

Q1 2020 Earnings Call

Company Participants

- Bruno Blatt, Chief Executive Officer
- Elton Hugo Carluci, Director
- Grace Cury De Almeida Goncalves Tourinho, Chief Financial Officer & Investor Relations Officer
- Pedro Henrique Rocha Nocetti, Investor Relation Manager
- Unidentified Speaker

Other Participants

- Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for standing by. At this time, we would like to welcome you to the Qualicorp Conference Call to discuss the results for the first Quarter 2020.

We have with us today, Mr. Bruno Blatt, the Company CEO. Mrs. Grace Tourinho, the CFO and IRO; and Mr. Pedro Henrique Rocha Nocetti, IR Manager.

This event is being broadcast live via webcast and may be accessed through Qualicorp's website at www.qualicorp.com.br/ir, where the respective presentation is also available. We would like to inform you that this event is being recorded, and all participants will be in listen-only mode during the company presentation. Ensuing this, we will go for the question-and-answer session, when further instructions will be given. (Operator Instructions)

I would now like to turn the floor over to Mr. Bruno Blatt, the company's CEO, who will begin the conference. You may proceed, sir.

Bruno Blatt {BIO 21352052 <GO>}

Hey, good morning to all of you and this is the day in which we present results. Each of us are in a different corner, but distance doesn't separate us, because we work on a single purpose. I would like to render tribute to the health professionals that are taking risks to preserve life. We thank 520 partner entities medical association, physical therapist, psychologist, pharmacist, and others; I can't name all of them. But I thank all of them on

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behalf of the President of the Brazilian Medical Association, one of the great partners of Quali and I once again render tribute to them.

We have a new reality the social and economic effects of the coronavirus that are so unpredictable. And of course, Qualicorp knows that it has a very important role to help society to go through this moment. The first step was to guarantee the normal operation even in these abnormal times; and because of this, we know that our clients are greatest asset and our associates are now called the Qualis. And I would like to once again thank our 1,837 associates for their dedication engagement and commitment that have given us a real show.

Nowadays, Qualicorp is delivering rapid and efficient solutions; and in two months, we have done what normally takes one year. The home office situation has been very correct and for more than two months, everybody has been working at home. The impact has been so positive that when the pandemic is over, we would like to adopt two days of the week and home office. This will give us facings, better results, and a better life for the Qualis. We have no case of COVID-19 in the Company.

The Company is making the commitment of not having mass layoffs or systemic layoffs during this pandemic. Now, home office is using the technology, that we use in all of the Qualicorp processes and this applies to all of our partners with 100% digital technology, we are able to guarantee sales for brokers as well. We see the severity caused by the coronavirus.

We have created a new system with several initiatives that I would like to highlight, just some of them. We have distributed more than BRL10 million to actions geared to a society for the help area for Quali associates, their families and our partner brokers. Part of these resources were devoted to the construction of three beds in the Santa Casa de Misericordia de Sao Paulo 200 in Rio de Janeiro; and in both cases to care for COVID-19 patients, exclusively, we also have the coronavirus project that helps the health professionals working in public hospitals very speedily. We have also donated 3,000 rapid tests and a 1,000 health professionals have already been tested thanks to this.

Another initiative was to donate 3,000 liters of sanitizing to the slums in Rio de Janeiro and Sao Paulo (inaudible) greatly affected by the disease. Our associates and their family members will also receive masks and rapid test as well as sanitizer at home. We have extended this to distributors and partners throughout Brazil. Now Qualicorp is doing its part offering help to the medical associates to people from the government and offering updated information on the pandemic. We have a site called Qualicorp explains; and since April, we have podcasts, frequent communiques, the communiques of the Health Ministry, coverage on health plans, and Qualicorp has worked with a great purpose, where the main association that represents supplementary health.

What we want to do is create and offer new products for access to health plans with joint efforts in partnership with (inaudible) and the national association of health companies and the Brazilian Association of Health Plans has enabled us to postpone the readjustment that would take place on March 1st in health plans. Qualicorp was the first benefit company

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that has adhered to this. And we're following up on the actions of these associations among society at large and the government and finding new paths to offer access to supplementary help. All of this is part of our role as a manager of benefits, and we want to include access for students, for professional liberal, all for supplementary health.

We have also deployed the efforts through our technical and medical associations to offer newer and more accessible products for the population at large in Brazil. This plan is underway even during this pandemic and then includes national and regional collaborators altering more accessible products, until the beginning of the pandemic for the first time in five years. We observed an inversion of the cycle. They will speak about this in the results, but this first quarter, we had a consistent growth in sales beyond our expectation. Of course, this pandemic has affected all sectors in Brazil and worldwide and Qualicorp is not out of this. We believe that this unprecedented pandemic will pass and that we will continue to offer quality private health.

Until last year, having a health plan was a second priority of Brazilians after having a home. After this pandemic, this will become the number one priority. Once again, we're in the quest for new opportunities. We're broadening our relationship with brokers, partners, and health entities. We are open to new partnerships, new channels, and new products. We're also very attentive to the fact that this moment is a moment for protection, but we are seeking opportunities for synergy. All of the teams have been working in the brilliant way, reducing calls that have been quite expressive.

We have eliminated seven of the 12 floors of the (inaudible) building; and in the first four months of the year, we have more than 40 relevant contracts with suppliers for items such as gardening and other products, any type of cost savings is being achieved. And this is in compliance with our previous goal of having a lighter more competent and more innovative company. With all of these initiatives, Qualicorp reaffirms its protagonism, and we know that we will surpass this crisis.

I now give the floor to Grace to speak about the results for the first quarter.

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

Thank you very much Bruno, a good day to all of you, and thank you for participating in our first quarter 2020 conference call.

About the quarter per se, once again, we highlight the strong operational cash generation, as well as the strength of the recurrent margin even in a cycle where we see a greater impact of commercial expenses; these are the recipe. This has been the great strength of Qualicorp in the last year, along with an operation that has been evolving and becoming ever more efficient. We can say that we have a strong company prepared to surpass this difficult moment jointly with our clients, our partners, and our associates.

I now would like to give the floor to Pedro. You may proceed, Pedro.

Pedro Henrique Rocha Nocetti {BIO 20904123 <GO>}

Gentlemen, good morning, and thank you very much. I began speaking about our portfolio on Slide Number 4. We see a deterioration of churn and the annual comparison. This was due to the loss of a portfolio of 15.7 lives in January. It did not have a significant impact on our revenues as I will refer further ahead.

Regarding the growth as, it is important to mention that in the first quarter '19, we had the entry of a portfolio adding up to 31,000 lives. If we were to exclude this effect, we would be speaking about an improvement in our gross add-ons, the recurrent growth add-ons. With this and if we consider the impact of these two portfolios, we had a negative net add-on of 21,000 lives.

It is important to highlight that the Company intensified its sales campaigns beginning in March, and we have continued to investing in sales seeking to have greater assertiveness to improve our gross add-ons despite this very difficult scenario. When it comes to the other segments and portfolios, we were able to increase the number of lives in the corporate segment as well as in the SME and GPA although the impact of GPA is limited on the company revenues.

We go on to Slide Number 5. We have BRL503 million of revenues in the first quarter 2020, an increase in the annual comparison reflecting the readjustment in affinity and greater revenues in the other segment a very good result, because of the increase in the portfolio. These are fourth quarter; we have an extraordinary revenue because of the agency revenues in the fourth quarter 2019. And this extraordinary revenue, if we did not have this, we would have revenues that are very similar to those -- in the fourth quarter.

In Slide Number 6, we speak about cost. We see that gross margin in the first quarter has increased both annually and quarter-on-quarter. Compared to the fourth quarter '19, you will recall that we had extraordinary cost with a loss ratio that occurred in that period. And the idea is that this will not repeat itself.

I would like to like to remind you as well that in the first quarter '19, we have an increase in our payroll because of the increase in the annual services to third parties and severance pay for that quarter. And what you see here is a reflection that the company has done in the last 12 months to rationalize these costs and offer you the results we see now.

Now, we are referring to our IT expenses, processes, improvements and processes and systems and all of this to increase the satisfaction of the client. Of course, we cannot automatically replace our systems and quickly, we're working with systems in parallel and we can observe periods that are better, when we compare this with the first quarter of the previous year. Notwithstanding this, when we compare this with a force COVID-19, you will observe a significant reduction showing that we are more mature in terms of the enhancement of processes implemented in these last two months.

When it comes to the administrative expenses, we're going to speak about this on Slide Number 7, we see an increase in administrative expenses, especially in expenses with

personnel. This is due to the severance of an executive and the amount was paid mostly through stock options in the first quarter. Now besides this, we have expenses relating to what happens with Qsaude everything referring to the Qsaude project. The sale of two Qsaude was approved in January and the divestment of this company took place only now in April; and as it was still part of the company in during this quarter, there was an impact on personnel services and third parties and leases.

If we eliminate these extraordinary effects because of the nature, we would have annual improvement in SG&A, in terms of absolute value as well as in the comparison of the revenues vis-a-vis the administrative expenses. We also observe a reduction in other administrative expenses that is the last line below depreciation and administration. And these are because we have a lower volume in infraction notices.

Qualicorp as a whole was very strongly to be able to offer the best service to the clients to be able to resolve all the clients' problems both speedily as possible; and of course, all of this should leave us to a lower volume of expenses with infraction notices. As mentioned with our series, we had a decrease because we no longer have the leases to Qsaude but they should only happen as of the second quarter.

I will speak about the selling expenses. Now, there has been a trend that I have been mentioning in previous call, which is the increase in the volume of amortization of commission for new sales, and there's increase has been occurring gradually in the year-to-year comparison, as well as in the sequential comparison; it reflects an increase in sales and the award campaigns per sales that have been put in place in the last 12 months.

Now, if we think about these expensive for more than two or almost three quarters, we have had higher expenses and avoiding campaigns amounting to approximately BRL40 million per semester now only during this quarters it was BRL21 million. Now BRL21 million for awards and the trend is to maintain this increase or perhaps as were speeding up the pace, we can have an increase or maintain the present day level and the volume of amortization of commission for new sales we will of course increase.

Now, these are the effort that we are setting forth to accelerate our sales and the trend is to have an increase and that it will gain more body vis-a-vis our revenues. We have work to become ever more efficient and to have more room and our official metrics to have greater comfort. It doesn't mean that we're going to lose in terms of margin. We have had gains in several areas in the company, and of course this will end up paying off.

I would now like to give the floor to Grace. Thank you very much.

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

Thank you, Pedro.

We go on to Slide Number 9 to speak about bad debt and other operating income. I would like to remind you that in the fourth quarter, we had a record results in the company because of the strong work that we had carried out in previous quarters. We recovered

more than BRL18 million in bad debt reported in the previous quarters. It is important to highlight that the performance in this quarter is the result of the company efforts, that we have been carrying out steadily and it offers us comfort to be able to more challenging potential scenarios. And we have worked a great deal in the field of client retention and we're focusing on each and every one of our clients. Regarding other expenses, we see a greater volume of precision for contingency disclosures. And once again, we're debating with the operators what is called the match to the invoice.

We go on to Slide Number 10 to speak about our financial income. The revenues had a strong sequential reduction, because we pay the capital reduction of BRL980 million in November 5th of last year. We have about BRL4 million of expenses in mark-to-market for our devaluation of quotas and the exclusive investment fund and due to the COVID-19 pandemic.

We go to Slide Number 11 to speak about the EBITDA. We have excluded non-recurring effects with an annual growth with relative stability and margins albeit with a greater weight of commercial expenses in the result. When compared to the fourth quarter '19, this increase is due to our cost with impairment and loss ratios that were reported as part of EBITDA during that period.

Once again, I would like to praise the work carried out by the entire company and by the leaders in the metrics of management controlling the expenses of the company. We're rationalizing not only our expenses, but we're also not losing sight of the quality delivered to the client. The present-day margin of Qualicorp will allow the company to sustain even more challenging macroeconomics scenarios. And we want to continue generating value for shareholders. This is as important as caring for our expenses.

We now go on to Slide Number 12, the net income drop in the annual comparison due to two reasons. The sale of two Qsaudes and some decisions or severance pay. In terms of our effective tax rate in this quarter, it is 37% vis-a-vis 39% in the first quarter '19. It is important to highlight that, if we were to exclude the expenses with two Qsaudes that are non-deductible, the effective tax rate would be of 34%.

On Slide Number 13, we have CapEx and the indebtedness. The company ended the first quarter with net debt of BRL778 million maintaining a strong operating cash generation. The company has always thought to deliver value to shareholders through dividend payout or to capital reduction. At this moment, when the COVID-19 pandemic brings about uncertainties, the Company has proposed to pay a difference or a minimum of 25% of the net earnings for 2019. And this was ratified by the ordinary general assembly of April 30th.

The rest of the profit reserve may be deliberated in the future if the management board feels comfortable in carrying out this payout. In the last five years, the Company has been paying out 100% of the earnings of each exercise. And the purchase of (inaudible) Qsaude was made effective in February of 2020 and their figures will be consolidated in the company. We purchased 75% of the company that has 35,000 lives for the final amount of BRL21 million paid in February and April.

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In Slide Number 14, we speak about our cash flow. Our operating cash flow after CapEx is positive by BRL116 million this quarter, lower than the previous quarter because of a greater consumption of working capital account and once again, because of the service of our debt.

We go on to Slide 15 to speak about the approval that we had for the sale of two Qsaudes, a final approval of the National Health Agency, enabling us to conclude this divestment in April of 2020. We transfer the totality of the Qualicorp. The managerial, administrative, and financial management will now take on all of the commitments, which are now pertaining to the acquirer. There has been a disagreement in terms of the acquisition price and this discussion is being carried out through arbitral proceedings.

We now go on to Slide number 16 to speak about the makeup of our management board. And if you allow me, I would like to thank the active participation of our shareholders in the assembly on April 30 where we approve the place of our management Board. As President we have Heraclito de Brito Gomes Jr. and Mr. Mauro Teixeira Sampaio, Otavio De Garcia Lazcano, Murilo Ramos Neto, Roberto Martins de Souza, Arthur Farne d Amoed Neto and Wilson Olivieri all the independent members. The Company would also like to thank Joao Cox, Rogerio Calderon, and Alexandre Dias, who are leaving the Board and we thank them for the services rendered. And we welcome the new members of the Board that were re-elected at the management board meeting. Bruno Blatt, Grace Cury, and Fabian Rocha; additionally as Strategic Affairs Officer, we elected Mr. Pablo Dos Santos Meneses.

I would now like to give the floor to Wilson, our innovation in new business officer. You have the floor.

Unidentified Speaker

Thank you, Grace, and a good day to all of you. As has been mentioned, our home office has been very dynamic. The last time we spoke, we have five (inaudible) company and some strategic initiative in less than two months. We have increased all of this; presently we have 25 squads working with more than 50 initiative. What is more important is that we have hired most of our research team and we are growing very positively.

To speak about innovation, we have been able to implement several tests for the loyalty process. At the last call, I mentioned that we were following up on the clients' life cycle to have the right product at the right time. This is our lifetime value policy; and now in some cases, we are able to discover, when a client is going to request cancellation.

Now, how do we do this? We base ourselves on data. You will recall that in the last call, I mentioned that Qualicorp had to have a more proactive company, now through some predictive modeling test, we have been able to determine in some cases, when the client is going to request cancellation using PML. Why? Because, we now look at the background of the client see how the entrepreneur works and we use this tool, and this has enabled us to anticipate the cancellation. Of course, certain measures are taken in a surgical way practically, because we're speaking about different portfolios with different margins.

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What we're going to do now is accelerate this type of initiative, increase the amount of product, and offer the best to our clients. This is only one of the 50 initiatives that are underway. I do hope that in the next call, we will have more initiatives that in place very similar to this initiative. We're also preparing some marketplace pilots always with a focus on increasing the average time of permanence of our clients.

I believe that in the next call, we will have some preliminary results that we can share. In the M&A front we're still assessing some opportunities and we're adapting to this new working dynamic, which sort of extends the processes. We're working in a segmented way, seeking new opportunities to have new products or new locations for synergy clients.

This is a very short update of what we are doing in the field of innovation and new businesses. We can now go on to the Q&A session.

Questions And Answers

Operator

(Question And Answer)

Thank you. We will now go on to the Q&A session. (Operator Instruction) Mr.Lee Ann from Citibank would like to pose a question.

Q - Analyst

Thank you and a good day to all of you. I have two questions in full; the first is you could comment on what has happened during the month of April and the beginning of May. And a second question that refers to the regulatory environment. We see that the agency is working on several processes pandemic, and if you have anything to add in terms of what is happening with these regulatory agencies. Thank you.

A - Elton Hugo Carluci {BIO 21743831 <GO>}

Lee Ann, this is Elton. Good morning, and thank you for your question.

I'm going to speak about some cancellations that we have observed in April and May. If anything is left, somebody will complement this question. And in terms of the regulatory part, I will give the floor to another speakers.

Let me speak about April and May. What we have been observing is a reduction, a systematic reduction of this indicator in the last few months in February, March, April month after month, of course, we do have more requests for cancellation. And now because of the COVID-19, we have begun to perceive this and there has been a cancellation of debt, and there has been a slight increase at the end of April and the beginning of May. We have seen a slight improvement in this indicator, so several of the activities that were set in place in the company since January. We do see improvement -- and because of the COVID-19, people are somewhat fearful of canceling their plans.

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Now in April and May once again, we see that the uncollectible receivables has had an exacerbation. I would say that April has been very good. It surprised the company as a whole, but May, we observe, will be somewhat more difficult. And once again, we're delving into the numbers, analyzing them to attempt to understand if this is due to COVID to economic reasons, but once again, May has had an exacerbation compared to April that was very good. And we're trying to anticipate this process, and we see some people carrying out sales because of COVID-19, but in sales and cancellation, I don't know if somebody would like to compliment it, and perhaps Pedro could help me in the regulatory issues.

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

Thank you. And let me compliment what Elton said in terms of the bad debt. This is something that we monitor day-after-day. Now in the month of March, we have some receivables accumulated in the company; they represent a 39% of our turnover in April. We're still waiting for these receivables. They're reserved for 35 days, and we're at 96% with all of the turnover received. Now when we look at this comparatively, it was very much in accordance with what we already had.

The sensitivity of a period such as this one shows clients that they cannot be left without a health climbing a pandemic like this one, and paying for the health plan has become a priority. And in some cases, we have received anticipated payment. We have never received as many as now, but we have to be conservative the economic situation is deteriorating and it will continue to do so.

And of course, this because people are remaining at home, they cannot work and their businesses, and I think we as Qualicorp has made enormous efforts to work to work at full steam and all of our areas to offer these benefits. However, it is very probable that we will have an impact and that is why we monitor this daily and along with our clients, we're trying to understand each and every one of their needs.

I now would like to give the floor to Bruno and others if they wish to speak about the regulatory environment. And I hope to have answered your question, Lee Ann.

A - Bruno Blatt {BIO 21352052 <GO>}

Yes. Thank you very much. Lee Ann, it's a pleasure to speak to you. Now, the topic that you have brought out is very important and we're very attentive to it. Now for you and for all of those that are listening to us, we have to say that the debate that has been tabled for many years already between operators and regulatory agencies. Now the collective plan, the affinity plan are part of a different segment. Now, it is on average we have 14% of the market through the sustainability segment and this is something that is well known by society and by the entities that represent the end consumers.

Now the negotiation with the operators includes an entire technical team in the background and this technical team is able to negotiate with the operators to find better products more accessible products and to also lead to a reduction in the -- a reduction in the adjustment and even in the loss ratio. It is important to highlight that what we are

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trying to do today to generate a greater tight to the health plans. And of course, this is something of supreme importance for health care managers. And all of this work is very helpful.

And what we are doing as managers is generating products specific products with prices that perhaps can even be lower for each different type of segments in the population. And this discussion is a permanent one, but we do not want to threaten the healthcare manager. What we want to do is to expand access to grow new products, including new segment, new affinity segments, and this is what we expect going forward. I hope that I have responded to your question.

Q - Analyst

Yes. That has been very clear. Thank you for your answers.

Operator

Gustavo from Itau BBA would like to pose the question.

Q - Analyst

Good morning to all of you. Thank you for taking my question. I hope that you are all well. My first question refers to cause the PMS more specifically for the quarter, your cost control. And my question is more geared to the following. You have adopted new process, made new decisions and all of these are more mature. If you have anything additional that you could do, it was mentioned during the call that you are committed in reducing these levels of people. Is there anything additional that you could do with third parties if there's anything else that you could cut costs fund?

My second question is a follow-up. I think that the panorama set forth by Grace was very clear. I would like to know what you are doing in terms of the recovery of credit. And if there's anything that was left over that can mitigate the impact of bad debt in coming quarters. If you think that you're going to have additional credit recovery bad debt recovery or not? Thank you very much.

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

Gustavo, thank you for your questions. First of all, I would like to respond in terms of bad debt. We don't have a huge accumulation. What we have at present is high, but it's not something that we will receive very rapidly in this scenario. I truly don't think that people will be paying off their debts from the past even though we become more flexible, eliminate interest rates -- I truly do not think we will have a recovery as we had in the fourth quarter of BRL18 million or perhaps upstairs recovery rate will drop somewhat. What I feel is that so far the company has not had any impact of this default. We're observing this very cautiously and it could change during the coming months. But at this specific point in time, the health sector is one of the last to be impacted because of the pandemic.

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Nobody can be without a health plan at present. This is the vision that we are working on. Now, we will not have an extraordinary recovery as we had in the fourth quarter '19. You will see that during this quarter our recovery was not fantastic, but it is very much aligned with what we had in the past. When it comes to the cost, we have to try to decrease them constantly, and with his new management, there is the opportunity to do something different. Now the only focus that requires a counterpart from savings will be that of sales incentive. I think that we're going to have to go back and revisit this topic once again.

Once again, I think that Bruno would like to add something to this. Simply to complement this Bruno's line is not working. He will not be able to complement this, but once he returns, of course he may remark on this.

A - Unidentified Speaker

Gustavo, simply to add an additional point to what was said by Grace. Of course, we have several enhancements in the coming months. But some of them depend on attaining maturity to see what else we can cut costs on beginning in December. We had a change in the CLN, which are the labor laws for several months, we brought in all of the operators to discuss this. So we still have to go through that cycle of maturity for this to truly understand what it is that we can further reduce.

You will see that we have process enhancements and that because of them they have helped us to cut down on costs as a result. More efficient processes enable us to better monitor our client. And once again, we try to cut down on infraction notices and all of this and complaints that are sent to the national health agents and all of this brings about some savings. You have been able to observe our results in this field.

Very well. Let me compliment something regarding the cup. We have an agenda that is a priority for our team. They were in a very focused way until '19, and we do have a very strong austerity agenda for this quarter. We have this ranging from the larger contracts to the smaller contract. Each of the contracts are renegotiated in detail, we are trying to cut down cost and things like gardening in different locations, which means that we are focusing on same on every single detail everything is important. Of course, we have savings in water on the power bills that are quite relevant as well as in the maintenance area, but we do have a very stringent agenda seeking for new opportunities to Cons and Corp for the company.

Q - Analyst

Excellent, excellent. Thank you very much. Congratulations.

Operator

Mauricio from Credit Suisse would like to pose a question.

Q - Analyst

Hey. Good morning to all of you and thank you for the call and for taking my question. I would like to focus on long-term issues here. Since 2018, we have observed a trend even

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in the affinity segment. We observe a certain stability and downward trend perhaps now going forward we know that we're going to have more unemployment, of course, a decrease in people's income.

My question therefore refers to what you are planning to do differently because of this new world? What would you like to do in terms of geography, partnerships, channel? Something that will set you even more excited than what have you what you have done up to present? Another question there is increase in the commercial cost due to amortization because of your more aggressive sales system. When are you going to reach a point of stability, because there will be a point when you will have fully covered demand, perhaps? These are my two questions. Thank you.

A - Bruno Blatt {BIO 21352052 <GO>}

Mauricio, thank you for your question. We're speaking here about different channels and products, and we're seeking several opportunities through some of the projects that have been underway at least for the last two months. We cannot disclose this, but last night we had a large vertical operator in a region that has become a partner in our channel and we will of course disclose this contract in a timely moment, where we held a very rich discussion and perhaps this is a good clue for you. And in the last call 3.5 months ago, we had some of the operators discussing the expansion and the inclusion of new products as a result of the partnership that we have created with the operators we have more than 10 partnerships that are underway.

We're trying to find new ways to operate in the company. We have pilot projects with these operators. And of course, this is a way to resolve what is happening in the market as a whole. We have a great deal of enthusiasm, optimism, and we're quite excited in terms of innovation, products, channels, and the new partnership. I believe that at least the coming week already, we can already disclose this new partner that is in a significant location or region of the country.

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

Thank you, Bruno. Mauricio, simply to complement your question and from the viewpoint of cost, we see that the commercial costs have been increasing, but when we see the impact of COVID-19, any more aggressive commercial campaign or sales campaign will be important. We have almost 20% increase in sales when we look at the same period the previous year. And this would justify this increase in costs. Well, one of the achievements in the company is that the personnel is fully focused on these new initiatives. This is how we optimize the cost.

And this doesn't necessarily mean to reduce the cost, but at least to leverage the cost. This is gargantuan work that is being done through the 30,000 brokers that are connected to our company. So, this is the work that is underway based on data new processes to be able to leverage the costs. And we will have to calibrate all of this, because of the moment that we live with COVID-19, perhaps we will have different compensation processes or a new way to gain the loyalty of customers change the type of customers that we're working with. Once again, all of this that will enable us to look at the acquisition cost in the different way.

And this moment where the COVID-19 is leading us to a great deal of reflection, and we will have to look upon our data from a completely different outlook. There is no perfect strategy -- there is a path, and we have a new conviction that our model is good, but perhaps we will have to make some temporary adjustments or perhaps permanent changes because of this new learning that we have with home office and this pandemic. I hope that that has responded to your question.

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A - Elton Hugo Carluci {BIO 21743831 <GO>}

Elton, this is. Let me speak somewhat more regarding M&A. We have several analysis or assessments under way, and we're quite optimistic that we will be able to conclude these in a few months. And these are opportunities the company was not looking upon. And we're quite enthusiastic to be able to disclose this to the market very soon. But this moment is a moment of caution and we have to be extremely judicious. We're revisiting our plans throughout the year 2020, but we do have several projects that are underway with some operators that we did not operate within the past and this should bring us good initial results.

Q - Analyst

Thank you, Bruno for complimenting the question. Thank you.

Operator

JP Morgan would like to pose a question, Mr.Jordano.

Q - Analyst

A good day to all of you. I hope that you are all well during this pandemic. I'm attempting to understand how you look upon the sales per region, and through differentiated health plan, which has been the behavior of Sao Paulo in this aspect. Thank you very much.

A - Elton Hugo Carluci {BIO 21743831 <GO>}

Hello, this is Elton. Good day, and I would like to give you more color on this topic. And then of course anybody can compliment my response.

Now this idea of distribution of regionalization and I also spoke about M&As on our outlook for this how we're looking upon Brazil. And gaps where we don't have products and the performance of our channels, and what we want of course is the lifetime cycle with the client and to be able to calibrate our investment. We have observed a trend, we see that there will be a lower ticket. And very clearly, a trend for an economic retraction and in those periods, as Bruno said very soon, we will have a partner that will help us in this strategy, especially considering what we're going to go through in the coming months. We're going to have a very challenging economic period in Brazil.

And about the health segment, we'll always be the last to feel this impact. As we said before, it's the last thing that our client will cancel, the health plan. And we can't see which will be the end of this cycle. But there will be a natural trend to have a distribution based

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on more or less expensive cycle. This will be a new pattern, and this is what we will do with our M&A. We're going to try to fill in that gap and not generate competition with our present-day products. Well, we don't want to cannibalize one of our partners in a specific location at present.

We are involved in a much more complex analysis at present. We're not trying to attack one or another operator. And we have to discuss these cautiously and overcome this desire when we're implementing a product, make sure that it complements our distribution strategy that makes sense from the M&A viewpoint. What we're looking for basically is to cover up our gap. These gaps have been mapped and we're seeking ways of covering these gaps through a contact or through a strategic and timely M&A. I hope that this has responded your question.

I would also like to compliment what was as by Mauricio before. We're expanding significantly in the public sector as well. We have a partnership and alliance, and we're focused on public health systems. We have several operators that are have pursued products for the public sector. They have some novelties, and we're quite enthusiastic about this new movement.

This is a segment, where the default is much lower the ticket is also lower. When it comes to the regional expansion as was mentioned, we're conversing with some regional operators. Up to this point, we had not inaugurated a conversation with them, and now we're very enthusiastic about this possibility. Of course, besides working with our great partners, Bradesco (inaudible) and others where we have held frequent meetings to discuss products as well as innovations in packages and products as well as channel.

Q - Analyst

I would like to present a follow-up here. Which are the regions or locations, where you should have a greater focus if you could respond to this? And what is it that you have done in terms of helping in this pandemic? I came into the call late.

A - Bruno Blatt {BIO 21352052 <GO>}

Well, the location of Sao Paulo, of course, is the one that we have devoted ourselves most. We have distributed direct products. We're also developing other possibilities for our channel here. And of course, we're thinking of new local projects here.

Q - Analyst

That's excellent, Bruno.

A - Unidentified Speaker

You don't know we have more accessible products or the location of Sao Paulo as well as for Rio. We're looking at the interior, the hinterlands of Sao Paulo with a greater focus there are local operators that of course could cover the region with products that will work that are efficient.

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And this is what we are conversing about at this precise moment about that type of location with different characteristics of course. Now, if there is a strong local operator there if we cannot sell our product, we're at a dead end. We will not have the return that we expect. What we end up doing there for is considering all of the collateral aspects. But what we are going to do is to cover this gap. There is an enormous potential market that would be important for the company and we're making adaptations in what we can do, and this is a dynamic perhaps that will take somewhat longer than we're used, but I think we will be able to set in place several new initiatives in the coming months. All of this depends on our positioning, and I will give the floor back to Bruno once again.

A - Bruno Blatt {BIO 21352052 <GO>}

Elton, we have a problem with a call. Is there anything you would like to add?

Q - Analyst

My question refers to what is your outlook for SG in terms of COVID-19? What are you doing to help the community?

A - Unidentified Speaker

I did refer to this at the beginning of the call. We have worked on several fronts to help society. We have a partner in the sector and we have participated with more than 300 beds in the sole health system 200 in the campaign hospital in Rio de Janeiro. We have also made donations of hand sanitizers to Sao Paulo and Rio de Janeiro and the same has been donated to all of our associates masks and sanitizers and the rapid test for COVID-19. And for our brokers were working very heavily for those who work in the selling position.

We have already delivered sanitizers. We're carrying out the COVID rapid test. And we have had a commercial campaign with an partner operator that has worked among these people who sell our products. This is a very challenging financial situation, and we have offered help one off help, which means that we have a great number of initiatives and the company is truly playing its role supporting the society.

Q - Analyst

Very good. Thank you.

Operator

We have a question from Bradesco Bank.

Q - Analyst

Good day to you. I have two questions -- yourself on a contract I would like to know what is happening with competition. What happens with your clients when they breach the contract and go to other operator? And the second question refers to the royalties, we know that the company is highly focused on growth. And we have an expectation that the amount of royalties would necessarily have a reduction, but it is increasing. So I would like

to know your outlook for the year. And what are you doing with the royalties? Are you paying these royalties? Is this of any aid in your sales? Thank you very much.

A - Elton Hugo Carluci {BIO 21743831 <GO>}

This is Elton speaking. I would like to refer to our churn and what we have been doing in that field and then we will speak about the royalties.

I think, this was said in a call in the past. Now, what happens when we have a have a cancellation. We have of course a very varied environment, but we have 62% that do this through a request. And the other 40% and this varies also is due to default to non-payment. Now when we look at the reason in both our business of course have a financial impact. The client will say, that I am requesting a cancellation, because I am unable to pay for this health care.

What we are doing is anticipating this process. We have identified this and a significant group of people that end up buying our products. Sometimes, we have those vertical products, and these clients end up buying a product from a cheaper operator local operator. Now, people, who have just gotten a new job, will become part of corporate policy, for example. Now we have a group of people focusing exclusively on this in the company. Now what we are doing from the viewpoint of product is to ensure that people can have these products, and that we have the products to offer, and we're working with some modeling at present that is somewhat different. We work with different margins and much more.

But in house in the company, we're able to identify when a buyer an engineer that did not have a company has joined the company and is now requesting a quotation for a product. And through the data, we're able to see that at some point in time. This customer is going to call us and try to buy in SME plans.

Now formerly, when we spoke to this client, I had already closed the deal with somebody else and so we're trying to have an impact on the flow. We're trying to get there a little earlier before that moment of decision and before the client will cancel the plan, and we're able to offer this client something new. We try to maintain the client in house, and of course, the broker continue to be paid for these clients, and we truly believe that this will improve the profile significantly. We're carefully analyzing this process to be able to use all of this data when it comes to churn. I hope I have responded to the question.

Q - Analyst

Yes. Thank you.

A - Unidentified Speaker

Hello. There is an important part here. We're working side-by-side with our brokers to increase the award that we give and of course we're looking for the best possible alignment when working with our brokers when it comes to the offer of products. And we're trying to find the healthiest, soundest client. Now, when we observe the first quarter '19, and the first quarter '20, we see that in the first quarter '19, there was a fluctuation a

reduction in the volume of transfers of sales. And the first quarter '20 is more similar to the fourth quarter '19, and this is the reality of the company. We want to make sure that we have a win-win situation for all here. Once again, we will have variations in the awards and what we pay that is called (inaudible) to our brokers here.

Q - Analyst

Thank you. Thank you very much.

Operator

Gustavo from Bradesco would like to pose a question.

Q - Analyst

Good day to all of you and thank you for taking my question. This is another question I have. I would like to ask about cancellation, because of debit if you have an outlook that there will be a change in this if you're going to try to hold back that person, because it would increase your bed debt. And you hold back the client for longer time or if you can hold and have an impact on your churn during this COVID-19 period. What is your outlook on this? If you allow me to ask another question about Qsaude, the resources that you spend in the first quarter should return during the second quarter and if this will truly happen if all of this amount will return in the second quarter.

A - Elton Hugo Carlucci {BIO 21743831 <GO>}

Hello Gustavo, this is Elton here. Thank you for your question. And I would like to speak about the cancellation through debit/bad debts and then I will speak about your other questions. Well, what are we doing because of this situation with COVID-19. We want clients to remain as long as possible, and we have an initiative in-house to try to offer installment quotas. We have challenge in terms of this and we have remark upon it often the compensation per ticket. We'll take out five months to recover when we have a client that enters a situation of non-payment.

We have to be very careful not to have a huge impact on our results going forward. The entire team working on client loyalty attempt to do what is possible to perhaps change the product to lead to a reduction. But once the client is truly and default, it is very difficult to operate with them. Our background shows us that it is very difficult to reverse this, and this is what I wanted to mentioned in terms of uncollectible receivables.

Gustavo, I think your second question refers to our expenses with Qsaude, yes, precisely. Qsaude was sold just recently now in the month of April. And from May going forward, we will no longer have any expensive with this entity Qsaude. We have the closing of the operation in April. And once again in May, we should not have any more operating expenses of any nature although the obligations and commitments of Qsaude were transferred to the transfer to the acquirer. Thank you.

Q - Analyst

Thank you very much.

A - Unidentified Speaker

A final comment as we have no more questions, we do have a medium and long-term strategic agenda that is quite positive. We're quite enthusiastic with this agenda, and despite all of the confidence that we have in Qualicorp and strategic agenda. There has been a change in the company since this was implemented, but I would like to leave here a message of optimism. We're going to carefully revisit all of our strategies. Of course, there is a possibility of collapses is an extremely serious crisis, and we're following up very closely on what is happening in the country.

Now, this is the message that I would like to leave with you now would like to thank my entire team and all of the associates that are imbued with the Quali spirit that are working full steam with the spirit of union. I think the company has been able to remain afloat for 50 days, these last 50 days. And we will continue working this way despite the challenges that we face. I would like to thank all of you for your participation, and say that the IR team is at your entire disposal should you have any question or doubt. Thank you very much, and let's continue on.

Operator

The Qualicorp conference call is concluded. We would like to thank all of you for your participation. Have a good day.

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