

Y 2018 Earnings Call

Company Participants

- Grace Cury De Almeida Goncalves Tourinho, Chief Financial Officer and Investor Relations Officer
- Pedro Henrique Rocha Nocetti, Investor Relations Manager
- Unidentified Speaker

Other Participants

- Frederico Mendes, Analyst
- Marco Calvi, Analyst
- Rodrigo Gastim, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for standing by. Welcome to Qualicorp's Conference Call to discuss the Results for the Fourth Quarter 2018. With us today, we have Mr. Jose Seripieri, CEO; Ms. 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 <https://www.qualicorp.com.br> where the presentation is also available. This event is being recorded and all participants will be in listen-only mode during the Company presentation. Ensuing this, we will go on to answer-and-question session. (Operator Instructions)

I will now turn the floor over to Mr. Jose Seripieri, who will begin the conference call. You may proceed, sir.

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

I will begin the call and then we will give the floor to Mr. Seripieri. Good morning, and thank you for participating in our earnings conference call for the fourth quarter '18. When we assess the year -- fourth quarter '18 as a whole, the Company was able to contain the loss of life even after the results -- and even after a readjustment, that was way above the average inflation of the country. Financially, we were able to maintain relatively stable operational results even in a challenging cycle, when it comes to revenue generation, which means we did our homework. Qualicorp was elected the best company in the EXAMINATION/IBRC Ranking, as a benefit management company. This was the first time that Qualicorp took part in this ranking, which is one of the most important in the market.

The Company was ahead of other large companies in the sector, acknowledged for their quality and customer service.

This achievement is due to a series of initiatives adopted by Qualicorp in the last years to -- and that has been enhanced year-after-year to make our service to customers more decisive, customized, and expeditious. We also made strides in the digital area and the sales sector, making available to brokers a software to expedite sales and we're working with the sole financial RP [ph] in this quarter that was implemented in January 2019. After we control this software in the Company, we will have created more value and control within the Company areas, not to speak of the savings compared to our previous system. For 2019, the Company is engaged and will continue to enhance processes to retain customers with more accessible projects and a more active communication.

I will now give the floor to Pedro, our IR Manager.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Thank you very much, Grace. Good morning to all of you. Thank you for participating in our results call. We begin on Slide number four on the portfolio. And we have been harping on this throughout 2018, a consistent improvement in our churn figure and then absolute and relative churns, when it comes to our customer base.

This, gentlemen, is a work of the Company as a whole, work that comes from having new products that we can offer and a retention that in 2018 had truly excellent performance for the Company, enabling us to hold back the customers and generate value for the customers and show that Qualicorp is side-by-side with the customer, our focus is the customer, and this is a focus that will remain within the Company for 2019. And while we have the customer by our side, we will be producing results.

When we speak about growth, as they have grown in the annual comparison, with totally retail sales, here we did not have any portfolio novelties or other sales. What you observe, it is 7% higher than the fourth quarter 2017, and this is a performance fully in retail with our share of 22% in the Health Club segment. With this, we ended Affinity and Medical Hospital portfolio with 23,000 lives less vis-a-vis September. When we observe the same period last year, the improvement was 25% and for the accrued figures of 2018, the performance improved 70% in terms of net lives in our portfolio vis-a-vis the year 2017.

When it comes to Self-management and the Corporate, we had a loss of sales. And it is important to reinforce something that Grace drew attention to previously, although you observe a reduction of more than 2 million sales in December '17 and '18, the impact of this on our results is very small. More than 90% of our net revenues come from the Affinity and Medical Hospital segment. Although, you do observe a reduction in volume of sales, this sales reduction has a minor impact on (Technical Difficulty) results in our portfolio and this continues to be our focus for 2019 going forward.

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Please go on to Slide number five, where I will speak about revenue. Here, you will observe a revenue of BRL479 million for the fourth quarter, a reduction once again due to a smaller portfolio and a reduction in the average customer base in terms of revenue. When we compare the fourth quarter 2017 and fourth quarter '18, we do have a certain stability, this is thanks to the price readjustment vis-a-vis the smaller portfolio, and a small drop year-on-year. When we analyze the evolution of Qualicorp after readjustments, the downgrade and the mix, we have a reduction of approximately 9%.

I would now like to ask you to go on to Slide number six, that refers to cost, where you will observe the gross margin for the fourth quarter '18, with a growth in the year-on-year comparison and in the sequential comparison. And between the lines, you can observe that we have a very consistent value capture in our expenses with ROIC and our expenses with personnel. This is something that has been underway for several years and that quarter-on-quarter we have gradually been able to show the positive impact on our results, but also a consistent impact. And you will observe this in gross margin, if you look at the last five quarters, we were able to grow the gross margin. Once again, this is consistent and this continues even within a very challenging scenario when it comes to revenue growth. The message therefore is that Qualicorp continues to do its homework regardless of the revenue scenario. As a Company, we will continue to do our homework to always be an efficient company.

We go on to administrative expenses on Slide number seven. There is a drop of 6.4% vis-a-vis the previous year and a slight increase in the sequential comparison. This is due to an increase in amortization and more expenses in services with third-parties, attorneys and consultancy. In the annual comparison of the fourth quarter '17 and the fourth quarter '18 there is a significant drop in other administrative expenses. This is due to a one-time event in the fourth quarter 2018, due to regulatory contingencies. And of course, we have a gain of results in 4Q'18 because we have less regulatory contingencies.

In the graph below, you see the consistent work and the evolution in administrative expenses. Although, we do have some oscillations year-on-year, we have been able to improve our percentage of SG&A as a percentage of net revenue.

Before I give the floor back to Grace, I would like to end with the selling expenses. You will observe the main selling expenses which refers to commissions, those that are linked to new sales. Since 2018, we have been capitalizing and amortizing them for 24 months. There is an increase in the amortization of commissions of 7% in the fourth quarter '18, vis-a-vis the fourth quarter 2017. If we were to use the former model before the IFRS in this line item, the expense amount would be BRL4 million. Now, it would be BRL17 million in the third quarter '18 and BRL16 million in the fourth quarter '17.

When it comes to the sales campaigns, which is also a very significant area for the Company in the last quarter, it has been our focus and we're capitalizing this, especially the campaign that refers directly to new sales. If we were to adopt former practices, we would be spending approximately BRL12 million in this quarter.

Now before I give the floor back to Grace, I would like to end by saying the following, 2019 begins with a strong sales campaign, geared and efficient with products that have great liquidity and with the engagement of our brokers. Something important that was mentioned by Grace, in this year, we began our digital sales for the entire sales channel. And in March 2019, we already see more than 35% of our sales being carried out without any paperwork. These are more expeditious say for sales, with greater efficiency, saving us unnecessary expenses.

Having said this, I give the floor back to Grace.

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

We go on to Slide number nine, profit sharing plan. Here we have an improvement in the quarter-on-quarter comparison. It is important to state that part of this result is due to the intense work on the losses calculated in previous quarters. Including the Alianca segment, we have more than doubled our volume of recovery. Besides this, as a non-recurrent event in the fourth quarter 2018, we recovered almost BRL5 million among our partners referring to the returns of customer amount. If we were to take away this one-time adjustments, in the fourth quarter, we would have had 6% of the total net revenues. If we analyze the improvement of our profit sharing plan and the exercise 2018, regardless of non-recurring effects, both positive and negative, we do have a constant work of the Company to work closely with the customers, not only to retain the customer but also to guarantee the customers capacity to pay.

We go on to Slide number 10, financial income. In the comparison with other quarters of 2018, there is a slight drop in our financial income due to the lower volume we had in cash throughout the fourth quarter. When it comes to our financial expenses, there is an annual improvement and the lowest interest rate, which reduces the cost of the interest of debentures whose payments are made in the second and fourth quarter of each year.

We go on to Slide number 11 where we speak about EBITDA. And in line with what was said by Pedro formerly about our EBITDA, we have a strong annual recovery in the fourth quarter '18, mainly associated to an improvement in the expenses with contingencies and uncollectible debts that allowed for a growth of more than 18% in volume and 8 percentage points in margin. In 2018, we had less revenue, but we were able to maintain our EBITDA margin, and it is important to reinforce that the Company maintains its pursuit to control costs, to use resources rationally and improve operation. We have the matricial expense management that surprises us constantly with the alternatives and controls to optimize costs. This is the attitude that has brought us to a good level of results and we are able to work with all of the levels and what is more important that is we will be able to leverage this when we once again resume our growth.

We go to Slide number 12, comparing the fourth quarter of '18 with the fourth quarter of '17. We had a growth in net income, especially, thanks to the improvement in operational profit obtaining a margin of 20%. When we compare this with the third quarter of '18, the drop comes not only from EBITDA, but also from an increase in amortization. Regarding the 2018, here we have an improvement of 4%, highlighting that we had non-recurring negative impacts in the net income of 2017. Effective tax rate stood at 38.6% in the fourth

quarter '18 vis-a-vis 34.9% in the third quarter '18 and 32.8% in the fourth quarter '18, somewhat higher in the fourth quarter '18, where we have already begun working to reduce this tax rate.

We go on to Slide 13 to speak about CapEx and investment. In September of 2018, the Company signs a non-compete agreement with the founding shareholder with a cost of acquisition was BRL206.9 million, and this has been amortized since October for a period in which it is in effect, which is 72 months. If we exclude this non-compete effect, the Company would end 2018 with net cash even after having paid BRL354.9 million in dividends and after having carried out the buyback of its shares in a volume of BRL130 million. In the fourth quarter of 2018, the Company bought back 2,370,000 shares at a total cost of almost BRL30 million cash flow.

We go on to Slide number 14. The operational cash flow after CapEx negative BRL130 million for the quarter is due to over spending and working capital and a cash outflow due to the investment in PPA and the interest rates paid on debentures as mentioned. Finally, we're continuing on with our company restructuring process and we will deliver value to our shareholders, both in the short and the long term.

With this, we end the presentation and open the floor for questions and answers. Thank you.

Questions And Answers

Operator

Thank you. We will now go on to the question-and-answer session. (Operator Instructions) Mr. Marco from Itau BBA would like to pose a question.

Q - Marco Calvi {BIO 19854632 <GO>}

Good morning. And I have two questions, if you allow me. The first refers to the sales scenario and the evolution in your life base. The fourth and third quarter seem to be healthier, although the Health Club has had a minor drop. Which were the main initiatives that you are putting in place and that you use during the fourth quarter to allow for this better net sales figure, even if you're losing share?

The second question refers to the commission of third parties in the commercial expenses or selling expenses line item. Of course, we see that this is having an impact on retention. What is the Company planning in terms of this line item for 2019?

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

Marco, thank you very much for your questions. When it comes to our sales, we have been offering timely incentives in some areas and only for some products. Of course, these are offered through time, but we're carrying out a geographical analysis of where it is that we want to sell, which are the regions, where we would like to have greater sales for Qualicorp, and we're working with products that offer more value to the Company.

And of course, we're giving more incentive to those who bring more sales to the Company.

To give you an idea of January and February of this year, although these tend to be weak months, we truly believe that we will have a good resumption in 2019. Unfortunately, this year, carnival began almost at the beginning of March, but we are planning a recovery already as of the beginning of March.

I give the floor to Pedro.

A - Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Marco, if you look at line that refers to recurrent commissions, this line item varies based on the logic and the strategy of the Company, not only to maintain the external sales channels motivated for sale, but also aligned with the Company's retention strategy. Although, we do have an internal retention sale channel with a very good performance, it is also important to have partner brokers working in partnership with us. When Qualicorp speaks to these brokers, it's important for these brokers to be very active, to maintain the customers within the Qualicorp portfolio even when we change the products or even when we have changes with the customers per se and all of this is part of our strategy not only to reinforce sales, but also to retain customers, and that is why this will remain in the year 2019. And in 2018, of course, the performance was much better vis-a-vis 2017.

Q - Marco Calvi {BIO 19854632 <GO>}

Thank you, Pedro, and thank you for the responses.

Operator

Mr. Rodrigo from BTG Pactual would like to pose a question.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Hey, good morning and I have two questions. The first refers to your average ticket. We seem to have a drop in the second quarter, impacted by the downgrades that you have done, the consolidation of the Health Club and so on. So what is your forecast for average ticket in 2019? Obviously, it should be lower than 2018. But I would also like to know which will be the impact of the products that you have in the main regions. This will also have an impact on your average ticket in the Company.

The second question refers to the second strategic line of the Company of 2018 of offering sales incentive to improve retention and much more. I presume that this will continue to be the scenario in 2019, and which are your initiative to struggle against margin pressures in terms of selling? The company is doing very good work and which are the efficiency gains that we can expect in 2019 to offset the selling part?

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

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Thank you for that question, Rodrigo, and I will begin speaking about the ticket and then speak about the initiatives. When we speak about average ticket, Rodrigo, as you mentioned, that simply to give you an idea, when we speak about the Qualicorp average portfolio at the close of 2018, the consolidated ticket, the Health Club, Qualicorp, and Alianca [ph], the average ticket was BRL788. When we compare this with the entry average ticket, those who come into the the company, have an average ticket of BRL469. As you mentioned, although we do have a lower share of the Health Club, we have observed an average ticket that is much lower, which of course is natural. Well, we are seeking, and the great opportunity that we foresee, is to have lives coming into Qualicorp in the middle and higher segments.

And it is in this niche that we truly have a challenge, not only in terms of seeking new products in different regions to increase our share, but also work with that customer that is more sensitive to readjustments and to a more complex financial scenario. Yes, we will have this disparity between the entry ticket and the average portfolio ticket, but this is the customer that we want as Qualicorp and this will allow us to grow our portfolio.

I will give the floor to Grace to speak about marketing initiative -- margin initiative.

We have several opportunities in terms of margin in 2019. Our Company is working in a very consistent way, entering the digital world. We have introduced a software and we have delivered this software to our brokers, so that they can expedite the sale. But in terms of control and the cost for the Company, there will be a significant decrease. Another opportunity that we have been working with, that we have not announced, is to also service the customers digitally in a more effective way, it is cheaper than using a call center. And this will leverage the Company, allowing us to obtain an expressive cost reduction.

When it comes to royalties and profit sharing. We will continue the work that we began in 2018. In terms of the commercial part, we're going to give it a greater thrust to have a resumption of sales. We do want to offer a very productive figure at the end of the year in terms of our activity. There are several opportunities in-house, thanks to the new system in the financial area. Now this readjustment still has not been done, because we're still stabilizing things, the Company is learning how to use the new system, there is a learning curve. But once this becomes more mature in the Company, we're going to migrate and have more consistent savings, which means that we will no longer have those peaks that we had in the last three years or four years. We have implemented novelties in our operation, and they will enable us to work at different cost levels and work in a better way. Now if there is a resumption of growth, we're more prepared and we will have better operational costs in our operations. I hope that I have responded to your questions, Rodrigo.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Yes, thank you very much for your answers.

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

Thank you, Rodrigo.

Operator

Mrs. Brudell from Credit Suisse would like to ask a question.

Q - Unidentified Participant

Thank you for taking my questions. First of all, I would like to have an idea of your strategic vision in 2019, in terms of downgrade. We see that it is around 30% and there is a drop in the volume, if you look at this sequentially. This is a very relevant issue and what will happen to it through the year? And the second is a follow-up of the former question. You're going to seek an efficiency enhancement in other businesses and other lines. But in the personnel line, is there still room for improvement or not? Thank you very much.

A - Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Personnel line, is there room for improvement? Good morning and thank you for the question. Well, the issue of downgrade, it is based on a strategy that was intensified into a team. And we base ourselves on our strategy of making active offers to the customers that were receiving that proposal for price readjustment. And I think all of this was highly effective, it reduced the loss of lives and also improved our image among customers. The incentive that was mentioned by Grace and the award mentioned by Grace shows that we are offering the customers more value.

Now the downgrade strategy remains for 2019, we will continue to have price readjustments. That will be lower compared to 2018, this will still have an impact on the customers' pockets and we do have an economy that is under recovery. Of course, we can enhance all of this, we can always do things better, but the work in 2018 was highly effective, it will continue on in 2019, and we will perhaps have not have an increase in the average ticket, but the great focus at present is the customer.

Now Grace will speak more about efficiency.

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

Allow me to complement the part of downgrades where we have an opportunity. The Company is prepared to carry out the downgrade of several customers in several of our main markets in our portfolio. Now the question is, how we can have a resumption and the need for doing that downgrade is something we have to get prepared for. Now if the economy does have a resumption, it is very possible that the Company will not have to do all of the downgrades it did in 2018 and would still have to do in 2019. We are ready for this, if the economy does not show an improvement. But if there is a slight resumption, this will be of great help for us, and instead of doing a downgrade, perhaps the customer will do an upgrade.

We know that none of the customers is happy in doing a downgrade in their coverage and the hospitals and in the health providers. And it's important to mention that, as soon as we see a resumption in the economy, we will be able to show improvements in this field.

When it comes to personnel, we have a very broad opportunity especially when it comes to costs. Not only in terms of costs, but also third parties that represent most of our costs. When we offer service to the customers through the digital means, we would have an opportunity therefore.

Q - Unidentified Participant

Thank you very much for your response.

Operator

JP Morgan would like to ask a question. Mrs. Camille [ph].

Q - Unidentified Participant

Good morning and thank you for taking my question. In truth, I have two questions referring to cost. I would like to gain a better understanding in the significant reduction of headcount in the Company. Now, if you have more space in this or if you're very close to the maximum headcount that you can cut. And the advances for operators, if there is a specific operator that has had a greater weight in this line item and how can we look upon this going forward?

A - Unidentified Speaker

Thank you very much for your question. And once again, when it comes to opportunities, we also have an opportunity in greater reductions in costs in the administrative part. Yes, we do have some things that we will deliver this year in a consistent way. Evidently, (inaudible) has already been done and we have some innovations that will enable us to further reduce headcount, but service our customers very well.

Now part of this question refers to the operators, we offer support to some operators, we offer them advances, but we do have receivables from them and from the customers and all this is normally finalized during the month itself or during the quarter. There are some very timely cases that go from one quarter to another, as happened now on December 31st 2018. Nevertheless, we do not tend to disseminate the name of our partners because this is listed company and they are our partners. They have been our partners for many years.

Q - Unidentified Participant

Well, thank you very much for that.

Operator

Mr. Mendes from Bradesco Bank would like to ask a question.

Q - Frederico Mendes {BIO 19832788 <GO>}

Good morning to all of you. Well, most of my questions have already been responded. Simply a follow-up. I would like to understand this increase in management costs of 15%,

perhaps through a better mix of customers or something you could get around this?

A - Unidentified Speaker

Excellent question, Fred, thank you very much for the opportunity to explain this more in depth. What is it that we would like you to look at? You should look at the management rates and the conditions, is a good mix to the company to work with going forward. Now when you look at this, in truth, the increase was not considerable. There was a slight replacement between one line item and another. And this year, the Company will try to recover its margin, which is a great focus for the Company. But we want to service our customers in the best way possible making available not only more products, but also a combination of factors. Therefore, do not only focus on the brokerage line, where there has been a reduction, and the management line item, where there is an increase. If you think of them jointly, perhaps, it will better reflect the efforts that the Company is making in this field.

Q - Frederico Mendes {BIO 19832788 <GO>}

Thank you very much, a very clear response.

Operator

Mr. Rodrigo from BTG Pactual would like to pose a question.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Well, simply another point here. You mentioned the health operations for the quarter. Now I would like to gain a better understanding of which is the Company rates in terms of health, the synergies that you have, if you could share this, in terms of the Health Club, Clube de Saude?

A - Unidentified Speaker

Good morning, Rodrigo. The Health Club is another of the groups of Qualicorp. And we have been working on a model with SulAmerica. And we have had a certain margin from this. The Health Club, the Clube de Saude is just another product, which is on our shelves at present. But it is a product of a different nature. And of course, it's different from what we do with our other partners. One does not enter and shock with the other, it complements the other and we're trying to work with all of them, and ensure that they function properly.

Now during our entire life in the Company, we have deployed our energy to retain our customers. Now, if you don't work on customer retention through downgrade, our users or customers will leave, they're quite smart. And the work that we carried out in 2018 to retain the customers from downgrade, once a work of retention, had it not been for there several of our customers what have left. So we have changed what would have been canceled and we're working on the downgrade. It's not about how much the customers will pay and the Health Club as well as other products are simply more tools that we have on the Qualicorp shelf.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Excellent. Very clear, thank you. If you could share with us the features of these new products, the pricing of the products, profitability for the Company and the operators that you're going to speak to, to have more health products, how is this going to operate, could you share this with us?

A - Unidentified Speaker

Well, we're still in a stage of pregnancy as we would say. We're only in the seventh month. We're going to be closing all of this in a few months before we get first one of these products. Therefore, anything I would say to you now could undergo changes in the next 30 days to 60 days. And because of a precaution responsibility of ours, we prefer not to speak about this. We prefer to wait a little more because we're still in the stage of gestation of these new products.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Oh, thank you very much. No problems, and thank you for the response.

Operator

We would like to end the question-and-answer session by returning the floor to Mrs. Grace Tourinho, the Company CFO and IFO.

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

Thank you very much for participating in one more call and myself and my IR team once again are at your entire disposal, should you have any additional clarifications, even after this call. Thank you very much and have a good day.

Operator

The Qualicorp conference call ends here. Thank you very much and have a good day.

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