Q2 2014 Earnings Call

Company Participants

- Adolpho Cyriaco Nunes de Souza Neto, Chief Financial Officer
- Joao Ricardo Kalil Patah, Director, Investor Relations Officer
- Vivien Bouzan Gomez Navarro Rosso, Chief Executive Officer

Other Participants

- Guilherme Assis, Analyst

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2014 Second Quarter Conference Call. Mrs. Vivien Rosso, CEO; Mr. Adolpho Souza Neto, CFO; Mr. Joao Patah, 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 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 beliefs 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 conditions and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Mrs. Vivien Rosso, CEO of Grupo Fleury. Ms. Vivien, you may now begin the presentation.

Vivien Bouzan Gomez Navarro Rosso {BIO 16579525 <GO>}

Good afternoon and thank you for attending our results conference. Our company has been pursuing a profitability rebound targeting to improve returns on assets and operational efficiencies, while focusing 2014 Fleury brand expansion plan and to rebalance our portfolio. The second quarter of this year have been pointed out on the dilution of fixed costs that was hindered by the comparison basis in Rio de Janeiro and as well the additional events and holidays in this quarter.

Consolidated gross revenue as a result decreased 4.9%. In spite of that, Fleury brand grow 7.1% and the same hospital sales grow 6.7%. The regional brands excluding Rio de Janeiro remaining at the same level of the last year. For the upcoming period, additional adjustments are underway, continue underway mainly in Rio de Janeiro and is targeting profitability recovery in the region.

The maturation of Fleury brand investments, together with the installed capacity, will also capture increasing demand and as a result diluting fixed cost and improving profitability. As main highlights, the average revenue per test is still growing in this quarter 10.7% in the PSCs.

The effect of the adjustments in late 2013 continue advancing. The improvement on cost and expenses management still continues to and offset some inflationary impact. And the Fluery brand expansion plan accelerated also in this quarter and we have added 1,700 square meters, to two extensions in the Fleury brand.

The financial highlights for this quarter are, EBITDA of 70 million, the net income of 16 million, the operation cash flow has reached 92 million and was the best quarterly value registered. Innovation on service offering, we have signed a contract of a medical-hematological consultancy for Petrobras. And we had started this kind of services in our business-to-business unit.

We also launched the operations at the Hospital Santa Luzia, in Brasilia. And some awards we have received this quarter related to the excellence in services, also adding reputation award is Most Admired Companies by HR and also we have been rated as one of the 50 strongest and most valuable Brazilian brand, according to the magazine Isto e Dinheiro.

And the Grupo Fluery goals for 2014 continues to be restoring the profitability of our portfolio, ensuring the delivery of this excellence in services and through continued recognized by the customers and the communities physicians as the best offering in medical diagnostics.

I will pass the word to Joao Patah, who will continue our highlights in the financial statements.

Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Good morning everyone and thank you Vivien. Beginning on slide 7, where we detail the revenue growth, we see the comparison effect on the decision taken at the end of 2013 in the portfolio selection of payers and services, which impact the growth of B2B business and Rio de Janeiro patient service centers. The effect was even higher this quarter due to the negative calendar, as already mentioned.

Here I highlight that only accounting for the additional holidays, the negative impact on working days was greater than 5% on the quarter. In addition, during the days of games and days after the games, mainly from Brazil's teams -- from Brazil's team demand was clearly lower than other normal days. This caused a distortion in the analysis and interpretation of the numbers and the appropriate dilution of fixed costs will only become clearer and softened as from the third quarter.

On slide eight, I highlight the continued growth of Fleury brand and expansion plan underway, again to capture the demand for higher quality and complex services. The growth of 7.1% comes to two digits levels when we consider the comparable working days, which brings good prospects for the second half of the year.

About expansion plan, the delivery of 4,700 square meters in the first half, an addition of about 7,000 square meters should be delivered as from December at needed capacity (inaudible) capturing of the latent demand. On the regional brands, I again emphasize that adjustments of the capacity in Rio, in the end of 2013, was lower than the volumes selected. So capacity is now above volume and this was done to evaluate the pace of the demand recovery. As a consequence, additional adjustments are underway to improve the margin. The positive news is a reflection on the quality of the revenue and consequently on the cash flow.

Regarding regional brands, in the other markets, the stable revenues together with improved cost control bring progress to the margin in upcoming months. Again, revenue per working day keep good perspectives.

On slide 8, we also comment some numbers on the table. Firstly, the average revenue per test show this the expected effect due to the evolution of the mix of services, mix of brands, mix of contracts and the annual adjustments of the contracts itself. On the revenue per square meters, there was a decrease caused by the recent opening of PSCs in Fleury brand, which will be matured in the coming months and the comparative reduction of the volumes in Rio, besides the calendar effect. Both this indicator and indicator revenue per square -- per patient service center had several joint effects such as the mix of brands shown in slide 9. Accordingly, revenue per PSC growth in the consolidated number due to the (inaudible) of Fleury brand which has larger and more complex units. On slide 10, we show the evolution view with positive trends (inaudible) indicators.

Before commenting on reductions, costs and expenses, it's worth mentioning in light of B2B businesses that we began a new operation in Brasilia Federal Capital and the health assessment services continued to grow robustly. The expansion of our clients continues to contribute to the business line growth, as seen by the same hospital sales.

About deduction in consolidations on slide 12, this quarter shows the effect of the provisions related to cancelled contracts. In other words, invoices issued before the cancellation of the contracts are entering in the upper bands of the policy provisions, while negotiations for payment are underway. Thus the accounting effect is negative in net revenue. These effects related to certain contracts totaled 103 basis points in the quarter. The number, considering only recurrent reductions are better than the previous year.

We have already commented in the previous quarter and reinforce now that the positive effect of better quality revenue on deductions will only become evident after completing the cleaning cycle on the balance sheet. However, the positive effects are already visible in the receivables and working capital cycle.

Let us now turn to the slides about costs and expenses, beginning on slide 13. Here as we have already (inaudible) in the previous quarter, we see the effect of the implemented plans and improved management of cost and expenses. The drivers of fixed costs are stabilized and we have selected operations and offerings and consequently could keep the total cost at the same level as the previous year, offsetting the effects of inflation and increased supply for the Fleury brand. So, the line of materials, which is predominantly variable, keeps on the same level as the prior year. And it's lower in the average of the semester. At the same time, the cost line, which has more fixed characteristics have decreased in general, with exception of the general services and rental cost line, which increased through the planned expansions.

In SG&A, the same stats can be seen. Thus, dilution of these costs in the new term as well as additional adjustments mentioned will be better through the future consolidated margins. Now, I'll pass the word on to Adolpho. Adolpho please.

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

Thank you Patah, good afternoon everybody. Turning now to the below the line, slide 17. We started the financial results for the quarter, which represented a net expense of 15.7 million compared to 13.6 million in the same period last year.

This change which was forecasted in our projections is caused by higher interest rates and the fact that we have a smaller amount of cash invested mainly due to the payment of dividends. It's appropriate at this point to give an explanation that the dividend payment made in quarter two of BRL100 million came from our investment reserves and was made to reflect the current expectations of management with respect to our total investment plan, which was reduced since the reserve was made, due to the company's focus on the expansion of the Fleury brand as well as the rationalization and greater efficiency in purchasing for those investments.

Now jumping to slides -- I'm going to slide 19, tax calculation. We see the breakdown of our rate of income tax and social contribution, which in the second quarter of 2014, was 36.7%, all of it on deferred taxes, since using the good view of our positions led again to our cash tax equal to zero resulting in improvement of our cash earnings.

Turning now to the previous slide, slide 18, consider our operating term of 41.3 million in the quarter and the financial tax results that I just mentioned, we've had a net profit of 16.3 million in the quarter or 25.6 million, excluding deferred taxes, the so called cash net income. This represented a margin of 6.3% in the quarter compared with 9.9% in the same period of last year. Going now to slide 20, we see that our operating cash flow in the quarter was close to BRL92 million, a record for the company and that shows that we are in the right direction in the actions taken to extend the payment terms with vendors and improve our internal processes so that we can bill and receive in a more efficient way.

Our average collection period was reduced to 5 days from the previous quarter, from 86 to 81 days, while our average payment rose 3 days reaching 50 days. This value of 92 million generated at the operational level was more than sufficient to fund the CapEx in the period close to 20 million, which added to the disbursement [ph] of the debit service of other ventures and the payment of the 100 million in dividends already mentioned, generated a total negative net cash flow of 40 million, in line with the previous year.

Finally, going to the next slides. We'll give a little more detail about the most important item in our working capital which is the accounts receivable. This account had a net decrease of 30 million against the balance of March 2014, despite the revenue growth of 4.1% in the second quarter against the previous quarter, reflecting the improvements already mentioned. We had a worsening in our aging profile mainly due to ongoing negotiations that should be finalized in the next two quarters and should result in some write offs in later periods. Since our (inaudible) provisions of that is beyond 120 days, continue its upward trend rising to 66% in the quarter. There are no expectations of significant impacts of these write offs in our results.

Finally, looking at CapEx, as mentioned before, the amount was 20.5 million, very focused on our expansion program of the Fleury brand where we (inaudible) and expansion of the Brasilian unit with a net addition of 1,300 square meters and the addition of a new floor in our (technical difficulty) unit, resulting in a net addition of 500 square meters.

We would like to anticipate that for the full year there will be a reduction in initial number of 220 million of CapEx, even considering the higher intensity of investments that we forecast for the second half and the strong expansion for the Fleury brand, which will continue through 2015. Now we will start the Q&A section.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question-and answer session. (Operator Instructions). Our first question comes from Mr. Guilherme Assis with Brasil Plural.

Q - Guilherme Assis {BIO 16143141 <GO>}

Hi, good afternoon, thanks for taking my call. I have a follow-up question from a Portuguese call, which is looking at the -- your number, we had reduced the number of physicians in your company.

I'd like to understand is that reduction is a part of the profitability efforts that you are taking to the regional and (inaudible) plans and why is that taking place, is that taking place at the patient service centers or is that taking place at the company's headquarters? And if we should expect a further reduction down the road or -- is it all the efforts that you are trying to make had already been completed, that's my question. Thank you.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Thank you, Guilherme, the number of physician Guilherme, they have two characteristics. First, as it's correlated to our reduction of offering in Rio de Janeiro mainly. So, it's just to remind Rio de Janeiro operations, (inaudible) operations was highly concentrated, is still highly concentrated in imaging.

And so as we reduced the number of patient service centers we could reduce also and concentrate the offering of services. At the same time that we -- it's part of one of our plans also to give more schedules to the same physicians. So sometimes we have a number of physicians doing lower numbers of days and we try to -- are trying to direct the offering to a lower number of physicians.

So there are these two effects on the same time, but mainly is about the offering you'll see or

there is no reduction in headquarters and there is, including increase of the number of physicians and we want to increase even more for the offering of Fleury brand than the other premium brands.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. Thank you.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Welcome.

Operator

(inaudible) Mrs. Vivien Rosso to proceed with her closing statements. Please go ahead, Mrs. Vivien.

A - Vivien Bouzan Gomez Navarro Rosso {BIO 16579525 <GO>}

I would like to point out that our second semester focus, will keep on stronger and first and the better expectation on the line of revenues. And mainly due to Fleury expansion continues as planned and also Rio de Janeiro recovery in a faster pace. The second is related to cost and expenses management and systems, which shall benefit mainly all the brands, the regional brands. And we also are accelerating initiatives in risk management and also intense internal auditing. And the last one is our commitment with the excellence in services delivery through better people and development practices, medical specialty integration mainly in Rio de Janeiro and leveraging the quality management in each brand. I would like to thank you, everyone, and good afternoon.

Operator

This concludes Fleury audio conference for today. Thank you very much for your participation and have a good day.