

Y 2019 Earnings Call

Company Participants

- Bruno Blatt, Chief Executive Officer
- Grace Cury De Almeida Goncalves Tourinho, Chief Financial Officer & Investor Relations Officer
- Jose Seripieri Filho, President
- Pedro Henrique Rocha Nocetti, Investor Relation Manager
- Unidentified Speaker

Other Participants

- Frederico Mendes
- Joseph Giordano
- Thiago Macruz

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for holding. At this time, we would like to welcome you to Qualicorp Conference Call to discuss the Results for the Fourth Quarter 2019. We have with us today, Mr. Bruno Blatt, the company's CEO; Mrs. Grace Tourinho, the CFO and IRO; and Mr. Pedro Henrique Rocha Nocetti, the IR Manager.

This event is being broadcast live via webcast and may be accessed through Qualicorp's website at www.qualicorp.com.br/ir where the presentation is also available. With this we would like to inform you that this event is being recorded and participants will be in listen-only mode during the company's presentation. And doing this, we will go on to the Q&A session, when further instructions will be given (Operator Instructions)

I will now turn over the floor to Mrs. Grace Tourinho, who will begin the conference call. Mrs. Tourinho, you may proceed.

Grace Cury De Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Thank you and a good day to all of you, and thank you for joining us in our conference call for the fourth quarter 2019. I apologize for our delay, we have had a minor problem with our call lines. We hope this will not happen again. Once again, we apologize for this, but we will begin the call.

FINAL

Before speaking about the last quarter, I think it is worth well briefly summarizing what happened in 2019 in the company. And what is that we expect for 2020. We were able to put the digital sales tool into operation successfully. And this tool nowadays account for 99% of our sales in house. With this tool, we have become more expeditious, more secure, and we're able to make adjustments in our personnel and to have a more efficient operation, allowing us to grow our margin during most of the year

For 2020, what we would like to streamline is the customer management tool that direct service with our customers, which will also help us enhance our processes, enhance the quality of service and our relationship with the customer. Beyond that, this will allow the company to be ready to grow consistently, opening up space to invest where we have greater need, especially in the commercial part in our products and in customer retention.

Let's focus a bit on the financial part, where we have had great achievements. First of all, we renewed the company debt, lengthening the period three or four years with great benefits and at lower rates. Formerly, we paid CDI plus 30%, we now pay CDI plus 15. Once again, great improvements in terms of our indebtedness. We reduced the capital by approximately BRL980 million, especially improving the capital structure of the company.

We concluded the company restructuring with a holding incorporating the brokerage company. And this is an operational highlight. This allows us to have greater operational efficiency, opens up new possibilities to deliver greater value to our shareholders, especially when it comes to shareholder equity payments that we'll now pay directly from the holding to our investors.

Having said this, I would like to refer to two issues that had a one-off impact on the fourth quarter: The first is Gama Sade and CRC that were acquired in 2014 for BRL202.3 million. Gama Sade and CRC once again were acquired in 2014 for BRL202.3 million -- company. The company has changed their focus and has now focused on the affinity area, which is where we have the greatest margins and revenue. And with this, despite the fact that in the last five years we have been focusing on the companies, they have never presented impactful results, result that would justify the goodwill paid for these companies. Although, we made several attempts to launch new products, to work with Gama Sade for a certain period of time.

We carried out an impairment test, and we decided to create a provision for the loss of recoverable value in the fourth quarter. Another point refers to one of the portfolio that we decided to migrate from one operator to another. And we took on approximately BRL24 million of costs were claims. Now we couldn't have worked in another way, working from one operator to the other. And it would have been very difficult to have a perfect migration. We would have lost 25% of the lives. Therefore, we prefer to make this investment --

(Technical Difficulty)

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

FINAL

-- In the past, and with this, the company went on increasing its portfolio after two years of loss of lives. We also had a slight reduction in the corporate segment. We had an increase of life in SMEs and TPA. But in the consolidated company portfolio, we had have a growth of more than 6% in number of lives.

We go on to Slide number 5 to speak about net revenue of BRL521 million for the fourth quarter 2019 in the annual and sequential comparison. This is a reflection of the readjustment. And we have higher revenues in terms of agency and brokerage in the addition segment. Now part of this comes from the agency itself for the previous quarter, when we compiled our results, and we saw that this had value and that we could calculate the agency rate. Now we also had a slight increase in other segments in the SME segment, as well as in the TPA segment.

We go on to Slide number 6 to speak about costs. Here, you can see a decrease in gross margin. And every year we have a reduction in expenses with personnel. And consequently, we have a reduction with the third-party services. Now, all of these costs related to tools, IT, our service tools with customers and customer management. The company has undergone streamlining. We're substituting ing several of our tools, and this has enabled us to have an enhancement viz-a-viz the third quarter '19. And we will continue to obtain gains in the coming quarters.

When it comes to royalties, savings of 3% year-on-year in the consolidated exercises. Thanks to the work carried out by the company in the management of these costs. And finally, to speak about other costs, we have the impact of the claims cost, as mentioned by Grace. Once again, this is a one-off event, and it is not a practice of the company to have these claims costs with its customers.

Now, when we look at the cost for the last quarter and the gross margin outlook, I would like to remind you that the company has done its homework very successfully. We continue to work successfully on this. We are going through a very difficult and challenging market situation when it comes to our portfolio. And what the company has obtained during the first month -- nine months of 2019, is the operating reality that ability of generating margins when compared to the fourth quarter '19. This is a more streamlined company now a days, and it is ready to sustain the growth that we wish to have going forward.

When it comes to administrative expenses, when you look at Slide number 7, the recurring administrative expenses, they increased 14%, more than in the sequential comparison. Now we had expenses with the initial process. And it is our understanding that the operational enhancements will enable us to reduce our expenses with administrative costs, especially when it comes to persone. We had costs with QSade project. This should not repeat itself going forward.

And we have some restricted actions, especially referring to executives that left the company in the month of November. When it comes to the amortization of expenses, you'll see the annual increases and the lease of the new headquarters of QSade in So Paulo, that will have an impact during the year 2020.

FINAL

Before giving the floor to Grace to speak about commercial expenses, I would once again like to show you the increase in amortization of expenses with lease, and the policy of awards and commissions referring to the sale of science, when it comes to these commissions. Now, if we were to way this by the old message, it was representing the BRL17 million for the fourth quarter '19.

Now what is important to highlight here for you to understand, which will be the behavior going forward. The commercial expenses of the company are based on commissions and awards for new sales. And the trend of this line of amortization of commissions is to increase, considering that our expenses in terms of cash have been much greater during the year.

In the fourth quarter of 2019, in our work for commissions, we amount to BRL17 million. In the second quarter, this will increase, as we increase sales. As we work with more aggressive campaigns, this line item will increase. And of course, will amount to BRL40 million, which is what the company is seeking to grow.

With this, I would like to return the floor to Grace.

Grace Cury De Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Thank you very much, Pedro. And let's speak about Slide 9, and that bad debts. Well, we are at this best moment, especially because of the recovery work that was carried out vis-a-vis the previous years. This quarter, we recovered BRL18 million, and the level in the coming quarter will be of approximately BRL10 million, give a bit here, give a bit there but of course it will be higher than in other quarters. And it was nothing as exceptional as we had this quarter, and net revenues were 1.3% of this.

Now we believe that with this, we were able to end the year with 3.5% of recovery, and this represents a significant recovery. We made strides, thanks to several initiatives that are being put in place to ensure that we can maintain this amount of bad debt at the lowest level possible. And what I would like to clarify here is that of course, we will not be able to maintain everything at the level of 1.3%. The outlook is to be more conservative, and thinks that it will remain at a level similar to 4%.

Now, when it comes to the other expenses, I would like to highlight two points. One, the impairment of Gama of BRL111 million that corresponds to a 100% of the goodwill recorded at the moment of acquiring the business, and extraordinary revenues with the sale of the aircraft of approximately BRL3 million in the fourth quarter.

In Slide 10, referring to our financial results, we had the renewal of our debentures in the third quarter '19. And we now have interest rates that will be pay in the third -- first and third quarters of every year. And revenues have a strong sequential reduction due to the recent reduction of capital that we carried out in November, November 5, of BRL918 million.

FINAL

We'll go on to Slide 11 to speak about EBITDA. EBITDA had a drop due to those two issues that I mentioned, the impairment and the claims cost. And of course, this will not repeat itself in the second quarter, as the contracts have been revisited. I would like to highlight the work of the company to adjust processes and implement digital transformation that has become ever stronger.

The operating reality of Qualicorp is the margin that we saw from January to September of 2019. What happened in the fourth quarter are one off events. And I would like to make it very clear that what we expect for coming periods is to have a return on our margin as we published from January to September of 2019. If we were to eliminate the non-recurring events of EBITDA, we would obtain BRL261 million this quarter with a margin of 50%. And we would obtain that BRL1 billion for the year 2019.

We go on to Slide 12 to speak about net income. We have a drop in terms of comparisons because of one off adjustments with an annual aliquot of taxes that is 30.8% vis-a-vis 36.8% in 2018, which means that we have had an advance of six percentage points.

I would like to thank the approval we had at the extraordinary assembly that enabled us to incorporate the brokerage company in October of 2019. And thus the company can launch the income tax and the fiscal losses, representing BRL50 million in the holding of this amount. BRL15 million have already been used in the exercise itself and BRL35 million will be used in future quarters. Most of these benefits of course will be used during the year 2020.

We go on to Slide 13, to speak about CapEx and indebtedness. The company ended the fourth quarter with a net debt of BRL918 million due to the capital reduction of BRL980 million, maintaining strong operational cash generation, enabling us to continue to deliver value to the shareholders, carry out acquisitions or payment of dividends.

The company was able to work with the acquisition of Uniconsult now in February of 2020. So we still haven't included this amount in the company balance. We have acquired 75% of this company with 35,000 lives through the amount of BRL25 million. We had the purchase of BRL12 million, adding 6,000 lives to the company portfolio.

We now go on to Slide 14 to speak about cash flow. Operating cash flow was positive and BRL189 million for the quarter, higher than the previous quarter, especially due to the strong performance vis-a-vis the third quarter 2019, because of an improvement in working capital, the sale of the aircraft and a lower use of cash, because we accounted for the losses that we had in the holding.

Now to speak a bit about the sale of our subsidiary QSade, the spinoff. We would like to thank the shareholders that participated in the assembly and helped us to approve this. The company followed the best governance practices to ensure that the information will be fully transparent for the decision-making process. And we are now awaiting the final approval to be able to materialize and conclude this sale.

It is important to highlight that their subsidiary -- health subsidiary that is still part of the Quali health group consumed BRL51 million from the company cash in 2019, BRL32 million directly impacted our results in 2019. And we will have savings, once this business is truly materialized. We believe, therefore, that this operation should be concluded in the coming weeks.

So I would like to thank you, and I now give the floor to Bruno Blatt, who will speak a bit about our outlook for the year 2020.

Bruno Blatt {BIO 21352052 <GO>}

Hey, good morning to all of you, and thank you for joining us in our conference call. Four months ago, I began working at Qualicorp, and I was ready for a new cycle of sustainable investment. Now all of this will represent a growth in revenue, more competitive products in our portfolio, and we should work better with market operators.

We have began speaking with new operators in some states, and we have some concrete achievements on this front. Now we have five new and more competitive products in the Southeast and Northeast. And all of this will come in the market, beginning in May. In the South, we have lower market penetration, and we're speaking with the operators in that region.

As mentioned by Grace, we have acquired some companies and strategically this complements our product portfolio. Now the company has become a sales machine and a health manager. Now the market is changing and there is an ever-growing demand for products that have higher quality. Now Qualicorp has to change to be able to adapt to this new market. I have met with the brokers and with our partners, to analyze new alternatives for products and services, and to ensure we have good offers for our end customers. And in the right time, we're going to disseminate this information.

Now in the four months, we took several initiatives for the company, always focusing on sales and retention of customers. We have 10,000 entities and 4,000 brokers, and all of these are fundamental. Once again, we have several initiatives underway. We're changing our way of working, and we're becoming ever more productive. And we're trying to resolve the problems in our business, and generate ever more value. We have a new Board, we have a new innovation team, new businesses, and we're going to speak with the President of this new business department.

Jose Seripieri Filho {BIO 17325794 <GO>}

Hey, good morning to all of you. Thank you Bruno. Now many of you know me. I have been in Qualicorp for more than 18 years in the financial department, but I have been a manager in several operational departments. And I was part of the team that worked on the IPO, the follow on and several acquisitions. And when we get the operations with and.

Now the innovation Board has the aim of consolidating and leveraging all of the initiatives linked to innovation, new business, M&As and of course, strategic business.

At the end of the day what we expect with this is to have a more modern company that is more agile to enhance the experience, and strengthen the relationship with our customers, brokers, operators, and especially with our team, our in-house team. Once again, I am deeply satisfied with this new challenge, and I hope to be able to contribute significantly. It has been a pleasure to be with you, thank you once again.

And I think that now, we can go on to the Q&A session. Thank you.

Questions And Answers

Operator

(Question And Answer)

Thank you. We will now go on to the Q&A session. (Operator Instructions) Mr.Thiago Macruz from Ita BBA would like to pose a question.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hey, good morning. This is (inaudible) Macruz. I would like to hear about the company's plans for this year to gain a better understanding. There's a great deal of things to still discuss within the company. So I would like to know your foundation? This is my first question. Secondly, I would like to gain a better understanding of your investments to help you to reduce the problems that you basically faced in this last quarter? Thank you very much. These are my questions.

A - Bruno Blatt {BIO 21352052 <GO>}

Thiago, this is Bruno Blatt, and thank you for your question. When it comes to products because of a commercial strategy, we're not going to go into the details of the products. As I mentioned before, we are working with 500 partner entities and with operators that we're holding a dialogue with. These are operators we were now working with. And we have well located products in regions where we did not have these products. We do continue with our traditional products. We have undergone a broad evolution. We already have some products for the coming in quarter, as I mentioned. Our team is on the streets to be able to work properly and decide which channel this will be sold through. So we have a significant number of new products and ideas that we will launch in coming quarters.

When it comes to the tool, I would like to speak about this in greater detail.

Now what the company wants is to generate a better experience in its customer service. If we are able to speed up the service to the customer using WhatsApp tools, if we are able to resolve the large number of demand with self attention through the application of a portal, we will have more satisfied customers. Customers that will complain less. And in the final amount, customers that will not seek the national health agency to resolve their problem.

Once we enhance our customer management tool, we will commit less mistakes, which means that this represents a series of enhancements that we have implemented and will continue to implement to enhance the customer's experience. Of course, it will allow us some savings and avoid that wear and tear with our customers. Through that we want is to satisfy customer, because they have the right projects for them or because they can count on Qualicorp to resolve their problem.

Q - Thiago Macruz {BIO 16404924 <GO>}

Very good. Thank you very much for the responses.

Operator

Mr.Frederico Mendes from Bradesco would like to pose a question.

Q - Frederico Mendes {BIO 19832788 <GO>}

Hey, good morning to all of you, and thank you for taking my questions. I would like to speak in greater detail about your -- I think, management enhancements during the fourth quarter, the considerable change vis--vis the third quarte. Now when I -- when we look at 2020, if we could focus on the main lines where you have an opportunity to reduce costs. If you could give us more visibility about this, how are you going to reduce your costs going forward in 2020 and 2021? Thank you.

Thank you for your question. When it comes to the agency costs, we receive an analysis from the operators about the products and in great detail. We carry out conciliation when it comes to specific products and some of them have different percentages, have -- some have 50%, other have 200%, depending on the operator and the product that is being sold.

And in this conciliation, we have noticed that we have some amounts that has already been realized but not paid for by the operators, and we were able to recover this in the fourth quarter. And that is why we're proceeding very cautiously. Part or some of these revenues may have happened in previous quarters, but we have now realized them. The fourth quarter does have a positive effect when it comes to this reconciliation and the payment of revenue that was done subsequently by the operators.

When it comes to the cost reductions, of course, we're constantly seeking opportunities in house. And there are new opportunities.

Well Bruno is looking upon this with a completely new pair of eyes. We're making adjustments. So we can have even more significant cost reductions.

A - Bruno Blatt {BIO 21352052 <GO>}

Fred, this is Blatt. Thank you for your question. We have made significant efforts. We had worked during previous years to reduce our costs and the team truly worked brilliantly when it comes to cost reduction. But we have found other opportunities. We had a

FINAL

building with seven floors. We're reducing this to five floors. The intention is to have a reduction of another two floors. Of course, this represents a significant savings. And there are opportunities. Day-after-day, we find these opportunities.

Now I don't want to speak about this further because we're about to invest in our distribution channel. And we're investing in new entities, new operators with a focus on the end customer, new products and new channels. And we're making a diversity of investment for the long term of the company. Of course, this will have a pressure on our expenses, but I will not go into details, as we don't have them to give at this moment.

Q - Frederico Mendes {BIO 19832788 <GO>}

Thank you. Thank you very much for your response.

A - Bruno Blatt {BIO 21352052 <GO>}

Thank you, Fred for your questions.

(Operator:) Mr.Leandro Bastos from Citibank would like to pose a question.

(Analyst:) Good morning. I would like to know how you're offsetting that capital -- after that capital reduction that you carried out?

A - Grace Cury De Almeida Goncalves Tourinho {BIO 17244138 <GO>}

Excellent question, Leandro, and thank you. Now since the beginning five years ago when I entered the company, the idea was to have 60% or 40%. 60% of indebtedness, and 40% of our own capital. We still have not even gotten to that, but we're very close. We have taken a step in the right direction. Another step is to intensify the structure of our companies.

We have just acquired Uniconsult, which means that we would have three managements with three different company names, and we will have to take that fourth step eventually. Thank you for your question and of course, we're always going to seek the best capital structure for the company. This is important to make the company more expeditious and to bring about higher returns for investors. This is something we will seek constantly. Thank you.

(Analyst:) Thank you, Grace for your response.

Operator

Mr.Joseph Giordano from JP Morgan would like to pose a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hey, good morning to all of you. Thank you for taking my questions. The first refers to the new products in new regions as was mentioned. I would like to know if there has been a

Bloomberg Transcript

change in the company economics to make these products ever more competitive in terms of price. If the parity will be somewhat lower, if the management rates charged by the company will be lower?

My second question goes to Grace in the financial part. Very good results. Now, I would like to understand going forward, what's going to happen with the recovery of bad debts and which would be a normalized situation going forward? And some timely issues referring to QSade, what is that we can imagine? Is it BRL 40 million, BRL 30 million or what is your intention?

A - Unidentified Speaker

This is Elton speaking to you and speaking about your products. Now I'm heading with initiative. And let me explain to you what is it that we foresee. We're beginning these new products now and what we have is a cluster vision. We're where no longer working with basic or intermediate products that are the same for everybody. And we're going to now see if it makes sense or not to change our product base to make our products more competitive, according to specific regions.

Going forward our economics have not changed very much, because we're making timely changes 1% to 3% this fine-tuning. Now where we've adopted a broader vision we're discussing the products in terms of customer loyalty and we're thinking perhaps of working with differentiated agency fees. Now it doesn't make sense to have very high commercial expenses with some of these products.

Now when we're working with retention products, perhaps the agency fee can be somewhat lower. But we do have a certain foundation. So we're working with the details to be able to create a more customized experience for the customer. And this is what we're working on primarily. And this was not your question, but we have 90 management companies that we could acquire and this would be acceptable by CADE with regional products that might be of interest for us in some specific regions. This means we would have additional annual products during the year 2020 with a different strategy.

We would have a local manager. And it would make sense to have these products in-house in the company. And we have mapped of this. And we're thinking about these local products as they would make sense for the company. Once again, we're simply serving this. And this would not have an impact on our recurring revenues and they would be important, in terms of retention or increasing customer loyalty. And this would lengthen the period in which people are with us within the company. And of course, this will enable us to leverage our returns.

Now regarding your second question that refers to uncollectible debts or bad debts. In 2018, our recovery rate was approximately 6%. I don't know if you recall, but we have some contracts in Rio de Janeiro, where we had customers who were not paying and we measured that this debt amounted to a very high percentage 2018. And these amounts were practically recovered in 2019.

FINAL

Bloomberg Transcript

FINAL

Benefiting our exercise for 2019. Now this wasn't the only positive impact on our exercise. There were other internal activities in the company that also had a positive impact. I don't believe in a rate of bad debts that will be higher than 6%. We have now changed this level, I'm sorry, but I also do not believe that we can get to 3.5% as we presented in 2019. I believe, in a rate of 4.5% or approximately 4.5% or 5%. Once again, it is not a very simple task. We do have a readjustment that will happen between July and August, and with this adjustment, if we have lower percentages, this will help us a great deal in terms of the uncollectible precedent, I think we will remain at around 4.5%, or even lower amount.

Now when we speak about the line item personnel, without saying anything extraordinary, I would like to say the third quarter 2019, we can reduce the figures when we withdraw all the effect of QSade and get to a level of BRL 3 million to BRL 4 million.

Now in my view point, I think we're very close to this, unless we have A one time impact on our administrative expenses. We have carried out a series of reductions in '19. We had cost with severance in 2019. And once again, this should not repeat itself in the year 2020. I hope that, that has responded to your question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Yes, great and thank you very much. And simply a follow up in terms of that benefit and you spoke about M&As. If quantify the universe of life that portfolio that we're speaking about?

A - Unidentified Speaker

Thank you for that additional question. We have 90 in terms of regional products that we think are worthwhile considering 109 active administrators with a good invoicing. And we have to look at them more calmly. Now at this precise moment, we're working in depth on this. We're serving potential markets, potential products. And we're also looking at the competition and their products.

Therefore we cannot divulge any information because of this. But what I can say is that we're looking upon this almost surgically of making investments in specific regions, considering the target audience that we have at present. And we cannot give you more color on this because at present we're working with the part of intelligence, business intelligence. And we have no figures that we could share with you presently. Thank you.

(Operator:) At this point we would like to end the question-and-answer session. We will now turn the floor back to Mrs. Grace Tourinho for the closing remarks.

A - Grace Cury De Almeida Goncalves Tourinho {BIO 17244138 <GO>}

I would like to Thank you, once again, and we're at your entire disposal the entire Investor Relations team, should you have any doubt. Thank you very much.

(Operator:) The conference call for Qualicorp ends here. We would like to thank all of you for your participation. Have a good day.

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