for women, the 10th integrated center in Sao Paulo as part of the expansion plan for our premium business units. In June, the company distributed 6.5 million in dividend -- BRL6.5 million in dividends. A survey of Data Folha recognized that the quality of Fluery brand service in Sao Paulo, there was a pool of over a thousand people in all regions of the city and Fluery was named as the best laboratory of clinical analysis in the city.

It's basically in the premium segment, for the second consecutive year Fluery brand participated in the Congress of the State of Sao Paulo Society of Cardiology, Society and promoting international symposium on women's heart health, there was an attendance of over 700 physicians to this symposium.

Fleury brand won for the 15th time the Consumidor Moderno award for Excellence in Customer Service, offered by Consumidor Moderno magazine and considered one of the top prizes for the consumer segment of products and services in Brazil.

Last but not least, it's worth noting that the administration is not detached at any level from the economic reality of the country and the challenges in front of us. We are a large and aware of our responsibility for the upcoming quarters and in the medium and longer-terms, actions related to the research called greater effectiveness of our expenses and cost, both in the corporate level and in the operational (inaudible) and will be refined in the coming months.

We are aware of the pressure that inflation, energy cost and exchange rate have on our costs, the metrics per this methodology adopted for more than two years remains as a management discipline in the organization and continues to capture benefit of greater efficiency and disciplined in controlling costs and expenses.

I turn now to, Adolpho in order to follow the presentation. Please, Adolpho.

Adolpho Cyriaco Nunes de Souza Neto {BIO 21636124 <GO>}

Thank you, Carlos and good morning, everyone. I will continue the presentation on slide five in which we present the growth of our business lines. The growth was 15.2% of the Group was impacted mainly by the expansion of the Fluery brands that also -- 15.2% by the brands in Rio de Janeiro that had up 22.3% expansion and the growth in hospital operations of 17.6%.

The growth rate of 6.9% from regional brand is excluding Rio de Janeiro was impacted by the milder expansion of A plus [ph] brand in Sao Paulo due to the repositioning for the upper intermediate segment and selection of payers. As we have a long business cycle, it is expected that this revenue will be recovered gradually over the coming quarters.

On slide six, the revenue per square meter indicate that -- shows an increase of 13.3% between quarters, resulting from efficiency gains in existing units and maturation of opened unit and expansions done in 2014 for Fluery brands, as well as the recuperation on volumes in Rio de Janeiro. The asset efficiency is also noted in the same-store sales indicator in the graph at the top right of the page. There is also growth in the gross revenue per PSC with 14.9% and the average price, which expanded 8.2% between quarters.

On the next slide, we show the performance of the patient service centers and we can verify the broad expansion of Rio de Janeiro in all indicators, a recovery lead by the additional volume in clinical analysis and improve the mix in emerging service.

On slide eight, we see the strong expansion of hospital operation, which reached a growth rate of 17.6%, result of a high demand registered during the quarter, combined with the entrance of the Santa Luzia hospital of Brasilia in the customer base.

On the next slide, we detailed the significant increase of 17.4% in net revenues. Taxes were at 6.2% slightly below the 6.4% recorded in the second quarter last year. Cancellations represented BRL19.2 million or 3.6% of our revenue, a decrease of 150 basis points compared to last year. This is a direct result of the focus on the management of cancellations in the company. Deductions aimed at improving the cash cycle conversion that include among the others, the review of internal processes and systems improvement.

On slide 10, we see the evolution of the company's cost in addition to indicators of the number of employees and the number of PSCs. This quarter we can see an increase of 19.7 -- 9.7% in the cost of services, or which we will provide further details in the next slide.

On the same slide, we see that our base of employees increased by 3% mainly due to the increase of the company's business volume. We also show the increase to 154 PSCs versus 153 in the previous quarter, due to the opening of the women's advanced diagnostic center in Republica do Avenue. This is the advanced integrated center of the Fleury brand in Sao Paulo.

On slide 11, we see the trend of the last quarters of some of the lines of the cost of services, which as mentioned earlier, we were 9.7% compared to the same period last year. These results reflect the good cost of management, both in the line of General Services, Rentals and Utilities that's grew only 4.2% and in general expenses, which decreased by 5.6%. On the other hand, we see a higher growth in the line of personal environmental services, which grew 16.6% between quarters.

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This valuation reflects first; the growth of the Group's operation is the volume of that in the quarter was 11% higher than last year, that's generating an increase in medical compensation. In addition to the aforementioned decrease of 3% on the headcount to serve a larger number of customers. Additionally, we had in the second quarter, the impact of inflation adjustments related to the collective agreement negotiated in Sao Paulo and Rio de Janeiro and adjustment of craft plants [ph] for employees, as they are all effect of selective wage increases in the operation.

Finally, as a result of this finalization of the stabilization period of the new SAP to human resources area, the SAP HCM, we made a general review of payroll provisions and recognized some differences that are non-recurring.

Moving to slide 12, we have a consolidated view of the cost of services, which includes besides the already mentioned lines materials and outsourcing testing, as well as depreciation, we can see that in the quarter cost reached 352 million representing 73.2% of net revenue, an improvement of 560 basis points, compared to the second quarter of 2014, which along with the revenue growth enabled the expansion of the gross margin by 45%.

On slide 13, we see the distribution of operating expenses, G&A expenses also showed that the impact of the adjustments operative and health insurance that will gave previously. But still lower as a percentage of sales if compared to last year. The line of other operating expenses was impacted by a non-recurring amount of 4.2 million in write-off charges related to the final adjustments of the inventory of fixed asset. With this, we finalized the most significant adjustments related to fixed asset.

On the next slide, we see the evolution of EBITDA between quarters. Where we show a strong improvement due to the combination of our robust revenue growth combined with continuous cost control, with three quarters, there was an increase of 347 basis points, which is 20.5%, again 17% in 2014. In the six month comparison, which is the graph at the bottom of the slide, we see that, isolating the effect of non-recurring items in the first quarter, there was an increase of 452 basis points in the EBITDA margin coming from 16.5% in 2014 to 21.1% in 2015.

We now move to slide 15, which shows the profile of our debt. It's composed mainly by the debentures and the loan with FINEP, which represents 10% of our fund. The cash balance at the end of the quarter was 544 million, so the Group ended the quarter with a net debt of 509 million, which represents a 1.5 times ratio to EBITDA.

On slide 16, we have the details of the financial results. In the quarter, we reported a net expense of 15 million, I guess 15.7 million last year, this slightly by the results despite to the increasing interest rates in the country comes from the improvement in the cash position and are lower weighted cost of debt due to the loan with FINEP.

In the next slide, we see the composition of the corporate tax rate, which was 37.5% due to the non-deductible expenses related to the assets write-off. Deferred income tax was 13.5 million in the second quarter and the cash tax totaled 6.1 million.

On the next slide, we see the reconciliation of EBITDA for the quarter and the semester, as well as the net income, both reported and excluded the non-recurring items. You can see that, due to the good operating results and the maintenance of financial expenses in the same level of 2014, net income nearly doubled in the quarter and has an even greater growth in the semester, which was 119% [ph] higher when excluding non-recurring items.

On slide 19, we have the profile of our accounts receivable, and we can see that there was an improvement in the aging profile with current balances increasing to 67% of the total, compared to 52% in the second quarter of 2014. Also they amounted to over 361 days, decreased from 18% last year to 7.2% in this quarter and the average collection period fell to 74 days. These results combined with the improvement of ratio of cancellations show that the company is on the right track in improvement of management of the cash conversion cycle, which is increasingly treated as an integrated process with our shared responsibility like everyone involved in the Group's value chain.

Our cash flow detailed on slide 20, where we can see an increase of 25% in our operating cash flow, which reached 114 million in the quarter, a record in the company's history and a result of good operating and financial results, as well as a good performance of the receivables within the working capital.

On slide 21, we see that the consolidated CapEx reached 40 million in the semester concentrated in the Fleury brand expansion plan and its strategic IT projects, including the SAP reimplementation and integration of the front office system in Rio de Janeiro or (inaudible).

The later, we'll have its completion in this third quarter, and besides finally, the end of the process of an execution of all the Group's production system, we'll also improve the service level for customers and the supply demand in management of that interregional.

In the second semester, we will have the largest share of the CapEx spending for the year, again mainly concentrated in the Fleury brand expansion project. It's planned that in the annum of 2015 and '16, we'll have an increase of, a total of 70,000 square meters in the brand expanding the presence of the Fleury brand in different regions of Sao Paulo.

On slide 22, we see our performance in the stock market, which shows an increasing daily trading volume in the second quarter, compared to the previous one. Last Friday, we announced the hiring of Credit Suisse as our market maker to have the company foster its liquidity of its shares. The activities are started this week on Monday, July 27.

Finally, we show the events in which we will be presence in the coming months, highlighting the Fleury Investors Day that will take place on October 1. And just a reminder, all the information on these and other events will be available in the Group's IR website.

We will now open the session for questions and answers. Thank you all.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from (inaudible) with Itau BBA.

Q - Unidentified Participant

Hello everyone, thank you for taking my question. Just a quick -- sorry just a quick question on regarding the top line growth in the quarter. We are seeing a pickup, a significant pick up in unemployment here in Brazil. And I would like to know if you have any type of color or even some internal data points that could show that due to this higher unemployment, clients are starting to become scared about potentially losing their jobs and trying to go to laboratories to make their test before they lose the benefits of healthcare plans given by the employees.

I think we have -- we had a significant effect from this side happening in 2008-2009. I just wanted to see if you guys are seeing already this effect happening or any type of movements on this front? Thank you.

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Hi, (inaudible) this is Carlos speaking. Thank you for your question. This is something that many people talks about the -- people that is employed of losing their jobs and so they get and get more medical expenses, because they have been. But it's not something that can be 55 in terms of knowing who is coming because they are fearing losing their jobs or not.

What I can tell you is that, for the segment that we are repositioning our businesses, both the premium segment and the high intermediate segment, both our segments that are more, as I have already said, more resilient to crisis, until this economic adjustment period that we are living in. So, what I see is that, the number of people that are not getting unemployed or losing their job, they're not getting access to health plans. It started on the base of the pyramid.

So the employment rates are increasing in the more basic segment of the population, and this is a segment of the market that we are not operating in. So, what we are seeing in our brands, both in the premium and the high intermediate segment is that our customers are coming, they are liking our services and they are coming back, even both because they like our service for, the physicians, where they -- who they consult. They recommend our services, so I think that our strategy, a recent strategy to reposition our business to be high intermediate segment and keeping track of the premium segment. And -- are making difference, on the spirit of the economy and it's a strategy that it's very important, because this segment is more resilient.

So for a moment of adjustment that we are living in, it's paying off and it's bringing the results that we want. Both in the higher volumes that we are getting, both and also in the market share that we believe that we are gaining on both segments.

Q - Unidentified Participant

Make sense, Carlos. Thank you for the answer.

Operator

Ladies and gentlemen. (Operator Instructions). This concludes today's question-and-answer session. I'd like to invite Mr. Carlos Marinelli to proceed with his closing statements. Please go ahead, sir.

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Once again, I would like to thank everyone for the attention and interest in the following -- this earnings release conference call. I would also like to point out that for the second half of 2015, we will continue to keep on track of the moment of growing demand for our services, processing on profitability and market share capture in all regions and market segments in which we've operate.

For this, we are operating in a careful and detailed management of our demand planning and services offering. We revise this administrative and operational structures with our partners on connecting the execution of our services with technical excellence and improve the profitability. With this focus and attention to monthly, weekly, and daily results, we enter the second half of 2015, knowing that we have a challenging, but very interesting period ahead, relying on the high competitiveness we have.

Thank you all and good day, everyone.

Operator

That does conclude, Grupo Fleury audio conference for today. Thank you very much for your participation and have a good day.

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