

## Q4 2017 Earnings Call

### Company Participants

- Grace Cury De Almeida Gonçalves Tourinho, CFO
- Pedro Henrique Rocha Nocetti, IR Manager
- Unidentified Speaker, Unknown

### Other Participants

- Joao Noronha, Head of Capital Good and Conglomerates
- Luciano T. Campos, Research Analyst
- Olivia B. Petronilho, Analyst
- Tobias Stingelin, Director
- Vinicius Figueiredo, Analyst

### Presentation

#### Operator

Good morning, ladies and gentlemen, thank you for holding and welcome to Qualicorp's earnings conference call to discuss the results for the Fourth Quarter 2017. We have with us today Mrs. Grace Tourinho, the CFO and IRO; Mr. Pedro Henrique Rocha Nocetti, the IR Manager and Mr. Jos   Filho Jr., the company's CEO. This event is also being broadcast live via webcast and may be accessed through Qualicorp's website at <http://www.qualicorp.com.br/ir> and on the platform MZiQ, [www.mziq.com](http://www.mziq.com), where the presentation is also available. We would like to inform you that this event is being recorded. (Operator Instructions)

I would now like to turn the floor over to Mrs. Grace Tourinho, who will begin the conference call. Mrs. Tourinho, you may proceed.

#### Grace Cury De Almeida Gon  salves Tourinho {BIO 17244138 <GO>}

Okay. Good morning, to all of you. And thank you for joining us. I would like to comment on the year 2017 as a whole and what you can expect from Qualicorp in the year 2018. Initially, we increased the company's operational efficiency, making the necessary adjustment in our expenses, which was shown through an increase of 5 percentage points in our margins in 2017. We delivered an adjusted EBITDA of BRL 942 million, 19% above 2016. We have a strong cash generation during the year, reducing the company's net debt by approximately 70%. We concluded the acquisition of Alian  sa with the payment of BRL 273 million for the 25% that was remaining. We have already included Alian  sa and (ATA) in our brokerage and live systems. And beginning in January of 2018, we should reap the fiscal benefits that will represent approximately BRL 260 million. We understand that for

FINAL

the year 2018, our challenge is to enhance the degree of efficiency that we have achieved in the last few years. So once again, we need to grow in our large portfolio. And for this, we're investing more vigorously in our channels besides developing more accessible products that will support our retention channels, especially in some important cities where not all of our products are available.

We would also like to reduce the cancellation in lives. This will be the main action so that we can act towards retaining our clients this year and also to improve our sales. Once again, we paid out in advance BRL 250 million in dividend, referring to the net profit of 2017. At the next General Assembly, we will discuss the payment of 100% of our net revenues. This is the fourth year of profit for our shareholders. Our focus at present is to go back to growing. This is what we're working on internally in the company.

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

### **Pedro Henrique Rocha Nocetti** {BIO 20904123 <GO>}

Thank you very much, Grace. And good day to all of you. And I would like to begin on Slide 4, speaking about our portfolio. You will observe a drop in sales quarter-on-quarter and sequentially for the year and the consolidated figures for 2017. It is important to mention that when we observe the behavior of the adjustment of our portfolio, there was also a real impact in the price list of our products. And of course, this has reduced our liquidity in some of the cities. It is precisely because of this that you will observe this drop in the sales in the annual comparison for the consolidated figures for the year. We had the price adjustment and we -- in 2017, with an adjustment of the second consecutive year of 22%. And of course, this has had a severe impact on churn and increase in our net debt.

It is important to also mention that this loss is due to the inability of the population to pay for their health plans. The macroeconomic scenario begins to show some recovery. But somehow this is a very gradual recovery. Nobody wants to not have a health plan. But once again, our clients and citizens are not always able to continue paying for their health plans.

Looking towards 2018, we're coming in with new products in several cities. We're also investing vigorously once again in the sales channel. This should enable us to recover our levels of growth efficiency that we had in previous periods. When we look at the preliminary figure of 2018, we already observe an improvement in our churn. Sales continue to be slow. But it is possible that when we go into the Second Quarter, we will see that turning point in Qualicorp and maybe enough to grow in terms of our life portfolio.

Having said, I would like to go onto Slide #5 (sic) (6), speak about our net revenues. The company delivered more than BRL 2 billion in revenue this year with a growth of 6% vis-à-vis 2016. There has been a slowdown in the Fourth Quarter. And this slowdown is due to the loss of the life portfolio -- a reduction in our portfolio. But it also refers to our portfolio mix. When we look at the profile of the products sold in 2017, there was a large share of

Bloomberg Transcript

the lower-cost product for the health club. And of course, this has had an impact on our portfolio and the slowdown of revenue.

When it comes to cost, you can observe more details in Slide #6. We had a gross margin growth as we were able to capture value and we were able to revise our cost in services of third parties and our personnel, enabling us to have an efficiency gain that you will be able to observe. We have an increase in the margins. When it comes to the financial transfers, there is a reduction, once again, due to the reduction in our portfolio.

In the 2 graphs below, especially to the right, we were able to show quarter-on-quarter how we have been working on the gross margin of the company that is growing. And this is a sustainable gain and achievement for Qualicorp throughout 2017 because of the company's culture showing that it is efficient. And this is what we will continue to do in coming years.

To speak about our administrative expenses and costs of services on Slide #7, there has been a growth of 11% for the expenses during the quarter, once again, due to the negative effects of regulatory contingency. And this tends to happen in the Fourth Quarter.

To speak specifically about our expenses. And I will speak about the -- speaking about cost, personnel expenses, there has been a reduction that comes from a reduction in our staff. And this is also what was mentioned, the gain of savings of 11% vis-à-vis 2016 was a gain of approximately 3 percentage points in margin with personnel expenses. This is no novelty for those who follow us in the company. In 2017 compared to 2016, we have increased our expenses in reals.

Now to speak about other SG&A, something that will perhaps draw your attention more. In the Fourth Quarter 2017, the company signed conduct adjustment commitment terms that we use for the past due in (plans). Formerly, we will pay 10%. Due to this new pledge, we are charging only 2% of fines for defaults. Additionally, through this, we adhere to the debt repayment program that refers to administrative processes admitted in this program. And once again, all of this has had an extraordinary impact, which is not recurrent, of approximate BRL 20 million for the quarter.

Before returning the floor to Grace, I would like to refer to our commercial expenses. I have already referred to the portfolio. And what we're imagining for 2018 is to perhaps spend more on sales. We had a reduction of 3% vis-à-vis -- well, year-on-year. And part of this gain comes from a review of our commercial practices, which is not only based on sales. A part of this represents optimizing our sales channel -- campaigns, the work with personnel to achieve better levels. We'll carry now this internal effort to review our practices while following up very closely on these practices to always enhance our results and to add value to the company. Having said that, in this line item, we're focused on increasing the lives in 2018 of growing.

And with this, I would like to return the floor to Grace to speak about our financial indicators.

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

Let's just go on to Slide #9. We have had an increase in the bad debt, the uncollectible receivables that has increased -- or decreased compared to the Third Quarter. As you know, there was an element of seasonality in the Third Quarter. There was a readjustment. And this is perhaps the worst moment for the past due credit recovery. In 2017, we stood -- we have the normative reception (in progress) enables us to reduce the number of bad debt. We were able to immediately cancel the plans when this was requested by our customer.

Now this cutdown on the customers has to be readjusted. And as you said -- I said, this is the most difficult part of the year. In the second semester for 2017, this was perhaps the worst semester for the company in many years. And these cancellations continue to occur due to lack of payment.

Let us go on to Slide #10, our financial income. As regard to our financial income, as Pedro has already mentioned, in October of 2017, we no longer enforce the fine of 10%. We are now pledging to only charge 2% in compliance with the contract adjustment that we have signed with the national health agency. This has been a significant decrease also due to the SELIC rate and because there's -- we will no longer have the financial assessment of Aliança for the conclusion of the acquisition. So we expect with this to have a considerable improvement in our financial results in the coming semester.

Let us go to Slide #11 the EBITDA. With the effect of regulatory contingencies, extraordinary contingencies and the reduction of the fine, the EBITDA remained stable vis-à-vis the Fourth Quarter 2016. When analyzing the year as a whole, we have a growth of more than 19% with a gain of 5 pps in margins. It is important to mention that part of this gain comes from the internal efforts deployed by the company that review the continuous control of operational expenses. I am very proud to be able to say today that this is part of the Qualicorp culture, which is consistent and will continue to help us in the operation leverage. In 2018, we will continue to work to maintain the efficiency levels of the company. And we're very aware of this challenge that we need to grow quickly again.

In Slide #10, net revenues. We observe an annual growth of 15.3% in net revenues for the Fourth Quarter 2017, highlighting the works that we carry out in the financial and fiscal areas. Our tax burden end of the Fourth Quarter 2017 was around 33%, before 34% for the Fourth Quarter of '16 and 35% for the Third Quarter of '17. For the entire year, we closed at 32%. It is important to show the complexity and how mandatory it is to comply with these indices and the demand of each of the operational companies of the Qualicorp Group. Despite these restrictions, we have been able to obtain better results. We would like to remind you that this tax burden in 2012 was 50%. And we are now at a level of 33%. But we're still not satisfied with that. And we're seeking new alternatives to continue improving this.

When it comes to our CapEx and indebtedness in Slide #13. At the end of December, we signed the contract for the assignation of rights for the amount of BRL 55 million with Vision Med Assistência Médica Ltda, offering the Golden Club to the SMEs with up to 29 lives. With this, the company undertakes what is set forth of approximately 78,000

FINAL

lives in health, 40,000 in dental health with an annual invoicing of approximately BRL 20 million. And we also take on the new lives generated in this portfolio for the next 24 months. There is still an amount of BRL 25 million that will be paid. We have paid off BRL 30 million. BRL 25 million will be paid until March 31. Conditions to the clause of adjustable variable price that will depend on the number of beneficiaries joining.

In Slide #14, our cash flow -- our operational cash flow after CapEx was up more than BRL 150 million, even after we have paid with our own resources the acquisitions of Alian a and the investment in Vision Med. The return on invested capital ended at 51%, 8percentage points above 2016.

With this, we would like to conclude the presentation of the call. And we will now go on to the question-and-answer session.

## Questions And Answers

### Operator

(Operator Instructions) Our first question comes from Mr. Luciano Campos from Bradesco BBI.

Mrs. Olivia Petronilho from JPMorgan would like to pose a question.

### Q - Olivia B. Petronilho {BIO 19090195 <GO>}

In truth, I have 2 questions. You have explained what you expect this year. And what is it that you have observed at the beginning of the year not only in terms of the penetration of the health club and downgrading, if we're going to continue on with the downgrading that we were seeing? And the second question, when it comes to margin, we have some moving parts. We have an idea of the reduction in fine from 10% to 2%, perhaps greater investments in marketing. But on the other hand, we have the new initiatives that are underway. So if it wasn't for this, you can expect in terms of margin for the year 2018?

### A - Unidentified Speaker

Thank you for your question, Olivia. Regarding the first question at what we have observed in the first question, what we feel is that this year has improved significantly. We see that the economy is blooming and the -- what we can observe is a faster churn in the First Quarter, a very fast churn compared to the Fourth Quarter of 2017 and even better than the previous year if we compare this with the First Quarter of 2017. When it comes to lives, we still cannot see an enhancement in the First Quarter. At the middle in the Second Quarter, we will see a resumption in this not only because we're launching new products and projects that are more adherent to our audience. But also due to the improvement in the economy. We're no longer swimming against the current. Our economy is recovering. And I am sure we will be able to observe an improvement in the company in the Second Quarter. Regarding your second question that refers to margin, the company margin still has not grown. It is important to highlight the effects of the IFRS that refers to the sales expenses and that we're made on the date of acquisition. Unfortunately, we would put all

FINAL

of these expenses. And as a result, beginning in 2018, we will have to defer these results. Our commercial expenses, albeit higher even in the year 2018, will not be transferred during the whole year 2018. They will have to be of more size according to the lifespan of the entire portfolio. Additionally to this, the company has been making other enhancements in terms of administrative costs and expenses. We're enhancing the process day after day. Of course, this enables us to have a better efficiency and improvements day after day. This is part of our company's culture. And I believe that through this, we will be able to maintain our margins and perhaps grow.

**Q - Olivia B. Petronilho** {BIO 19090195 <GO>}

If you allow me a follow-up, we have seen a great deal of efficiency improvement, especially in terms of headcount. Will all of this be annualized? Will this effect be annualized?

**A - Grace Cury De Almeida Gonalves Tourinho** {BIO 17244138 <GO>}

So we have the CEO here who says that we will always have this whenever the opportunities come around. As I mentioned, we have 2 fronts that we were focus on [ph]. The first was fiscal. And we're now focusing on the incorporation of Aliana. 90% of this front has been concluded. And we do have a completely new vision in fiscal since 90% of what we wanted to do has been done. And regarding the second front, I think we are at 50%. We still have another 50% to achieve. Nevertheless, it has become clear that the additional 50% is perhaps the most difficult one. But this is part of the gain. And I'm extremely motivated to making 50% happen and deliver this to the company as well. I think that this has responded to all of your questions.

**Operator**

Mr. Thiago Macruz from Itau BBA would like to pose a question.

**Q - Vinicius Figueiredo** {BIO 20592660 <GO>}

This is Vinicius in truth. I would like to comment on the impact of regulatory changes that has forced you to cancel the plan for the clients as soon as they requested. Of course, this reduces the uncollectible receivables. We have seen an improvement in the quarter. I would like to know how much of this improvement is associated to the regulatory changes and which was the impact of seasonality of the Third Quarter and if we should consider the level of the Fourth Quarter 2017 as being sustainable going forward.

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

Vinicius, this is Pedro. Of course, the regulatory change had a positive aspect because it allows our beneficiaries to cancel their plans with an impact on the company. There is an installment of the clients that is sometimes canceled due to lack of payment. Now because of seasonality, this tends to grow in the Fourth Quarter because my portfolio is still under the strong and very recent impacts of the price readjustment. When we think that there's a new regulatory change came into effect in May, the first semester of the year still has not have that benefit. In the first semester, we had a somewhat faster drop. It is also important to mention that the company is working towards retaining its clients

and recovering the credit. This is ongoing and continuous work regardless of the regulatory changes. And as we mentioned during the call, this year, we're working on producing more accessible products, having more offers to the clients. And it is important to mention this, the work to decrease the past due payments does not depend, of course, on the output, entirely it depends on proactive work within the company.

## Operator

Mr. Tobias from Cr dit Suisse would like to pose a question.

### Q - Tobias Stingelin {BIO 18290133 <GO>}

Grace, when it comes specifically to your expenses, you have worked strongly with very good results this year. And you mentioned that the churn will improve in the second semester. Do you think that in some cases, you have cut down too much that perhaps you will have to pay more commissions, perhaps you were overly aggressive last year?

### A - Grace Cury De Almeida Gon salves Tourinho {BIO 17244138 <GO>}

Quite honestly, Tobias, I don't think so. We are going to have greater sales expenses because 90% of our sales are carried out by third parties. And of course, we have to pay the commissions. And when they sell a specific number of additional lives during sales campaigns, we also have to pay for those campaigns. But we're coming in with very -- new campaigns that are attractive. We do see this recovery. And of course, this commercial expense will become very natural, differently from 2017 and 2018. The sales expenses with commissions will be deferred. It will no longer be included in our results because of the IFRS.

### Q - Tobias Stingelin {BIO 18290133 <GO>}

In marketing, for example, your strategy, perhaps I'm under the wrong impression. But you're going to increase your investments?

### A - Grace Cury De Almeida Gon salves Tourinho {BIO 17244138 <GO>}

That is going to happen. And in so far as -- along with the operators, we're able to obtain new products for specific regions, regions that are important for the growth of the company. We will identify additional investments. But nothing that will change our normal level. And once again, we are expecting perhaps more sales. And we're quite calm when it comes to the recovery of our sales, especially in the Second Quarter. We're working internally and very strongly towards that. Even the financial area is doing this. The entire company is involved in this. And we are going to allow the company to recover. And this enables me to foresee an important exchange. We have already been able to set forth an acceptable level of costs and expenses. Once the sales recover, we will have a gain in production.

## Operator

Mr. Jo o Noronha from Santander Bank would like to pose a question.

**Q - Joao Noronha** {BIO 17451608 <GO>}

I would like to ask a question about your new products. If you would perhaps like to comment further on these?

## **A - Unidentified Speaker**

There are a great deal of rumors of new products at Qualicorp. Qualicorp is not an operator. And Qualicorp will never undertake any type of risk and Qualicorp will never compete with insurance companies, for example, that are present in the market. Now when you speak about new projects, this type of projects does not exist. Nevertheless, we do have a partnership that is being negotiated. And I would say that we're in the final stages with Mapfre for the Mapfre projects. Mapfre Brazil has decided to enter the health field in Brazil. And once again, we are under negotiation with them. And you don't create a product in 24 hours. We're going to be working with their products. There'll be logistics issue for the distribution of Qualicorp. But once again, we're dealing with a Mapfre product. We're not competing with our own product. And Mapfre will be one more that we'll add to our portfolio (while we face on the present to resolve). This is an in-house issue. And we have with SulAmÃ©rica also the creation of a product -- perhaps not a product. But a new form of distribution with SulAmÃ©rica that has an excellent system. The -- well, SulAmÃ©rica, historically, has been our best partner in-house. And what is happening is we're going to be able to sell more than what is normal. We do observe that there is fast recovery. We're perhaps concerned more with the profile of the customer. We don't want to sell a fairly low-priced product. And we have historically have partnerships with insurance companies. We will continue to hold these partnerships. We have a very good partnership that has just been renewed for an additional five years. So at the end of the day, this means that Qualicorp will be selling more its (inaudible) and (very binary) and simple (inaudible) as we sell more than others. But we will say for the significant economic crisis, we were forced to make readjustments. And this crisis impacted everybody at large. It didn't impact only our company. It has an enormous impact on all companies. And this is not a justification. All of these roles have an impact, a general impact, not only on our company but on everybody. And of course, Qualicorp wants to sell. They want to grow fast, to sell more than they did when the company began. And retention of customers will have to go through our internal processes. They will depend on the economy. And we can also work with insurance companies and readjustments. We do have positive indications. For example, in terms of SulAmÃ©rica, they will have a readjustment this year. SulAmÃ©rica has done excellent work when it comes to the management of claims. And they have been working in partnership with us. And this is the scenario. And of course, it has a cost. We have been around for 21 years. There's a technological cost. This is normal. And if we're going to be spending more with sales or not, I think this question is irrelevant and somewhat absurd. This is how Qualicorp was built. And this is how it's going to continue to build the business going forward. And once again, we underwent difficult season the last three years because of the economic crisis.

## **Operator**

Mr. Luciano Campos from Bradesco BBI would like to pose a question.

FINAL

Bloomberg Transcript



**Q - Luciano T. Campos** {BIO 21177595 <GO>}

Well most of the questions have already been asked. Something that draws attention is the addition of cost and expenses that are not commercial. There is a drop of 10% in life beneficiaries. But there's also a drop of 20% in cost as a whole, once again showing the efficiencies that you are able to implement throughout 2017. And what I would like is a confirmation, what happens with line items like these? When you go back to growing with your new product plan and with marketing, what will happen when you go back to growth, if there will be pressure on these line items and if it will cause a pressure on your margin because these were the main forces for the margin improvement in 2017.

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

Luciano, thank you so much for your question. This is an extremely important question. And I'll explain why. Because we could only improve in this field and show you why we were not able to show these results in 2017, which began in 2015. We were working with a company called (inaudible). We launched the portfolio -- this launch was founded in 2015. And in 2016, we also had (inaudible). We only reaped the benefits in 2017. We didn't carry out (inaudible). We invested in enhancements in the works that we were doing. Now if you were to ask me, Grace, have you stopped with these enhancements? Certainly, not. We still have a great deal to improve our operational efficiency, the way that we service our customers. And our focus is to service our customers in the best way possible. To make these enhancements, we have to make some investments. And the company never shied away from making investments whenever they were necessary. What is important to show you is the following: everything that we have achieved until 2017 is something consistent. And it won't be necessary to have any increase if we have an increase in sales. I think we have had enormous benefits because of the work we did. And once again, I will not have to change the level of the company cost to be able to service new lives. This is new culture within the company.

**Q - Luciano T. Campos** {BIO 21177595 <GO>}

My second question is more conceptual, perhaps more difficult. So as the second semester of 2017, you had a lower level of new sales and you are committed to addressing this in 2018 to ensure that the company will grow based on your beneficiary. So you said, you have been able to identify all of the problems that led to the results in volume in 2017, do you feel that you have the necessary tools or weapons to address this in 2018? Or do you still have to go through that process of developing new products with Mapfre or new tests to be able to invert this issue? Or do you have a significant degree of confidence that all of this has been done?

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

Well it's more or less the same question. Again, let me divide your question into 2 parts. First of all, the new products. All of this will depend on Mapfre and partnerships with new companies or partners that we have been working, Bradesco, SulAmérica. And beforehand, we have developed with operators the main projects that will be sold in specific cities that are extremely important for our cities where we do not have these products -- or did not have these products at the time to be able to retain our customers when we had the readjustment. The fact that we're working to have these products will also have an impact on sales. And once we have these products, we will be able to retain

FINAL

our customers. And once again, the situation of the economy. Formerly, we have all of the products available in all of the cities that we were literally swimming against the current. I don't know if you have attempted to do this. The best thing is perhaps to come to a standstill. This is no longer the case. And I can already speak about some figures of the company. We're feeling an improvement in the economy. And if there is an economic recovery, I will have a very positive feeling. I do have a positive feeling and optimism in terms of the economy in 2018. Now although you make appropriate products for the different markets, even though you have trained personnel, operators that are good, if you're working with the right incentive for the salespeople, if the economy begins to shake, it will be very difficult if people don't have any money in their pocket. Now these customers have proven to be highly resilient because of this very prolonged crisis. The situation became ever more difficult. What we need is to maintain the recovery of the economy. And in that case, I have no doubt that, in-house, we're all prepared to face all of this new momentum and go back to growing. We, of course, depend on these external factors.

## Operator

With this, we would like to adjourn the question-and-answer question for analysts and investors. I would like to return the floor to Mrs. Grace Tourinho, the CFO and IRO, for her closing remarks.

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

Thank you very much. I would like to thank you for your participation at the call. I'm at your disposal. If you continue to have questions, once again, our IR team is at your disposal should you need any additional information from the company. If you need more information about the moment that we're going through, once again, we're at your disposal. Thank you very much. And as I said, I'm highly confident in the work that we have been carrying out internally in the company.

## Operator

The conference call for Qualicorp to discuss the results for the Fourth Quarter 2017 is adjourned. We would like to thank all of you for your participation. Have a good day.

*This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.*

Bloomberg Transcript

FINAL

Bloomberg Transcript