

Q2 2016 Earnings Call

Company Participants

- Grace Cury de Almeida Gonçalves Tourinho
- Natália Lacava

Other Participants

- Bruno Giardino
- Joseph Giordano
- Leon G. Cooperman
- Rodrigo Gastim
- Thiago Macruz

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and thanks for waiting. Welcome to the Conference Call of Qualicorp to discuss the earnings of the second quarter 2016. Today with us are, Ms. Grace Tourinho, CFO, Operations and IR Officer; and Ms. Natália Lacava, IR Supervisor.

We would like to inform you that this event is being recorded and that all participants will (0:34) listening the conference call during the company's presentation. Later on, we are going to start the Q&A session when further instructions will be provided.

We'll now turn the call over to Ms. Grace Tourinho who will open the conference call. Please, Ms. Tourinho, you may go on.

Grace Cury de Almeida Gonçalves Tourinho {BIO 17244138 <GO>}

Good morning, everyone and thanks for joining us. I'd like to present some initiatives, in fact the key initiatives that took place in the second quarter of 2016 and that we can share with you. First with the record of the finalization of the corporate restructuring that we started last year and also part of the tax portion that we have been completing now. So this quarter, we are completing the corporate restructuring that we wanted to do since the end of last year. In April, we were able to incorporate Medlink, then MultiCare and in June, we had the partial merger of MC/Gama to Gama. The objective is to generate both administrative and operational synergies, enable to deliver results, structure and more efficiently to all Qualicorp group, knowhow in the services, improve quality control and enhance the portfolio of solutions offered to the market by the group's companies.

Also fiscal-wise, we built a small portion relating R\$7.7 million in tax gains that was recognized in the direct line of income tax. As for the increase of performance optimization of investments that we've been marketing, in fact, the company has been trying to have more efficiencies in costs. In marketing, we worked very hard to (3:00) the company's strategy, enable to improve our performance in the area and also to reduce costs.

And that involved strong renegotiation with suppliers and the review of our model to acquire new clients. So, to focus to improve performance and acquire new clients. With that, the strategy had positive results generating an increase of 28% and reducing costs by 47% when compared with the same six months of 2016 and 2015. We also aim to reduce marketing investments by about 36% compared to the same six months of the previous year.

Finally, we had great continuous approach to retain and make our customers more and more loyal. We all know about the country's political economic scenario, the inflation and the difficulty now to pass on readjustments of prices of 21.8%. We are engaging all our efforts investing to keep our customers in-house with new communications, new products to suit their needs, retention activities and several other initiatives that we have been constantly announcing to you.

Right now, we have the views of the month of July, which is the first month with the impact of the readjustment of most of our portfolio of 80%. Historically, the month of July is lower when we compare to August and September. However, the numbers that we have in hand with regards to the month of July, show that we have very good preliminary results of a negative of 5,000 lives.

Now, I'm going to turn the call over to Ms. Lacava to talk about financial results in more detail.

Natália Lacava

Good morning, everyone. I'm going to start the presentation with slide number three. I'm going to give you some numbers. The idea is briefly to go through results, and then, open for your questions, and clarify your doubts. I think this quarter is no secret. We had strong revenues of 16.5%, influenced by strong sales that brought the revenues and also Barueri that continues to impact our results in the second quarter of 2015. This was still not reflected in our results and therefore we have a pressure of our revenues up. In case EBITDA (06:18) rose, 15.5%.

Later on, I'm going to give you more details on that. Some of you know that we had some adjustments and I would like to tell you what numbers will be adjusted, but we decided some time ago to have the minimum pricing (06:37) adjustment in our EBITDA. So the number is R\$192 million. And I'm going to talk about the impacts that had on this number. Margin of 40.7%, almost flat related to last year and a bit lower than the first quarter basically because of the sales that increased our commercial expenses and selling expenses, especially in this quarter.

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Going to slide four, where we talk about portfolio. I think, Affinity is the highlight. We were able to reach a larger number of lives, this is because better sales, controlled churn. In the case of sales, we had a very good performance in São Paulo, Rio de Janeiro in the year. We had the help of some factors that rearrange power portfolio with great receptivity of our customers and that helped our sales to grow by almost 19%. Also important to mention is the seasonality of the second quarter, which is generally the best quarter of the year.

So this increase of sales, of course, is a result of the efforts of the company but also there is this portion of seasonality, compared to the first quarter of 2016. With regard to churn, we are making more investment in retention in (08:05) we have been talking to you that for some time, we improved the churning terms of delinquency.

But we had some work to do for those people that called to proactively ask for cancelations and we did our homework and this is reflected in a more controlled churn. And because of that we had a number of more than 26,000 of new lives added.

As for corporate, we had visible losses in this quarter but on the other hand when we take a look in EBITDA, the impact was much lower because these were lives that did not have a very high contribution margin to the company. And the other thing, in terms of health management with TPA, I'm sorry, with growth of more than 9% which has to do with the maturation of some projects that have been implemented successfully by the company and have been increasing the number of lives in this line.

With that, we closed our portfolio with 7 million lives (09:23) financial performance in this quarter. As for revenues, I'm not going to repeat the numbers I think the only comment to make just to remind you all is that we had some effects along the year of 2015, which was the leaving of Potencial because of the initiatives with CADE (09:48).

We had the leaving of Unimed Seguros, Unimed Paulistana and all of that had an impact on revenues. So, if we wanted to have a pro-forma, if we didn't have these portfolios, we would have an increase of revenues of more than 20% year-against-year. And these portfolios were lost along the year of 2015.

When we talk about costs on the next slide, I would like to highlight some points. We still have a growing gross margin year against year, but I think some points are important to mention. In personnel, we had a very large impact with the extension of the CRC project that was a counterpart in revenues because those projects are maturing. But when you compare absolute numbers, it reflects an increase, because we had to have implementation in new regions and that demanded the hiring of new teams. Also the restructuring for Barueri, it was as if I had to restructure the employees and had to advance some part of payments and that just had an impact on the line of personnel expenses, and therefore, this variation of 14.3%.

As for third-party services, there are some important things to share with you. Our volumetry has been increasing in call center that is more people calling. What makes us happy is that cancellations have not been as often. We have been more effective, but the

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number of people calling asking for information has increased, and therefore an increase in this line. In addition, we kept a very high level of services even before our - above our needs to prepare us for this pre-adjustment times. And therefore, we have a bit larger third-party services than usual. And finally, because the health club has been having a very positive performance, we know that the portfolio grew, life grew and therefore, we also needed restructuring in terms of back office for the health club.

As for occupancy expenses, I have just one comment. We know that administration, we went up in cost, we went down. When we went to Barueri, what happened is that rental in Barueri is cheaper. So, the areas that went to Barueri that's more in the coast area, they are paying lower rental. As a counterpart to the areas that stays in São Paulo, are having a different apportionment of costs. You have less people with a higher cost. And therefore, in administrative, this line goes up and that reflects in the occupancy expenses and therefore a slightly strange behavior of expenses.

If we go to the next slide, you'll see administrative expenses. Here, I would just like to highlight personnel expenses, which is part of the recovery that we had in December. We still see an important drop in this line. I think that, we see that we are more streamlining number of employees and therefore we see a minus in this line.

As for third-party services, we had two important factors. We invested in new equipment for CRC for new support for them. So, we had an increasing costs. We had some impact of tax and legal consulting services due to the corporate restructuring that Ms. Tourinho mentioned in the opening remarks.

And occupancies as I mentioned, the apportionment of the rental in São Paulo with the lower number of people, especially in the administrative area.

Going to slide number eight, when we talk about selling expenses, here we have reflects of what Ms. Tourinho mentioned in the beginning. We had publicity and advertising going down because of our restructuring in our alliances and also commissions, selling campaign.

The impacts of higher sales than last year compared to a readjustment of allowances initiatives that generates more revenues. But, if you think consolidated selling expenses went up together with our tickets and the increase of our sales. So, we are very much in line in this area.

Going to slide number nine, when we talk about bad debt, well, final numbers are 5.2%. I think that it's important to mention and we mentioned that before, it's important to remember that we have what we call (15:08) in Portuguese, the dragging, that is if the client has one payment slip that was unpaid, we have to keep those clients in separate and in this case, we have a very important (15:26) in 5.2%. If we didn't have this effect, we would have 6.3%.

I have been talking to you that in the quarter it makes sense to think of 6.3% as the recurring bad debt of the business. When we think of the average of the last 12 months,

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we took a look at a longer period. It would be interesting to have this reversal, because at some point, it was negative. So, we in an analysis of the last 12 months, we believe that this reversal has to be reflected in the real bad debt numbers of a longer period. 6.3%, if you look just at this quarter is a bit higher than last quarter. And bad debt, we already expected it to increase year-on-year, but we believe that's quite well controlled. After the readjustment, we believe that this is going to go up, but not above the record numbers that we had in the past.

Today, we have training enough to keep this under control. And we see people asking more for cancellations than just failing to pay. So, we are quite comfortable with this line. As for others, I think the highlight here is the R\$7.3 million positive in impairment. This is part of the tax work we have developed. We had opened the last five years of our balance sheet in our accounting. And as a result, some expenses had to be reversed, because we redid the spread and some revenues that were - and expenses that were entered in the past. So, this is what those impairment show, so we have R\$7.3 million, which is a one-time result. There is no recurrence for this number.

On the next slide, I think we are getting close to the end. This is just basically an overview of our financial expenses, nothing really new. A bit worse than last year because we are paying out dividend so our yield is going down. And keeping the minimum cash necessary in our balance sheet and we had the debenture interest that went up a bit. But I think there is really nothing new in this area.

Other financial expenses; remember that, we're still paying in this quarter of IOS (18:18) in motors and while the change of the debentures initiatives have not been completed yet and that's using other financial expenses.

On slide 11, EBITDA again the R\$192 million, 40.7% of margin, so no readjustment. The R\$7 million is not here. As I said, the last three is something that we could consider as a one-time number, but not considering the whole of the 12 months. Even with the adjustment we get to an EBITDA of above R\$180 million, which is a number we believe is quite positive considering everything that's happened along the year with a margin close to 40%, which is an incredible asset to be able to manage the company with all the challenges we had along the year with very high readjustments. So regardless of the adjustments we had to make, we believe it's a very high EBITDA for the company.

Going to slide 12, when we talk about net income, the only comment is that the R\$70 million we accomplished were recurring R\$7 million in terms of net income. Last year, we had the leasing of Potencial and the sales of our (19:58) assets so the R\$70 million would be almost R\$40 million without this effect. So we did have an increase in our net income because of the higher efficiency of our efforts.

So you're talking about almost R\$200 million in the first quarter, R\$70 million in the second quarter, which is very important technical reserve, when we have the possibility of giving that back to our shareholders. In terms of CapEx for the next quarter you see that we're very closer to R\$50 million, very much in line with what we had been sharing with you, nothing really new. We continue to invest in our systems that we have been implementing

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in Qualicorp. Also the system of (20:54) that we charge to support the company and this is very much in line with what we have been sharing with you.

As for indebtedness, capital structure, I think that we increased our net debt, but that was completely expected due to the initiatives of the company. And finally, when we talk about cash flow, we continue with very high cash flow with almost R\$149 million after CapEx R\$125 million, so with the highest cash flow in the company and that has contributing to us continue paying out the dividends. We have some commitments along the year of 2017, but regardless of it all, we have a very healthy cash flow, which gives us the possibility of continuing paying out returns to our shareholders.

With that, I complete our presentation. I think there is not really anything new compared to our release, and we are going to be available to all your questions. Thank you very much. We will now start the Q&A session.

Q&A

Operator

. Our first question comes from Thiago Macruz from Itaú BBA.

Q - Thiago Macruz {BIO 16404924 <GO>}

Hello, everyone. Good morning. I have a question about selling expenses. I think in your sales campaign residents (23:06) year-on-year, and I would like if this is a new level for the company to deliver the results that we saw in the second quarter? And also if you could give us a bit more color in terms of growth that you have, and what impact that can have on the company overall?

A - Operator

Hello, Thiago. Thank you. With regards to the selling campaigns, I think the direct answer to your question is yes, this is a new level. We have been focusing on campaigns. That should bring us a higher return on sales.

The only thing I would like to highlight that we are always rethinking our initiatives where it's best to spend our money and we manage that in a consolidated manner. So, we've had some point in the future, we understand that commissions for third-parties for instance will have a better impact or a greater effect and we are going to decrease campaigns to spend more on commissions. This is something, that may happen.

But the direct answer to your question, it is yes, this is something that you may consider as recurrent. As for your second question about new products, yes, I think that the health club had high represent activity in this quarter. On the other hand, when we look at the average tickets of the portfolio, it continues to grow by two digits about 15%.

So, the health club is contributing to our sales but on the other hand the sale of these products has also be encompassing other products, other than the health club. So one thing to offset the other and our ticket in the portfolio continues to grow by about 15%.

Q - Thiago Macruz {BIO 16404924 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Rodrigo Gastim from BTG Pactual.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Good morning everyone. I have two questions. The first is with regard to Mauricio's project. If you could give us some color about this project especially about Gama Saúde, I would like to know, if you have better control in loss ratios and how much you intend to save with this initiative of migrating employees to Gama Saúde inside Qualicorp? And also about bad debt, if that is related to a higher cancellation and what you expect for the next half of the year? Thank you very much.

A - Operator

Well. Thanks, Rodrigo for your questions. As for GSP, which was a pilot project that we just launched and that started on March 30. The first month being the month of April, so we did have a reduction of costs, but still we are talking about preliminary numbers and very small numbers, it's a very small sample for us to rest assure that this is a successful project.

So we are already reaping the fruit, which is extremely positive. However, we still have some maturity to confirm that this indeed will be something that will be in a trend (26:59). So we only have a month. It takes some time for medical expenses to get to Gama and be reflected in the payments of Qualicorp.

As for the reduction itself, which was - what was arranged at the beginning is that, we would have a 6% reduction. However, in the balance sheet we still keep the amount that we paid before because we don't have a history. We are starting to build a history and so we are very conservative use the history in our accounting. When we have a more thorough view with two, three months then we are going to start to adjust and present that in the numbers of this quarter.

What was the other question? Oh, bad debt. Well, the company for a longtime now has been developing excellent work and that has not changed. In fact, we have daily focused an efforts to try to keep it in control. We all know that the country's economic situation is improving, but not enough so that all our customers can pay their bills. We know this is a resilient product. We already can see that our customers have a higher rate of debts.

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We do have some late payments, but indeed we can see that clients do their best to make payments in the end, but when we compare the same period with the previous year and the days that are in late payment, this is something that we see. So, the company is engaging all efforts to be able to recover credits and show the numbers we have been historically showing.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Okay. Thank you very much, Grace. Thanks for the answer.

Operator

Our next question comes from Joseph Giordano from JPMorgan.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hello, good morning, everyone. Thanks for taking my question. Grace, Natália, my first question is with regard to growth. I would like to know if you see higher migration to Affinity of people that lost their corporate plans because of an increase of unemployment. Then also I would like to know, if you are working with health plans inside CRC/Gama, should develop more affordable plans to be able to protect with this new demand?

My second question has to do with expenses with legal suits, we see an increase in this line and I would like to know why you have an increasing lawsuits. Is it related to just (30:22) of health that we have been seeing in the country or is it just because you're moving to Barueri?

A - Natália Lacava

Hi, Joseph. This is Natália speaking. With regard to your first question in terms of growth, we have been sharing with you that we have a demand of former corporate customers that are purchasing Affinity. I think that everyone in the company have been in a situation of friends calling and asking for help in this sense. We have no numbers. It's very difficult to have the numbers because people do not say that they were employed before. We are just waiting for the moment to kind of settle down for us to develop a research, but we believe that this is an impact that we had in our results.

As far CRC/Gama, the project is still very incipient. We are still in the pilot part of it along the time is that CRC/Gama can really help to address some problems that we have, but it's still very incipient. We cannot say anything yet. The project is still being tested and I cannot give you a more thorough view about the project and the mapping of what it will represent. I think that we're still putting together a business model for it to stand on its own and then we'll take the second step.

As far expenses with lawsuits that has to do with the industry as a whole, it's no secret to anyone, the levels of readjustments that we had in recent years that somehow increases the need of people, and the feeling to file a lawsuits and I think that has to do with the industry as a whole. I think it's a macro issue.

I don't see it as a result of Barueri, quite the opposite. I think that we did make the right decision of going to Barueri. I think that the financial gains that we had, were much above any losses. So, I do not see going to Barueri as an increase in lawsuits. I think this is much more of a macro issue related to the industry, much more to do with the consumer than with the company.

Q - Operator

You talked about the growth and you were thinking of a flat margin for the year. Do you think that you can keep this expectation for the second half of the year, even thinking of the potential churn that you had after the increase of prices?

Well, we always try to be conservative. When you look at the first half of the year, we could even be a bit more optimistic, but there are so many variables that we have in terms of churn, bad debts in August, September they are all very important variables if you think, of the whole of the year.

So, we're still not ready to change our expectations in terms of price margins. We prefer to wait to see the preliminary indicators of August, September before changing any expectations. But what we see, until July as Grace said, really makes us quite optimistic about the company results throughout the year.

Okay. Thank you very much.

Our next question comes from Bruno Giardino from Santander.

Q - Bruno Giardino {BIO 15974970 <GO>}

Good morning everyone. I would like to talk about admin expenses. You said, that there were extra expenses because of legal and consulting expenses especially due to the corporate restructuring. I would like to know, what expenses are about. Is it the restructuring that we saw in the first quarter or something that I haven't captured here?

A - Operator

No, exactly what we had talked about. Companies have to have a report to be incorporated and that has to be developed by external attorneys. And also we have the incorporation itself, documentation, everything, to make it efficient. The authorization of regulatory agencies, everything was performed, and obviously we had to incur in costs.

However, we believe that the cost that were incurred in the period will help us to have better savings, not all in terms of admin expenses, but also in our controls with an efficiency in the delivery of results. The company will be able to better manage its numbers and deliveries to investors.

Q - Bruno Giardino {BIO 15974970 <GO>}

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Okay. Thank you very much. My second question Grace, talk about the price readjustment, you did talk a bit about that in the beginning of the call, but if you could give us a bit more color on that?

A - Grace Cury de Almeida Gonçalves Tourinho {BIO 17244138 <GO>}

Well, we have been working today. And in fact, we started with that a long time ago, with the whole of the company, all departments involved marketing, write communication to our customers, to make our customers understand the product they are acquiring, what is available in the market.

And we also detected, we're very strong, especially in delinquency rates. We sometimes would reach the customers in delinquency much faster than those that would call to cancel their product. Of course, if a person calls, and wants to cancel, we are going to see to it.

However, there are some clients that we would consider the flattening (37:16) customers, that we would have to talk to and we would have to give them as much information as they need to make good decisions and that has been extremely productive for us and has been bringing excellent results for the company. Despite the deterioration in our economy, we thought the churn would be a lot worse and it's just not because of the work we've been developing on our day to day with those customers.

Q - Bruno Giardino {BIO 15974970 <GO>}

Yes. And I would like to hear a bit more about the portfolio readjustment of July?

A - Operator

Well, we have several dates of readjustment. But almost 80% of our portfolio is readjusted in the month of July. So along the year, we had just a average readjustment of 21.8%.

Q - Bruno Giardino {BIO 15974970 <GO>}

21.8 years. That's it. Thank you very much.

A - Operator

You're welcome.

We have a question of our call in English, Leon Cooperman from Omega Advisors would like to ask a question.

Q - Leon G. Cooperman {BIO 1456503 <GO>}

Yeah. Thank you very much. Really a question, not designed to embarrass you, but there has been a great deal of speculation in the press regarding private equities interest in the company. Could you elaborate on that? And also, is the company seeking their involvement or is it subject to their affections or no one's affections, kind of why don't you just update us on the status of things. Thank you.

A - Operator

Hello, and thanks for your question. With regard to speculation and the articles that were published in the media, I think the company already made public our position. We received the three letters, denying interest in control. This is not in our radar. Our focus is to deliver results, improve our sales, work on margins and that has been our day-to-day. So it's really not in our radar.

Please wait, while we collect questions again. Since there are no further questions, we are going to turn the call back to Natália Lacava, Investor Relations to provide her further final considerations.

A - Natália Lacava

Well, thank you very much for joining us. As always our IR team, myself, Gabriel, Natália here to clarify your questions and you may count on us on whatever you need and I wish you a good day.

A - Grace Cury de Almeida Gonçalves Tourinho {BIO 17244138 <GO>}

Well, this is Grace here. Once again, thank you and would like to reinforce our commitment of making the company more efficient. This is something that we have been doing on our day-to-day and we are not going to stop. And we can tell you that we do have opportunities, although we are going through difficult times, especially in July and August, we do have very good opportunities in our company. Thank you very much.

Operator

Qualicorp conference call is now closed. We thank you very much for joining us and wish you a good day.

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