Q1 2018 Earnings Call

Company Participants

- Carlos Alberto Iwata Marinelli, Chief Executive Officer
- Viviane Behar de Castro, Investor Relations Officer

Other Participants

- Joseph Giordano, Analyst
- Leandro Bastos, Analyst
- Marco Calvi, Analyst
- Rodrigo Gastim, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, everybody and thank you for holding. Welcome to the Grupo Fleury Conference Call regarding the Results for the First Quarter 2018. We have with us today Mr. Carlos Marinelli, the CEO; Mr. Viviane Behar de Castro, the IRO; and Fernando Leao, the CFO and Chief Legal Officer. We would like to inform you that this event has been recorded and all participants will be in listen-only mode during the company presentation. And following this, we will go on to the question-and-answer session and further instructions will be given. (Operator Instructions) This event is also being broadcast simultaneously through Internet via webcast and can be accessed at the address www.fleury.com.br/ir where the respective presentation is also available. You yourself will be able to control the slides. The replay of this event will be available soon after the closing. We would like to remind the participants of the webcast that they can record via website any question for the Fleury Group.

Before proceeding, we would like to clarify that forward-looking statements made during this conference call referring to the business outlooks of the Fleury Group, projections, operating and financial goals are based on beliefs and premises of the company management as well as information presently available to the Fleury Group. Future forward-looking statements are no guarantee of performance as they involve risks, uncertainties and premises as they refer to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that general conditions, the sector conditions and other operating factors could affect the future results of the Fleury Group and could lead to results that differ materially from those expressed in the forward-looking statements. I would now like to give the floor to Mr. Carlos Marinelli, who will begin the presentation. You have the floor Mr. Marinelli.

Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Good morning and thank you for the interest and presence of all of you at our earnings conference call for the first quarter '18. I begin this conference call highlighting the main financial indicators on slide number 3.

The net revenues presented a growth of 11.1% totaling R$653.3 million. Cancellations represented 1.4% with 89 basis points improvement. EBITDA reached 7.4%, reaching a margin of 28.5%, the second highest margin in the company's history. Our net income was 96.4 million, a growth of 18.2%.

And finally, return on invested capital without goodwill reached 45.3%, a strong evolution, compared to 36% reported in 2017. These indicators once again point to the sustainable growth of our operations with the continuous evolution of the main line items of our results. Despite the strong organic expansion of our operations with 34 new units inaugurated in the last 12 months. Perhaps more importantly they reflect the consistency of our innovation and growth strategy adopted by the company alongside the permanent discipline in operating efficiency of our business.

As you can observe in slide number 4, we maintain our focus on the execution of the expansion plan, so much so that we kicked off 2018 with the inauguration in February of a medium-size unit in Santo Andre, the fifth largest city in the State of Sao Paulo, which will enable the Fleury brand to continue to grow in clinical analysis and images including MRI, as the full unit in Santo Andre faces high occupational levels.

In April, we inaugurated the first a+ brand in Guarulhos, a city that is part of the metropolitan region of Sao Paulo. This unit has a full offer of clinical analysis and imaging, including mammography, ultrasound, MRI and fetal medicine. With this, we obtained 35 new units since the beginning of the expansion plan, totaling 11.9 thousand square meters of service area. Of this total 91% is still in the incipient stage of maturity with less than 12 months of operation. It is important to highlight that strengthening our capillarity foresees further inaugurations this year, especially with the a brand in Sao Paulo and Felippe Mattoso and Labs a+ in Rio de Janeiro, most of the inaugurations will concentrate on the second semester.

We go on to slide number 5 to show you our operating highlights. Once again, we have the consolidation of NPS, which is a quality indicator of our service rendering. We reached 76% for the quarter, an increase of 366 basis points with the goal of enhancing the experience of our clients, we are fully engaged on our journey of digital transformation that is present in different fronts such as back office, medical relations and service.

We're launching the pilot phase of a Digital Reception Project in the a+ Queiroz Filho unit in Sao Paulo through the app. This project will allow the client to carry out a digital check-in 48 hours before the scheduled exam. Upon reaching the unit, the client will present his or her confirmation online through the QR codes and have a more expeditious services at the unit.

After the pilot phase, the project will be rolled out to the other units of a+ in Sao Paulo and Fleury and subsequently to the other group brands. We're also investing heavily in the development of products and services in the genomics segment to consolidate our leading position. In the first months of this year, we launched a complete portfolio in neurogenetics with 23 genetic tests to diagnose conditions such as autism, epilepsy and other neurological syndromes, added to the broad portfolio in oncology and cardiology and confirming that the Fleury Group is at the forefront of personalized and precision medicine.

We also signed agreements with pharmaceutical companies through a partnership where we carry out genetic tests to verify if patients will benefit from specific medication, broadening channels for genetic testing and variety of specialties.

In the capital market, our investor base increased 36.1%, since the company was included in the Ibovespa Index in January of this year. In April, we disclosed raising BRL500 million through the fourth issuance of debentures. This reinforces the company cash further to honor our investments in the expansion of markets and business, maintaining an efficient capital structure with costs and terms that are very adequate to the economic dynamic of the sector.

In April, we held the ASM with the participation of 65% of our shareholders has approved all of the issues proposed. Among this meeting ratified the make up of the Board of Management from 8 to 10 members, 4 nominated by Integritas the holding made up of founding physicians, 3 nominated by Bradesco Seguros and 3 independent members representing 30% of the total and reiterating our commitment with the best corporate governance practices. Their shareholders also approved setting up a Fiscal Council with three effective members for the 2018 exercise.

Finally, I would like to highlight the award secured by the company. The Weinmann brand is the most remembered and preferred in the category clinical laboratory for the 20th time and the brand we have brought for this site in Rio Grande do Sul. The Fleury brand is a leader in the most hospitable brands in a award promoted by the Brazilian Institute on Entrepreneurial Hospitality. And in the Brazilian Institute of relationship of the client that evaluated a 150 brands, Fleury was ranked fifth. We are confident that we will continue delivering sustainable growth in 2018 based on our pillars technical, medical, service and management excellence.

For this, we will continue to develop full discipline in the execution of our expansion plan with the development of innovative solutions and medicine that is precise and personalized and also enhancing the experience of the client when using our services.

In parallel, we will maintain our attention in the search for greater operational efficiencies through the digital transformation that is underway in the company.

I would now like to give the floor to Viviane for her to proceed with the presentation of results.

Viviane Behar de Castro {BIO 16620272 <GO>}

Thank you, Carlos and a good morning to all of you. We begin the presentation on slide number 6, where I show you the growth revenue. We presented a growth of 10% in total gross revenue amounting to 706.3 million. The growth of total gross revenue shows the soundness of our robust brand portfolio. These was also placed in a calendar where we have less working days, longer holidays vis-a-vis the same period in the last year, impacting the demand in a one-time way.

Additionally, during the quarter, we also had the impact of the price negotiations carried out with healthcare operators at the end of 2017. We underscore that our annual price adjustments are based on the broader consumer price index that reflects a lower level of inflation, considerably low compared to the previous year. In this context, our service units grew 10% with the following makeup, 6.4% for the Fleury brand, 21.7% for regional brands excluding Rio de Janeiro, 8.5% for the Rio de Janeiro brand. Our hospital operations showed a growth of 9.9%. Net income during the quarter had a growth of 11.1% with an improvement of 89 basis points in the cancellation indicator that reached 1.4% of gross revenue.

On slide 7, in greater detail, we see the growth of our portfolio brands. In the graph, you can observe that a large part of the growth is due to the advance of regional brands excluding Rio de Janeiro representing 24.5 million growth followed by 20.7 million for the Fleury brand. The brand in Rio de Janeiro contributed with 9 million.

In the graph below, we see the expressive of growth of gross revenue and same-store sales. If we begin with the regional brands excluding Rio de Janeiro, we have a 21.7% growth in gross revenue with same-store sales of 9.4%. We highlight the a+ brands in Sao Paulo with strong organic growth of 28.9% due to the effect of newly inaugurated units.

Additionally, we have a increase in gross revenue in the Rio do Grande Sul region with 31.7% reflecting their confirmation of the Serdil brand acquired in the fourth quarter of 2017.

In the Rio de Janeiro brand, we have an increase of 8.5% in gross revenue with 61% in the same-store sales. This quarter there is a growth acceleration vis-a-vis the fourth quarter '17. Among these factors, this is due to our accreditation of new operators in the previous quarter. Even in the situation of the calendar effect that we mentioned previously, that in Rio de Janeiro has a greater impact in the use of services.

Of the six new units inaugurated in Rio de Janeiro in the fourth quarter of '17, four were inaugurated in December and are therefore in second stages of maturity. In the Fleury brand, we verified an increase of 6.4% in gross revenue with same-store sales vis-a-vis the same period in the previous year. This is entailed by the new units that are still in an initial stage of maturity.

91% of the service square meters inaugurated have less than 12 months of operations. These new units are performing according to plan, advancing in the revenue potential and servicing regions and neighborhoods where our service needed to be expanded. The same-store sales of the Fleury brand is impacted by the new units, this effect refers to client distribution brought all the new among existing units and new units in the same geographic area, which we call cluster.

With the opening of the new units, we carry out an adjustment in the existing units in the cluster through a retrofit or a reorganization of the service mix offers impacting the same-store sales. This semester the MRI and CAT scan came to a standstill for three months to replace the equipment at Republica do Libano III unit in Sao Paulo. We would like to highlight that we recorded impact due to the calendar effect with less working days and with a lower price readjustment due to the drop in the inflation in business.

In slide number 8, we show you the execution of our expansion plan that added 34 new units until March of 2018. This represents 11.1 thousand square meters or 10% of incremental area. In the graph, you can see that 92% of the total inaugurated area has less than 12 months of operation. The units inaugurated are performing according to what was expected and are already contributing to the growth of our brand portfolio. In slide number 9, we would like to share with you the growth of the Fleury brand cluster made up of two large units of Analia Franco and Morumbi inaugurated in June and July of 2017. These units together represent 51% of the meters inaugurated by this brand until the moment. As you can observe in the bar graph that two clusters presented a relevant growth in gross revenue generation immediately after their inauguration. In the first quarter 2018, the growth was of 37% confirming the demand that exists in these regions for our services.

We go on to slide number 10, where we highlight cancellations and net income. To the left, you'll see that cancellations reached 1.4% in the quarter, a reduction of 89 basis points. Now considering this one-time effect of these negotiation with health care payers, this indicator would be 1.6, and this result reflects the continuous improvement in our receivables cycle. To the right of the slide, you'll see the expansion of 11.1% totaling 653.3 million.

In the next slide number 11 to the left we highlight our costs. In the quarter, we had an increase of 14.2% and an increase of 180 basis points in net income, impacted by personnel and medical services and the increase in number of associates to support the expansion plan and demand for our operation.

In the graph to the right, an increase of 14.3% in our expenses and growth of 13 basis points in net revenue due to discretionary expenses with consulting and marketing. We continue with our stringent discipline in cost and expense management with an evolution of our target -- of our controls and a tireless quest for efficiency.

This can be observed in slide number 12, where the EBITDA margin reached 28.5%, the second highest margin recorded by the company. Showing our continuous effort for operational efficiency gains. The sustainable evolution of EBITDA margin in the first quarter '18 was surpassed in the previous year in a 100 basis points due to seasonal effect on the re-implementation of SAP.

The EBITDA reached a 185 million during the quarter, an increase of 7.4% vis-a vis the previous year. In the same slide in the graph to the right, we show net income that obtained 96.4 million in the quarter, an increase of 18.2%. The net margin was of 14.8%, compared to 13.9% in the first quarter of 2017. To gain a better understanding of net income between periods, we show you in -- the effect of the linearization of the effective rate and new taxes over shareholders' equity was an effective -- expressive increase in 2018 compared to the same quarter in 2017.

In slide 13, we show you the operating cash flow that recorded a 103.9 million in the quarter, an increase of 21.0 vis-a-vis the previous year. The conversion of operating cash and EBITDA reached 55.9% vis-a-vis 49.6% in the first quarter of 2017. To the right, we show you the quarter's CapEx totaling 32.5 million, a reduction of 42.2% vis-a-vis the first quarter in '17 of this amount, 51.9% are concentrated on expansion and an enhancement in the service units. These investments in expansion will be intensified in the coming quarters.

In slide 14, we show you our return on invested capital without goodwill that reached 45.3% with a strong evolution, compared to the first quarter '17. This growth has proved that investments that are being carried out are on the right path. In the same slide in the graphs to the right, we show you the NPS evolution that reached 76% in this quarter, an improvement of 336 basis points. NPS is a metric used to measure clients recommending our services. This evolution shows that the continuous evolution of our return on investment capital is done in a sustainable way and based on the principles of medical, technical and service excellence and setting our services aside, and this is acknowledged by clients.

In slide number 15, we show you the average daily trading volume that obtained 53 million, an amount that is twofold greater than in the same period of 2017. And slide 16, the Board of Management on April 12, approved the admission of debentures of the company for a total of 500 million divided into two equal series of 250 million. The first series is a compound rate of CDI plus 0.35% with maturity in April of 2021. The second series has a CDI rate of 0.60% with maturity in April of 2023. With a weighted cost of CDI plus 0.50 for the company, these resources are geared to reinforcing our cash.

On slide number 17, you'll see our market agenda for events that has already been confirmed. We now offer you the floor for questions-and-answers and despite Carlos and myself, we will have Fernando Leao with us.

Questions And Answers

Operator

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

Q - Marco Calvi {BIO 19854632 <GO>}

Hey, good morning to all of you and I have two questions. The first referring to the cost of material. We see a change in the way that you pay your supplier with an impact on the line item cost and materials. And in the leasing line item, I would like to ask you to please remark on the impact of this change, it seems to be quite positive when we look at the gross margin evolution? My second question, there was a slight decrease year-on-year following the decrease that we had in the fourth quarter. I would like to know if this decrease will tend to be recurrent or not? Thank you very much.

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Marco, this is Carlos Marinelli. Regarding your question on cost and material, this arises from the work that our technical team has carried out throughout the last year. As you may recall and as we remarked in the last call, we spoke about this technical change in the future, this is complex work that we're carrying out, it has endured the future of the company regarding our growth particularly and we have worked with in a diversity of ways, and this includes cost and the material offered by suppliers. The difference that you see in this line item of cost of material and equipment shows the change in some of the contracts and has led to this gain. This negotiation on the part of the supplier shows that it is more interesting to work with a reconfiguration which is ever more important is that we're already capturing gains and we have future gains going forward with our technical area as well. As you know, we do not offer guidance on these figures, we do not give fore disclosure on the impact, but I can say that this is an interest income track going forward. In terms of receivables, in the fourth quarter of '17, the delta that you observed refers to some negotiations that were underway. It was of nine days in the fourth quarter 2017, in the first quarter of 2018, this has been reduced to 3 days. Would be help when you look at the net and the average term for payment, the term of payment has been reduced allowing us to have a significant evolution in this figure, between receiving and payment, once again we've had a reduction.

Q - Marco Calvi {BIO 19854632 <GO>}

Thank you, Carlos and thank you very much for your response.

Operator

Mr. Joseph Giordano from J.P. Morgan, would like to pose a question.

Q - Joseph Giordano {BIO 17751061 <GO>}

Hey, good morning to all of you. My question refers to volume, price and service. You have had a significant growth in volume, although your average ticket remains practically the same. I would like to hear from you, how we should consider this ticket, which is the price component in SAP and which refers to the costs. And when we speak about the expansion, it has been a year and a half of the guidance, you have already delivered more than half of your expansion plan. When we look at the performance of the new units, which is your opinion of this expansion going forward if you believe that you can feed it up even further?

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Joseph, this is Carlos and thank you for your questions. When it comes to the volume and price of the average ticket, I think this is part of our earnings and we have a variation from 2017 where it was 1.4. If we look at the average of inflation, this does not correspond. The mix of the company in terms of revenues shows a growth in the regional brands that have a lower ticket compared to the Fleury brand. What I can say regarding this is that we have the focus on growing the company portfolio and this is precisely what we are doing. The a+ brand has grown beyond the 28%, reaching 30% more specifically in Sao Paulo. The message here is that we have prepared to become what we are and we're going to continue to increase our portfolio ever more. This is a companies that have a differentiated assets, which is the Flurey brand and the people that we service through the Fleury brand. And logically, this has a cost and a differentiated price of course, and we continue to grow the Fleury brand as you are able to observe in this quarter with a growth of practically 7%.

In terms of regional brands, we have more space to grow and to capture value, and this is what we have been doing. Therefore the average ticket in our portfolio, now which has been the growth of Fleury. And what is happening with the addition of genetics and other factors for example, we also see that our regional brands have had a very good performance. When we look at the average price, it grows 1.4%, but in (inaudible) this is excellent news. The company volume is also growing and we have had a growth of 1.1% or 11.1% excuse me in net revenues. When it comes to the expansion, there is no doubt whatsoever, Joseph, that for a year and half, we have been undergoing this expansion plan. We have seen more than 50% with the inauguration of 35 units. And this incentivates us to continue on with the expansion plan. As you know, we do not offer guidance, but in house, the team is highly enthusiastic to do as much as possible to anticipate the delivery of several units that are undergoing work, that are under construction or are hiring people. Which means that this will enable us to pace up to the demand we have going forward.

Q - Joseph Giordano {BIO 17751061 <GO>}

Thank you very much, Carlos.

Operator

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

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Hey, good morning to all of you. I have two questions. The first refers to the calendar effect. I would like to know how this impacted the quarter and how much more revenue you could have made were it not for the calendar effect. And if you believe you will have a better calendar effect dynamic for the second semester. The second question refers to cost. We have a growth of personnel above the growth of revenue, this is no novelty of course because of the strong growth that you had last year. The question is that in the second quarter, this line item of cost will be ever more diluted. Thank you.

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Thank you. Now, as we highlighted in terms of the calendar effect, there was an impact. Now what is this calendar effect? I recall when this question was made and well this happens the entire year and the great days are December 25 and January, where we also open our units. I do not generate demand. My demand comes from the physicians' need in the office. The physicians' need and the patients' need of having a diagnosis. And this will enable these clients to go on with therapy. Now when you don't have a working day, you don't have the medical service at the office as you normally do. We're faced therefore with a holiday that will now extend until Tuesday. And I must mention that for the physicians and users of the Fleury Group, to try to set up on medical appointments on Monday will be somewhat difficult, because we are dealing with liberal professionals that will take advantage of this long holiday to carry out other activities. And most of the offices will be closed on Tuesday. Now this is the impact that we have on our demand, when we speak about these longer holidays and the lack of working days. We do have some metrics that we use, when it comes to counting the number of working days. What I can say is that, if we linearize -- well, this is not the solution perhaps, linearize working days. And secondly, if we pay attention to this, we tend to lose some of the enthusiasm that we have going forward. We prefer therefore not to dwell so much on these figures.

When it comes to the personnel cost that you raised, perhaps this is the first time in a long time seeing an advance in this expense line item with an increase that is greater than the company EBITDA or the company revenues.

In a scenario as I just explained to you where we had 35 inaugurations since the beginning of the expansion plan, you have to have people to work there. You need to hire people and you have to have a minimum number of people at the units ready for the ramp up, even if the demand already have had this ramp up and of course this has an impact on cost that we need to manage. Even faced with this scenario, pressure was 35 new units, 91% of these 35 units with less than 12 months of operation. Despite all this, we have attained the second greatest EBITDA margin in the company's history. This is a test that the team is focusing on, optimizing all of the line items, especially that of personnel. We are in an extreme situation and we have projects such as redesigning the layout of some units, not only Fleury, but a+ to have more functional layouts. And the digital transformation that I mentioned in the presentation, this is being implemented in case of Filho which is a Sao Paulo unit and this will of course have a positive impact, and this also requires personnel. Once again, as I mentioned, we prefer not to give you any guidance on this. We simply reaffirm our commitment of enhancing the units, managing them stringently and ensuring that the capital invested and the returns for shareholders will take place as usual.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Thank you very much, Carlos for your answers.

Operator

Mr. Leandro Bastos from Credit Suisse would like to pose a question.

Q - Leandro Bastos {BIO 21416405 <GO>}

Hey. Good morning to all of you and thank you for taking my question. My question refers to your operations in Rio de Janeiro. There has been a slower acceleration in revenue compared to what we were expecting, somewhat below the levels of the first nine months of 2017. If you could comment on the accreditation of the new healthcare operators as you did? Perhaps you could speak about the monthly performance and see if there has been an evolution. There are new units that will be inaugurated in Rio de Janeiro as part of your expansion pipeline. And we would like to see if there is a trend for positive revenues, it would be very welcome at this moment. Thank you.

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

Thank you for your question. This is Carlos responding to it. It's exactly what you said, this would of course encourage what is happening. We had a quarter where we did face some challenges in terms of working days and the general behavior. And in the Rio de Janeiro market, the dynamic tends to be somewhat different, and we manage each market according to its own respective dynamics. There are differences between Sao Paulo and the Northeast.

More specifically in Rio de Janeiro, we have a strong expansion in 2018, especially in the Felippe Mattoso units. We have a figure that in the fourth quarter was lower, it began to accelerate in the first quarter of 2018 and the trend of the curve in January, February and March, at the end of March shows a better growth trend which allows us to be ever more encouraged, not only to open these new units in Rio de Janeiro, but to also look upon the opportunities that we happen to anticipate the inauguration of the unit.

Q - Unidentified Participant

Thank you very much.

Operator

(Operator Instructions) At this moment, we wold like to end the question-and-answer session. I will return the floor to Mr. Carlos Marinelli for his closing remarks.

A - Carlos Alberto Iwata Marinelli {BIO 18884059 <GO>}

As you were able to observe, our company continues to focus on its management and on the long-term objectives, capturing new clients through our brand portfolio and through our hospital operations by offering innovative solutions in personalized and precision medicine at our service units.

Our competitive edge will continue to set us aside through our technical, medical attention that characterizes our services for more than a decade. Thank you very much and have a good day. The conference call for the Fleury Group referring to the results of the first quarter 2018 ends here. We would like to thank all of you for your participation. Have a good day.