Q1 2013 Earnings Call

Company Participants

- Joao Patah, Head of Investor Relation
- Omar Hauache, Chief Executive Officer

Other Participants

- Andrea Teixeira, Analyst
- Joao Carlos dos Santos, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

Good afternoon, everyone. Welcome to Grupo Fleury 2013 First Quarter Conference Call. Mr. Omar Hauache, CEO and 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 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 statements are based on the beliefs and assumptions of Grupo Fleury 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 conditions related to macroeconomic conditions, industry, 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 Mr. Omar Hauache, CEO of Grupo Fleury. Mr. Hauache, you may begin your presentation.

Omar Hauache {BIO 16579589 <GO>}

Okya, thank you and good morning, everyone. So let's move to slide number three. Here we show you how our organic growth performed in the last quarters. In spite of the economic slowdown and a tough comparison with the first quarter of 2012 when our organic growth was closed to 19% and even considering less working days in the first quarter of 2013 versus last year, we were still able to reach a double-digit organic growth.

The main drivers for our 10.5% gross revenue growth and 12% net revenue growth were mainly patient service centers and hospitals operations growth. We consider our good growth performance to be a result of market share expansion both for Fleury and a+. The integration of Labs is underway and contribution for margin growth coming from this business should happen in the second semester.

On slide number four, we comment on some other financial highlights. PSCs grew 11.2% as the maturation of 2011 investment cycle advances. We observed a well-balanced contribution of volume, price and mix for this performance. Same-store sales increased by 9.6%. Revenue per square meter achieved R$3.7 thousand, an improvement of 10.4% year-over-year. This result has to do with our focus on productivity and profitability, and we understand that there are still opportunities to improve these indicators especially in Rio de Janeiro.

Our organic growth in hospitals reached 11% and same-hospital sales increases by 17.5%, meaning that in spite of high occupancy rates, these hospitals are growing consistently. Well, we are looking for new contracts but, that is a case which acquisitions we need to be very selective when evaluating if it's worth on not to work with some specific hospitals.

EBITDA amounts to R$73.2 million and this corresponds to 18.6% margin on net revenue, which is lower than the 22% EBITDA margin that we reported in the first quarter of last year, but is 160 [ph] base points higher than the recurrent EBITDA margin of the fourth quarter of 2012. This recurrent margin expansion when compared to the last quarter should be considered a positive trend.

Net income achieves R$21.6 million, meaning a 5.5% margin on net revenue and operating cash flow was R$39 million in the first quarter of this year compared to R$13 million in the first quarter of 2012. This cash flow was enough to fund the quarters' CapEx.

We have been encouraged with the market sharing our thoughts on how our margins and net income should perform this year. In this context, it is no surprise our margin results during this first quarter of 2013. This is related to how we are preparing our company for further growth, with higher profitability in the next quarters including 2014.

We decided to increase salaries of some physicians and employees during the fourth quarter of last year, and this was important to retain talents and to keep our strategy of differentiation. This effect will be partially offset as of the second quarter of this year, thanks to restructuring efforts or layoffs that were promoted during the first quarter of 2013. Severance charges totaled R$4 million in the first quarter or 100 base points in our EBITDA margin.

In addition to the increase in personnel and medical expenses, pre-operating costs should be mentioned as one other factor that plays an influence in our margins. During a recent meeting with analysts, which was held here in Sao Paulo, we described the major factors that will contribute to margins increase in the next coming quarters. I'd like to highlight some of these factors.

First, the review of processes and cost structures that started during the first quarter of this year. This is being done always making sure that the quality levels must never be harmed. Gains coming from this review will start to benefit our margins as of the second quarter of this year, and more importantly during the second semester.

Second, PSCs' maturation and increased services offering in 2011-2012 cycle with consequent dilution of fixed costs for the continuing organic growth. In addition to that, profitability enrichment in Labs and integration synergies with the completion of the integration process and the beginning of the Labs a+ brand unification are always important drivers for margin expansion. We always count on best price negotiations, arriving from internal drivers by selecting the portfolio of payers and increases at minimum of 100% of inflation. Regarding receivables, we still need to improve even more our cash collection efficiency and Patah will comment more on this topic later on.

Restructuring of the preventive medicine business focusing on margins is also underway. The same thing we did in the lab-to-lab business is underway for the preventive medicine businesses, which are health promotion and chronic disease management. Lab-to-lab decreased its revenues when compared with the corresponding quarter of 2012, but now is delivering much better profitabilities. We no longer accept non-profitable businesses in our company regardless the size of these businesses.

Now let's move to slide five and here, we mentioned some operational highlights. We describe in details the investments related with expansion projects during the last meeting I mentioned with analysts that was held in April of '12. The presentation is available at our IR website and is included in the appendix of this presentation. Regarding Grupo Papaiz, the deal was concluded and the figures have been consolidated as of February 2013.

Now some words on recent recognitions. For the fourth consecutive year, we were awarded as the Most Welcoming Company for Customers in a survey conducted by the Brazilian Institute of Corporate Hospitality. Weinmann was awarded by Jornal do Comercio and Qualidata as top of mind brand in the category of clinical labs in Rio Grande do Sul. Grupo Fleury's Corporate University was recognized for its business education programs by International Quality Productivity Center as one of the five best corporate universities in Brazil.

And finally, Fleurybrand was once more ranked as one of the most valuable brands in Brazil in a survey conducted by Dinheiro Magazine and Brand Analytics, Millward Brown.

Now I will pass on the word to Joao Patah.

Joao Patah

Thank you, Omar and good morning, everyone. I will start with slide six on revenue, commenting on the increased participation of clinical analysis. The growth of these services in Labs brand and in hospital operations exceeded the imaging growth. I remind you that the chunk increasing the imaging supply for example in a+ brand in Sao Paulo city has brought great growth in these services by many of the customers also make -- but many of the customers also make clinical analysis tests jointly.

On slide seven, we see the growth in average revenue per exam of approximately 3.5%, mainly as an effect of the annual adjustment of prices. Adding this factor to the increase in volumes, we have made effective progress in asset utilization as shown in revenue per square meter. The continued progress should generate expansion of margins throughout the year.

Slide eight relating to operation in hospitals was already mentioned by Omar. Growth prospects remain very good in this business line and we continue to strengthen our relationship with our partner hospitals. On slide nine, I emphasize that the process of restructuring [ph] lab-to-lab business, as also mentioned by Omar, improved the average prices, the mix of exams and consequently margins in this business line, similar to what we expect to begin in chronicle disease management and health promotion after the undergoing revision.

Commenting on the accounts receivables of the quarter, there was a small increase, but it includes amounts already negotiated with some payers, with some signed IOUs and these negotiations that must be paid along the year, which will result in progressive improvements in working capital along the year. We are advancing in other negotiations to adjust prices and correct some payment practices, which will complement the improvement of internal processes already underway.

On costs open it on slide 11, I emphasize that materials and outsourcing costs line follows a good efficiency and volume growth. The two major cost lines deserve some comments on slide 12. As previously mentioned it in the 4Q12 conference call and by Omar today, the company increased its staff and physicians to enhance the high-levels of services and quality operations offered, both in patient service centers and operations in hospitals.

Salaries and benefits were also adjusted in some regions to ensure talent retention and attraction of new professionals. The results have been positive overall, in the overall level of satisfaction and generated gains in market shares. The expected dilution of fixed costs combined with other restructurings already underway as in the example of leadership structures, will lead to changes in margins mainly in the second half of the year.

The line of general services, rent and utilities and this line was an increase compared to 4Q12, even with calculation adjustments. However, this line was impacted by new local rents and contract fines. In conclusion, for the two lines, we expect small adjustments in this second Q of this year, already including the effect of inflation, with progressive improvement in percentage terms.

Operating expenses on slide 13, G&A has noticed improvements in relations to 4Q12, and should evolve positively in the following quarters, excluding specific expenses of marketing which will be focused on the second and third quarters of this year, is slightly growing the percentage of revenues.

On slide 14, we consolidate the main points that impacted EBITDA, which were exactly the lines we expect to gain efficiency in the coming quarters, especially in the second half of the year. In slide 15 on debt and financial results worth two comments. Firstly, the leverage remains low, with net debt over EBITDA lower than 1.5 times in this quarter. The second comment refers to the net financial result which was within our expected levels, since there was no further use of cash after the second issuance of debentures completed in February.

Going to the net income slides 16 and 17, we see that non-cash effects such as deferred income taxes impacted by 1.6% compared to 1Q12. The tax benefit that caused the cash tax to be zero in this quarter should continue in the rest of the year, and shall generate lower values in the following years. This is explained by the amortization of goodwill and the future use of accumulated tax losses.

Our operating cash flow shown in the slide 18 was enough for organic CapEx for the quarter. The working capital was still above our expectations, but we expect continuous evolution in these items. As I have already observed in light of the accounts receivables.

Commenting on CapEx in the next slide, it was mainly related to the evolution of the IT platform and the beginning of the execution of the expansion projects. Higher investment reimbursements will be concentrated in the end of the year as forecasted by our project schedules.

To finish the presentation before moving to the Q&A session, I want to highlight the increased liquidity of the shares. The average daily trade volume of 7.5 million in the first quarter of the year, already exceeded 11 million in April.

Thank you and we are now available for Q&A session.

Questions And Answers

Operator

Excuse me, ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Mr. Joao Carlos dos Santos with BTG Pactual.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Thanks for taking the question. Actually Omar, just as a follow-up from our discussion in the Portuguese conference call on the sales per square meter evolution over the year, just wanted to confirm if it's reasonable to assume that as sales accelerate throughout the year, this metric should go up throughout the next quarters and if you do have some sort of a target for the end of the year on this metric.

And the second question would be related to CapEx. If this acceleration that we should see throughout the year, if it should start in the second quarter or if it's going to be more back-loaded to the end, like in the fourth quarter of this year due to the opening of new Patient Service Centers. Thanks.

A - Omar Hauache {BIO 16579589 <GO>}

Thank you, Joao Carlos. So, the first question regarding the revenue per square meters, we expect this indicator to increase along time. We also need to respect the seasonality of each quarter, so it's very important to compare the correspondent quarters of the year of course, but there is room for further increase. We have no targets, no specific targets that we can share with you, but as I mentioned to you before, there is room for further increase especially coming from Rio de Janeiro.

We have PSCs in Rio de Janeiro under Labs brands, that are very strong in imaging, but they are not strong enough in clinical analysis and we are -- by now, we are just adding clinical analysis to some of these PSCs. And we are doing the same thing for the current a+ brand in Rio, we are enriching some of these PSCs with imaging and so we are preparing for the co-branding Labs a+ that we are going to launch by the second semester of this year, but there is room for further improvement.

We just need to be cautious when we compare the figures respecting seasonality in the corresponding quarters. The other question you mentioned was regarding the CapEx?

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Yeah, CapEx acceleration throughout the year.

A - Omar Hauache {BIO 16579589 <GO>}

The CapEx acceleration, of course. Yeah, we expect this CapEx should accelerate by the second semester, right, that is the major bulk of the CapEx will be spent during the second semester of this year. So during the second quarter, we are going to have a stronger CapEx projects than the first, but the bulk of the investments are going to be concentrated in the second semester.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Thanks Omar, thank you very much.

A - Joao Patah

Joao just to complement on the first question, if we imagine the growth continuing and the levels that we are right now on the patient service centers to give objective numbers is not very difficult to imagine that we can be above R$4,000 per square meter, per quarter in the second and third quarter of the year. We are not far from there and so in the total of the year, it's not very hard to imagine number above 15.2 for example.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

That's very helpful, Patah. Thank you very much for that.

Operator

Our next question comes from Mr. Thiago Macruz with Itau BBA.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hey, good morning. Actually my question is regarding competition in the premium market here in the state of Sao Paulo. If you could provide us with an update on your view on this specific matter, I know that this has been a recurring subject throughout 2012 and now that you're targeting growth in the Fleury brand once again, I think it's just important to get a sense on how you're seeing competition in this market. Thank you.

A - Omar Hauache {BIO 16579589 <GO>}

Thank you, Thiago. Yes, this is a recurring question and what I usually say is that, that we have good competitors during this premium segment here in Sao Paulo, but Fleury is so strong and it's doing so well, it's performing so well and not only that. As you know we are preparing Fleury with this strong expansion plan that is going to be majorly delivered in 2014 to be able to get even more clients.

We have plenty of clients looking for Fleury services and we need to expand our facilities. We need to have more square footage available to see all these clients. So yes, the competition exists. Some of these competitors, they are good competitors, but at Fleury, again, we are investing a lot from Fleury is always a very strong and is doing very well.

Q - Thiago Macruz {BIO 16404924 <GO>}

All right thank you.

A - Omar Hauache {BIO 16579589 <GO>}

Thanks.

Operator

Our next question comes from Ms. Andrea Teixeira with J.P. Morgan.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hi, good afternoon again and thanks for taking my follow-up question. Omar just to complement from what you mentioned in the Portuguese call on the sales deductions or the NPLs, you had 21 million from the press release coming from past-due accounts, but last year, you had the equivalent amount, I mean 19 million, but if I recall well about 10 million were -- and I was looking at the press release this morning like -- actual last evening, the 10 million were actually nonrecurring, there was like an additional adjustment to the account. So that means what you had this year -- and I appreciate your comment that you said well, it's something exogenous and it's something that it has been happening for a while, that you have been having in that increase in deductions.

But you also hinted that things should improve sequentially. So I was just wondering if we should think of the 10 million as a potential reduction there, because that goes directly into your margins, and in a similar way to ask that if you're counting on your guidance of reaching like 22% EBITDA margin for 2013, if that is part of the game. Thank you.

A - Joao Patah

Andrea, just to see if I understand, you are asking mainly about the effect of specific cancellations on our forecast to continue improving this number, is that correct?

Q - Andrea Teixeira {BIO 1941397 <GO>}

No, I guess -- I mean, it's very specific on the number, there were 21 million in the first quarter of '13. Last year there were 19 million but on your comments on the press release of the first quarter of '13 -- I'm sorry, first quarter of '12, you had said that out of the 19 million, 10 million were additional or nonrecurring, okay were like an adjustment. And it sounds like as if like the 10 million then became more recurring, because it's the same level right now. So my question is and I know you wish -- Omar responded in the same way, it's better part of life as a healthcare provider that you have the negotiation going on.

My question is -- and he also said that he hopes to improve throughout the year. I'm just trying to reconcile that if you hope to improve throughout the year and you're hoping to improve margins, if it's embedded in the margin of 22% guidance that you have an improvement in that line as well or not, you can still reach the --

A - Joao Patah

Andrea, just to remind as I think the 10 million in the first quarter were write-off from accounts receivables and not provisions. They were directly write-offs from the balance sheet. So the number, the comparison is exactly the 19.1 [ph]. I don't have to take out the 10 million from the 19 million to compare. The 10 million that were nonrecurring in the first quarter of '12 were write-offs directly of the balance sheet and we're not impacting this specific line of cancellations. But anyway the improvement, the answer is yes, the improvement in this line will help the EBITDA evolution along the year, because we will -- as we improve this line, the level of cancellations will be lower in average than 4% and this will help to deliver better results.

Also jointly with this improvement that is connected with the negotiations, the portfolio negotiations of payers. As we negotiate better payers, normally they also have better average prices and they are better payers also. They help us in the cash that helps the financial results and this will not only help to improve the EBITDA margin but we expect that to improve also along the year the net income margin.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay, it's just like in the same sentence as if we had -- the same paragraph that we had the deductions had the same comment here, but I appreciate that then, the level remains the same, the 4% deduction. We should expect, but -- do you think we should expect the reduction already this year in this item throughout the quarters?

A - Omar Hauache {BIO 16579589 <GO>}

Andrea, so just reminding what you are talking about is that in the first quarter of 2012, the cancellations, they totaled R$21 million and this included these R$10 million that you are recalling. This 10 million has to do with the adjustment of bad debt provision policy that we reviewed at that time, that was a -- at that time was a nonrecurring item that we included, you're right, it is non-recurrent.

But that was already the new bad debt provision policy that we were applying for the Fleury Group. Now we are making use of these provision policies. So this is correct, this is all adapted to this new provision policy. So this is included in our results.

But what we expect you're right, we expect to improve these. We expect not to -- we cannot tolerate to see our aging worsening along quarters. We need to improve these indicators as well. So it's part of one strategic project that we had here at Grupo Fleury.

Q - Andrea Teixeira {BIO 1941397 <GO>}

And you expect [ph]-- thank you very much Omar and you expect that to be sequentially improving or it's a fact of -- as you have more negotiations more negotiations you have -- I mean because part of the conversation also is that you had a tremendous effort in the past year and a half to improve that.

A - Omar Hauache {BIO 16579589 <GO>}

Right, it has improved along some quarters. This first quarter, we were not satisfied with these results, that's a fact and we need to improve even more. So we are -- again this is a strategic project for us, we have some people now dedicated for this specific effort. I'm not satisfied with this index and we need to improve even more.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay, great. Thank you very much, again.

Operator

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Omar Hauache to proceed with his closing statements. Please go ahead, sir.

A - Omar Hauache {BIO 16579589 <GO>}

Thank you very much. Thank you all for the interest you have in our company, for being here with us today. I would like to thank your comments and questions. We are always available to answer any further doubts that you may have. Thank you and good morning.

Operator

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