Q3 2015 Earnings Call

Company Participants

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

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2015 Third 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 Relations 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-looking statements are based on the belief and assumptions of Grupo Fleury's management and on information currently available to the company. They involve risks and uncertainties, because they relate to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that macroeconomic conditions, industry conditions and other operating factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I will 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 third quarter 2015 results conference call. Again, we disclosed our results in a challenging macroeconomic environment and we know that for a while this will be the reality of business in Brazil.

However, as important as understanding the scale and impact of this environment it's established and implement a clear plan to enable the organization to go through it and also establish a new level of operations and business for during and after this crisis. In this sense, the results for the third quarter of 2015 showed once again the resilience and the strength of our strategy in the healthcare market in face of an appreciated basis of comparison considering the third quarter of 2014.

The evolution of financial and operational indicators of the company is in line with our plan to strengthen the revenue line with organic growth and the use of additional opportunities of our assets in all geographies where we operate.

In the third quarter of 2015, Grupo Fleury reached R$547 million of gross revenues, a new record and an increase of 8.4% compared with 2014. It is important to mention that during this period, we held a final stage of the unification of our client care systems in Rio de Janeiro, as usual in this type of implementation, there is a period of maturation and adaptation, which limits the supply and production of services.

(inaudible) we have already exceeded the pre-unification volume levels of requisitions and in (inaudible) we are performing the programmed ramp up to deliver pre-unification volumes. This process allowed us from day one of implementation to a better information management of our operations in Rio de Janeiro, as well as improvements in the care of our customers in that region. Now our clients have access to clinical analysis and imaging through a single title offering in our patient services centers, increasing the flexibility of services and customer satisfaction level in addition to making the process more efficient regarding operation costs.

Also in the top line we continued advancing in the line of net revenues in an even greater speed. We achieved an increase of 9.5% comparing with same period year-over-year. This growth is only possible by a continued improvement on our order to cash process that is our main engine of qualification of our revenues. Continuous integration and process reviewing among teams of service, billing and collections has enabled us to establish lower levels of cancellations, in addition to qualifying our receivables portfolio.

It also important to highlight that strategic partnerships for the long-term relationship with the select and strong group of payers allow us to have a lower risk exposure when compared to the market average in general.

In operations, we accelerated and intensified our physician relationship actions to be even closer to those customers. We continue to serve them with our solutions that go beyond simple exam results. Therefore, we have maintained, increased and enriched our relationship with physicians through our diagnostic application in all specialties we cover.

It's still within our operations, it is important to know that we continue to, with our firm commitment, to welcome our customers in a differentiated way and make them a source of recommendation as important as the physicians. We know that the experience of our customers with our services is key through the sustainability of our business. So NPS indicators and satisfaction level developments will continue to be a target of our investments.

In third quarter of 2015, Fleury Group NPS reached 73.2%, a significant increase of 210 basis points compared to the third quarter of 2014. Fleury brand continues to evolve and reached 84.2% of NPS in the period. At the same time, (inaudible) Sao Paulo consolidates as a competitive choice of technical quality and quality of servicing in the high intermediate segment delivering new record level of satisfaction with an average grade of 8.62 given by its customers.

Going beyond customer satisfaction, we continue to focus on our profitability, which is reflected in our EBITDA margin that remains above 20% and our ability of generating cash flow establishing a new record in third quarter of 2015 of R$129.3 million with an EBITDA conversion rate of 125%. We know that this measure is essential to stay healthy and prepared for a period, then we will show more and more opportunities.

Completing the financial highlights, we've seen the evolution in our indicators of leveraging and profitability where there was a reduction of the net debt to EBITDA indicator of the last 12 months from 1.7 times in the third quarter of 2014 to 1.1 times in the third quarter of 2015. There is also a strong evolution of the adjusted ROIC not considering goodwill, which reached 21.5% in the third quarter of 2015 versus 13.4% in the third quarter of 2014.

Going to slide four of the presentation, we have the general highlights of the third quarter of 2015. During this period, we obtained the accreditation in Brazil Innovation Awards 2015 is sponsored by the Journals Valor and with Strategy& Consulting for a second place in the service sector.

We also participated in the Paulista Society of Gynecology Congress where we launched our Advanced Diagnostic Center for Women. We set that opened in our Patient Service Center at Republica do Libano Avenue. Regarding our proximity with the medical community, we continued to deliver our medical diagnostic solutions through lectures given by our doctors, including our participation in the 49th Brazilian Congress of Clinical Pathology in Fortaleza.

It is also important to point out that over the third quarter of 2015, we signed the same contract of the Cruzeiro do Sul Medicina Diagnostica to meet the anti-drugs regulator requirement originated with the acquisition of Labs D'or in July 2011. Another relevant point of the third quarter is that, in September, the medical partners concluded the sale of 13% of the stocks of Fleury Group to Advent International.

In the next slide, slide six, we detailed the ownership structure with the compression of the deal that took place on October 6 after the Shareholders' Extraordinary Meeting, which included the election of the new Board of Directors. As can be seen in the new organizational chart, there is a simplification of our shareholders' structure only with direct investments.

Now we have a participation of Advent with 13% of the company's capital and BradSeg continued with 16.4%, while our free float also remains at 39.9%. The new Board of Directors was reorganized to have 10 permanent members with the medical partners appointing three members including Chairman of the Board and Advent and BradSeg with two members each. There was also an increase in the numbers of independent members from two to three members on the new Board.

I'll turn over to Adolpho to proceed with the presentation. I'll be available at the end for questions. Adolpho, Please proceed.

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

Thank you, Carlos, and good morning, everyone. I will continue the presentation on slide six, which shows the growth of our business lines in the third quarter. We've recorded the highest gross revenue in our history, with 8.4% growth impacted mainly by the growth of the Fleury brand of 9.6%, regional brands excluding Rio with plus 7.5% and operations in hospitals with an increase of 19.4%.

In this quarter, Rio de Janeiro showed a slight downturn of 0.5% compared to Q3 of 2014. The comparison is against the base and it was already beginning to reflect the positive effects of the profitability improvement actions and the HMO selection measures then in that market. But we also have the impact of the immigration of the multi-imaging patented system, for the SAP systems, which was finalized this quarter and completed the integration of all the Group's operations within a single system that is used for the management of exam scheduling and production.

The integration of systems provides improvement in the customer service, medical processes and the management of the Rio de Janeiro market. I'd like to highlight three main points. First, the integration improves the ability to manage the supply and demand of exams resulting in greater operational leverage. Second, the standardization of processes and protocols throughout the whole customer experience cycle improves the customer experience, increases the employees productivity and increases the efficiency in the use of direct materials.

And finally, we had the introduction of a voice recognition tool for physicians, which eliminates the low-value added steps in the preparation of medical reports, reducing the delivery time of the reports, increases the productivity of the physicians and also reduces the cost related to packing.

It is noteworthy that we continue to see positive signs in volumes [ph] Rio de Janeiro as we can see by the increase of 21.3% in revenues from clinical analysis business segments that we are expanding in the region and that was not impacted by the systems integration since that was already done in 2013. In addition, in the (inaudible) brand, which had its migration process completed in the second quarter, we have noted in the Q3 the same volume levels seen before the migration.

On the next slide, we see the growth in gross revenue in the year by brand and segments. Here we can see that the Fleury in hospitals operations gain more space in distribution of gross income by business with about 50.4% [ph] and 50.1% [ph], respectively. In the chart, we have the growth of consolidated revenues from which you can see consistent growth in all lines, especially in the Fleury brand with 12.4% and hospital operations with 17.8%.

On slide eight, we can observe the growth of revenues per square meter indicator with 6.6% increase and the revenue per patient service center with an increase of 9.1%, reflecting efficiency gains in the existing units and the maturation of new units and expanded units in recent quarters. This efficiency is also seen in the same-store sales indicator in the chart to the top right of the page with a 6.9% growth. Finally, it is worth to note, the increase of 4.5% in average price as a result of price repositioning actions undertaken primarily in the original plan.

On the next slide, we detail the PSC's performance by business segment, highlighting the results of the indicators of same-store sales in Fleury brand, an increase of 8.5% and regional brands, excluding Rio, with 7.5%, which in addition had a positive performance in all other indicators. Results of the brand repositioning actions, pricing and the improving of the customer experience in the PSCs of those brands.

We continue in slide 10, where we detail the B2B operations. The hospital operation shows an increase of 19.4% in the quarter, with gross revenue of almost R$80 million. The same hospital sales increased to 13.2% reflecting the strong demand of hospitals where we operate. Also noteworthy is the increase of 17.8% in the average price of the Reference Laboratory segment as a result of the price adjustments in unprofitable contracts done in recent quarters. Gross revenue in this segment increased by only 3.8%, but with a much better profitability.

On the next slide, we detail the composition of net revenue, which continues to expand more rapidly than the gross revenue, up 9.5% in the quarter and 13.2% year-to-date. This result is a direct consequence of the management of cancellations and allowances with actions to improve the revenue cycle like processes and systems improvement. These actions have reduced cancellations by 8 basis points quarter-over-quarter from 4% in 2014 to 3.2% this year.

On slide 12, we can see the evolution of the company's cost and indicators related to the number of employees and PSCs. This quarter we can see an increase of 9.4% in the cost of service, which we will detail in the next slides. In the chart to the top right of the page, we see that our employee base increased by 2.9%, mainly due to the increase in operations.

On slide 13, we see a breakdown of the cost of services. And the line of personnel and medical services increased 15.2% and represents 36.6% of net revenue in the quarter. This increase is mainly related to, one, the impact of inflational salaries with the full impact we felt for the first time this year in the third quarter as comparable payroll [ph] provision than in the third quarter of this year, of course to a partial reversal in the provision than in the same quarter last year.

Increase of 2.9% of the number of employees as mentioned before and increase in the medical insurance cost for employees after the renegotiation done with the operators in

April of this year. In this context, the Group has initiated actions to reduce the impact of these increases in profitability seeking efficiency gains without compromising the service provided to our customers.

In the line of general services ranks and activities and also general expenses, we noticed that the continued discipline in cost management in the company through the zero based budgeting methodology let us to have the increases below inflation, 4.5% in the first case and 2.5% in the second.

On the next slide, slide 14, we see the consolidated cost of service provided, including materials and outsourcing, which accounts for 10% of net revenue, as well as depreciation. In the quarter, cost totaled R$360 million, representing 72.7% of net revenue. In the full year, we see a dilution of 331 basis points in this line if compared to last year.

Moving to slide 15, we see the distribution of operating expenses. General and admin expenses totaled R$50 million in the third quarter, 10.1% of net sales against 9.6% last year. Increases in this line is mainly related to the increase of wages through to the collective agreements, which had as in the cost of services, its full impacts appearing for the first time this year in the third quarter.

Also termination expenses of R$1.4 million due to the restructuring made in G&A aiming to simplify the structure and increase the agility in decision making in the company and also the same effect of the provision for profit sharing maybe in the quarter versus the partial reversion done in the third quarter of last year.

The line of other operating expenses accumulated R$2.1 million in the quarter in non-cash expense, primarily impacted by the write-off of assets of two PSCs and the EOL of some equipments.

On the next slide, we see the evolution of EBITDA between quarters, an increase of 4.4% in the quarter, which reached R$102 million with a margin of 20.6%, stable if compared to the second quarter of this year. Year-to-date, the combination of consistent growth in revenue combined with continued control of costs and expenses resulted in an increase of 28.8% in adjusted EBITDA and an increase of 254 basis points in the EBITDA margin, which reaches 20.9%.

Moving to slide 17, we see the profile of our debt. It's composed by two remissions of debentures and a loan with FINEP for strategic projects, which together totaled R$1 billion, the weighted-average cost of this debt is now at base rate, 98.5% of the CDI with a very good maturation profile.

We can also see that the cash balance at the end of the third quarter was R$617 million, that's 19% [ph] compared to last year, resulting in a net debt of R$421 million in a very positive evolution of the company's leverage, measured by the net debt to EBITDA indicator which reached the level of 1.1 times compared to 1.7 times in the third quarter of 2014.

On slide 18, we have the details of the financial results. In the quarter, we had net financial expenses of R$15.9 million versus R$16.5 million last year, a decrease of 3.6% mainly due to the low cost of our debt and the improvement of our cash position.

On the next slide, we see the composition of the effective tax rate, which was 35.8% versus 40.6% last year. Deferred income tax was R$14.7 million, while the actual cash tax totaled only R$5 million.

On the next slide, we see the reconciliation of EBITDA for the quarter and for the full year as well as the reported net income excluding non-recurring items. The third quarter of 2015 represented the growth in the net profit of 13.5% compared to the same period of 2014. This result reflects the sum of all the initiatives that were mentioned before demonstrating a sustainable evolution of our financial indicators over the last few quarters. In the nine-month comparison, we present a strong growth of almost 65% net income growing from R$61 billion to R$100 million.

On slide 21, we have the profile of our accounts receivables, you can see that's -- there was an improvement in the aging profile with our current balances responding for 73% of the total, up from 56.8% in the third quarter of 2014. Also they amounted to over 361 days, a decrease from 10.4% to 6.1% this year and the average collection periods totaled 74 days versus the 78 days of service [ph] last year.

These results combined with the improvements of the ratio of cancellations show that the company is on the right track in improving the cash conversion cycle, which is increasingly treated as an integrated process with a shared responsibility by everyone involved in the group strategy, which points to further improvement in the medium and long-term.

On the next slide, we detail our cash generation in which we see an increase of 67% in operating cash flow versus the third quarter of 2014, which is R$129.3 million, a record in the company's history with a conversion of operating cash of 127% of EBITDA.

The growth of operating cash flow can be explained mainly by the reduction in our working capital, which reflects an excellent performance of accounts receivable in the period. In year-to-date, we generated R$250 million of operating cash with a conversion rate of 92% of EBITDA.

On slide 23, we can see the CapEx for the quarter and year-to-date. In 2015, we have invested R$70 million mainly in the expansion of the Fleury brand and strategic IT projects, including the SAP reimplementation and integration of the front office system in Rio de Janeiro, which was previously mentioned.

Finally on slide 24, we see that our performance in the stock market had an increase of 32% on the average daily trading volume this quarter compared to the previous one. The share price closed the quarter at R$16.25, an increase of 14.8% from the end of the third quarter of last year.

We will now open the question-and-answer session. Thank you, all.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (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 you all for your attention and interest in following this earnings release. We've entered the fourth quarter of 2015 with confident in our strategy and competitive positioning with our brands, operations and qualifications of medical, technical and administrative personnel that makes us confident to deliver differentiated solutions to our customers with quality and profitability.

The attention to the lines of cost and expenses remain very strong, especially in our high inflation period, we have focused ourselves especially to review our productivity both in operations and in corporate structures. We have been pursuing, in a consistent and recurring manner, new ways to maximize our investments in personnel.

Finally, once more, I want to emphasize that the results obtained in the third quarter of 2015 and three quarters of 2015 accumulated leave us certain that the chosen path is correct. The strength of the company, its brands and values all of this it ensures a differentiated combination of leverages that make us able to grow through the current economic context and at the same time allow us to capture opportunities for growth and profitability always in a sustainable manner. Thank you, and a good day to everyone.

Operator

That does conclude the Grupo Fleury audio conference for today. Thank you very much for your participation. Have a good day, and thank you for using Chorus Call.