Q4 2013 Earnings Call

Company Participants

- Adolfo Souza Neto, CFO
- Joao Patah, Head of IR
- Vivien Rosso, CEO

Presentation

Operator

Good afternoon, everyone. Welcome to Grupo Fleury's 2013 Fourth Quarter conference call. Mrs. Vivien Rosso, CEO; Mr. Adolfo Souza Neto, CFO; 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 the investor relations website at www.fleury.com.br/ir, where the presentation is also available. Those following the presentation via the webcast may pose their questions in advance on our website. They will be answered in the Q&A session, as long as we have enough time.

Before proceeding, let me mention that forward-looking 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 results 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 the 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. Mrs. Vivien, you may begin your presentation.

Vivien Rosso {BIO 16579525 <GO>}

Good morning. We thank you for attending our Fourth Quarter results conference. Let me start sharing the key messages regarding our (management) strategy, the short-term expected impacts, some of the KPIs and initiatives for 2014, and then our IR Director Joao Patah will explain the financial release.

Jumping to the fourth slide, I would like to comment during the previous year, the Company has performed strong revenue growth, either organic and through acquisition, delivering a portfolio transformation. Brand -- example, brands other than Fleury and business-to-business, together, have jumped to 54% of the total revenues in 2013, and have managed a (rebalancing) margin outcome.

Operational results have been pressured due to the challenges and additional costs from labs in Rio de Janeiro, a business under merger conclusion last quarter, as you know.

As anticipated in the Third Quarter results conference, and during the last months, the Company has implemented a strategy targeting profitability rebound to improve return on assets and operational efficiency, while focusing 2014 Fleury brand expansion plan in order to capture growing demand and, at the same, rebalancing portfolio margins.

The most important movement implemented during the Fourth Quarter was -- the first one was the portfolio selection targeting sustained profitability. It was concluded by services' line-up enrichment, shutdown of unprofitable small PSCs in Rio de Janeiro and some in Sao Paulo, terminate unprofitable contracts, the disease management business phase-out, and, at the same time, decelerating -- those combined effects have decelerated total growth to 5.8% in the Fourth Quarter. We expect that for us that's the U-turn point.

The second group was composed for the restructuring initiatives. They were introduced to drive the operational efficiency, the cost management, and also the key process redesign, such as cash conversion workflow, the zero-based budgeting methodology, IT systems to, for example, workforce management, and the upgrade -- the IT systems upgrade like the SAP to HR transactional, and also the (ETC).

The financial KPIs were affected, as you know, in short term, as expected, due to these restructuring initiatives, also by the non-recurring write-offs and the pre-operational expenses in a low seasonality quarter, at the same time. However, this decision was mandatory to ensure the Fleury Group profitability improvement from 2014 onward.

The next slide, the focus on Fleury's brand expansion strategic action plan, also accelerated revenue growth through 15.6% in the Fourth Quarter versus 12% when we consider the whole year. And it was related to the more efficient capacity offering, and, at the same time, capturing the growing demand.

Regional brands, except Rio de Janeiro, also expanded to 14.1% in the Fourth Quarter. This means that we can face the first outcome from this strategy, which has been implemented during the second semester.

Another KPI, interesting KPI, is related to average revenue per test, which grew 13.2% in the Fourth Quarter in the growth of patient service centers, the PSCs. As a result of service mix enrichment and also the contract renegotiation. This effect will contribute to profitability improvement during 2014.

Other operational KPIs already reviewed for cost of services, personnel, and general expenses have started downward trends, as Joao Patah will explain later.

Another key indicator was the operating activities that generated in the fourth BRL76 million cash. It represents the Company's highest historical level.

The Company keeps being recognized and awarded by our stakeholders, as you may see in the next slide. Recognition that Fleury's relationship with the customers, innovation in our R&D company, sustainability, best practices, and also in the business segment.

In addition, the Company was selected to compose the ISE Index from the Bovespa corporate sustainability index, to be part of this group during 2014.

Another recognition was received by Weinmann brand. It's our brand in the south region of Brazil, and it was one of five recognized as the category top of mind.

Now I would like to (inaudible) Mr. Patah the financial and operational KPI explanation.

Joao Patah

Thank you, everybody. I'll go in detail now a little bit more on the revenues.

First, on the right, (slide) 11 just to emphasize that we are doing this, this period, during the Fourth Quarter, already showing that we are bettering our asset utilization. Revenue per square meter, as an indictor, the ticket, average ticket, or the average per patient service center.

I will jump to slide 13, which are the same indicators, where we show that we -- when we detail in our brands, Fleury brand keeps moving strongly, as Vivien has mentioned, but also that a+, Felippe Mattoso, Weinmann, and Diagnoson have shown good growth.

The strengthening of the offering of Fleury brand, such as the patient service centers already opened as of February, will enable the acceleration of the capturing of demand for high quality services. The point of impact on margins and return on assets will be progressive from the Fourth Quarter on.

Along this year, we will show that revenues on all the brands will keep on growing. The comparison basis for Rio de Janeiro will suffer until September because of the continuation of the health plan that we implemented in the beginning of October, but this detail on the brands that are growing, and where we are growing, will help you to see that the trend is positive, and that the normalized basis continues to grow above the market.

In B2B, on slide 14, I emphasize the indicator same-hospital sales and the profitability for new contracts hold the potential of the business operation in hospitals. Also in this segment, we implemented a decision, already announced in the second half of 2013, to discontinue the small contract operations, including chronic disease management.

The hospital segment service keeps the great performance in growth, which we fostered by a new operation in Alphaville patient service center in Sao Paulo state.

Going now to cancellations and allowances, and consequently the effect of the net income in the slide, we can see the effect of one-off allowances led to the lower growth in net revenue. However, the indicator shows positive trends for these allowances, already partially reflected in our operating cash flow, which was the highest in our history, and we will detail later on.

Let us move now for costs and expenses.

On slide 16, the table shows that compared to the same period of the previous year, fixed costs continuing growing, but here, let's understand in more detail the evolution of the Fourth Quarter and the trend in the context of the action plans already mentioned by Vivien.

The first observation is related to the non-recurring effect of the action plan, which impacted by 292 basis points in the quarter, as detailed in slide 17.

The second observation is related to the pre-operational costs related to recently opened units, and other patient service centers to be opened along the year. The increasing productivity of our next period will help them to dilute these fixed costs.

Just to remember, Fleury brand, which is the main subject of our expansion plan, have a very quick maturity sales comparing to the average of our other brands. It's higher. Its payback is also better, and so, the evolution will help the Company along the year.

The increasing productivity along this period will dilute costs and SG&A, as I will comment later on.

Finally, I would like to comment on the indicators of slides 18 and 19. Here, we can see that, even including in these indicators the pre-operational and non-recurring costs, there is a turning point of the fixed-cost curve. The average costs for the quarter do not reflect the full effect of the action plans, because they were implemented along the quarter. So the marginal effect shall be better, and already signals a trend of greater dilution in the months ahead, with signal impacts of more positive revenue also helping.

In addition, the previously mentioned rebalancing of mix, price, and businesses will improve the average revenue per test. We have already mentioned that the revenue per test, because of this balancing of mix, price, mix of services, mix of contracts, and everything else, impacts on a positive 13.2% in patient service centers, and this will be reflected fully in the-- along the year.

Going to the operational expenses, as detailed on slide 20, and in the earnings release, there are positive and negative non-recurring effects in G&A that we will bring more detail on the disclosure of the First Quarter.

Since our action plans were implemented in the beginning of this year, the impact of the dilution of the SG&A will be lower through the year, so, the dilution will be better and the impact will be lower for the Company, helping the positive improvement of the EBITDA margin.

On slide 21, we open the non-recurring effect and the pre-operational effect on EBITDA, not only the costs-- the costs, as we mentioned, but also on the operational costs. The total impact, comparing to the Fourth Quarter of 2012, is 480 basis points.

Now I'll jump to the financial results and the debt profile, and here I would like to emphasize that our debts have a profile, a more conservative profile now, with long-term debt which includes the debenture issuance that we did on February of 2013.

The only funding that we have, besides these long-term debentures, is relative to a loan with one bank that is motivating as ours to invest in innovation. So our innovation projects receive some financing from this (inaudible).

Going now to tax, we'd like to emphasize in slide 23, that our current tax, our cash tax, is still zero for this year, and we expect that to continue to be low in 2014, because of the amortization of goodwill, as we show on the table on the lower part of the slide. And in slide 24 we also show the goodwill amortization, together with other effects, which is resulting in the zero current tax for us.

Also, we would like to explain better in slide 25 why if our deferred tax with a basis above the 34%, the standard of 34%, the total of the year is 45%, and it's mainly a result from some non-deductible expenses that we had along the year.

So as a consequence, even having -- even not affecting our cash, we will see the effect being slightly above 34% for this year, as a result of these non; deductible expenses.

Going now to cash flow, the good news is that we have the highest in the history, operational cash flow, on the Fourth Quarter '13, of 2013. In full year, we have an evolution in the operational cash flow of 26%, mainly resulting from the working capital improvement.

We can see on the indicators, operating cash flow, the conversion of EBITDA into operating cash flow that it reached 76%. Also, we have improved the working capital for (inaudible) revenue.

In receivables profile, next slide, we will comment later on, but we see that we will keep for next period, as we are negotiating some receivables, some long-term receivables, we will keep this controlled with our plans.

And finally, some comments about our CapEx, our investments for this year. We ended 2013 with a total of BRL148 million in CapEx, mainly concentrated on expansions, which resulted from some openings, the launch of the new patient service centers for Fleury brands that are shown on the next slide.

For this year, we estimate a total of BRL220 million in CapEx, mainly concentrated on Fleury expansions again. We'll keep on expanding our offerings, together with our -- other restructuring projects, and IT platform, and some strategic products that we have, some were mentioned by Vivien as the IT platforms.

In slide 29 and 30, we show our new patient service center, which includes the cardiovascular disease center. We are very proud of this center, and I invite everybody to visit, which we show some photos right here, and we plan to organize a visit next month.

And to finish on slide 31, we show the evolution of our negotiability index, and also the evolution of the liquidity of our shares, and also on the last slide, 32, we show the events that we will be present the next couple of months. We will show later on the-- what we will do, also, after the First Quarter release that will be on the beginning of May.

Thank you. Now I'll pass over to Adolfo, our CFO.

Adolfo Souza Neto

I would like to take the opportunity to make a summary of the Fourth Quarter results and the current situation of the Company.

The weak results in the Fourth Quarter of 2013 are a result of a (functional) and necessary decision made by the Company to improve results, and the intention to make these improvements sustainable.

The Fourth Quarter results are the conjunction of temporary effects in the gross sales, like selection of health plans, hospital (inaudible), divestitures in non-profitable businesses in the B2B, like the chronic disease management, and the expected low seasonality, combined with the impact of non-recurring items related to the decisions taken, the employee dismissal costs, (inaudible) and PSC terminations, asset write-offs, and so forth.

Despite the negative point of inflection in our results, the business metrics already show in the current figures shared today a reversion of the trend in a sustainable way, and to prove that, I would like to highlight the following indicators -- the growth in the Fleury brand of 15.6% in the quarter; the growth on the regional brands, excluding Rio, of 14%; the increase in the average price of exams in PSCs of 13% versus same period last year; the growth in the revenues per square meter of 7%; the reduction of cancellation percentage in the year of 60 basis points, from 4.5% to 3.9% of gross sales in the whole of 2013; the reversion of the trend of growing cost of services of eight consecutive quarters, the slide 18 that Patah showed; the fact that we are in the third consecutive quarter of reduction in the number of employees, and now this represents a 10% reduction versus the First Quarter of 2013, from 9.8 thousand employees to 8.8 thousand; the rationalization and lowering of our debt; current income taxes of 0%; the fact that we had the highest operational cash flow in the history of the Company in the Fourth Quarter, with a 16% increase total year, and looking only in the fourth a 4 times increase versus last year, and this was mainly by the reduction of 58% in the need of additional working capital to support our growth.

Combined with that, as Vivien has said, we have the ongoing initiatives to improve the way we manage the business, like the zero-based budgeting and the management by process.

Thank you.

Vivien Rosso {BIO 16579525 <GO>}

Well I would like to share some perspectives for 2014, and during this year, our focus will be concentrated to complete the strategic implementation, this strategy we have been following since September, and it comprehends four steps.

The first one is related to accelerate Fleury's expansion plan. There is a growing demand. Fleury is capturing the demand since the last -- accelerated this quarter since the last quarter and continue doing so this year, and we have programs to deliver more than 10,000 square meters of facilities in this ramp.

So including these new ones, Patah has commented, already released last February this is a facility with more than 3,000 square meters, and our new center for integrated medical diagnostic and (cardio neurovascular) area in the south region of Sao Paulo.

The second is related to managing regional brand growth, supported by stronger financials, and (inaudible) well positioned businesses.

The third one is continue expanding the B2B business through the current operations and also by new prospects.

And the last one, as mentioned by Adolfo, delivery of the restructuring initiatives and outcomes we have started.

Besides that, our commitment is to enhance competitiveness and differentiation, preserve the quality, the culture, and intellectual capital, at the same time balancing growth and sustainable profitability for the whole portfolio and for the long-term value creation.

I would like to finish our speech. Thank you, all for your attention and we are ready for questions from now on.

Questions And Answers

Operator

Ladies and gentlemen. we'll now begin the question-and-answer session. (Operator Instructions)

This concludes today's question-and-answer session. I would like to invite Mrs. Vivien Rosso to proceed with her closing statement. Please go ahead.

A - Vivien Rosso {BIO 16579525 <GO>}

One more time I would like to thank you, everybody, for your attention, and we are pleased to have you in our conference right now. Thank you. Good afternoon.

Operator

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