

Q1 2015 Earnings Call

Company Participants

- Grace Tourinho, CFO, COO and IRO
- Mauricio Ceschin, CEO
- Natalia Lacava, Investors Relations Superintendent

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Qualicorp's conference call to discuss the results of the first quarter of 2015. We have with us today Mr. Jose Seripieri Jr., Chairman; Mr. Mauricio Ceschin, CEO; Ms. Grace Tourinho, CFO, COO and IRO; Rosangela Souza, Financial Director; and Natalia Lacava, Investor Relations Superintendent.

This event will be recorded and participants will be in listen-only mode during the Company's presentation, after which we will begin the question-and-answer session, when further instructions will be given. (Operator Instructions) I would now like to turn the floor over to Ms. Grace, who will start the conference call. Ms. Grace, you may proceed.

Grace Tourinho {BIO 17244138 <GO>}

Good morning, everyone, and thank you for participating in another earnings call to discuss the results for the first quarter of 2015. Let us take a quick look at the operations and financial highlights of the Company before beginning our presentation, which you can follow through our Investor Relations website.

We closed the first quarter of 2015 with a consolidated net income of R\$44.7 million, representing an increase of almost 70% when compared to last year, that is the amount of R\$26.4 million in the same period of last year, which makes us very optimistic about an increase in the payment of future dividends.

Our total net revenues ex-CRC-Gama grew 20% year-over-year in the first quarter of 2015, reaching R\$393 million, while our comparable adjusted EBITDA, also excluding the participation of CRC-Gama, grew 31.8% year-over-year, reaching R\$173 million and representing an EBITDA margin of 44% in the quarter; record margins inside the Company.

The CRC-Gama standalone presented a negative R\$7.2 million of EBITDA, which must be recovered in the coming quarters as the new projects are started. However, even with this

negative contribution, our consolidated adjusted EBITDA grew 26% year-over-year, closing at R\$166 million with a margin of 41.3% in the first quarter of 2015.

Finally, before moving into a more detailed presentation, we highlight the performance of our total portfolio of beneficiaries, approximately R\$5.2 million, which includes all segments growth, 13% year-over-year in the first quarter of 2015.

This total growth is due to the combination of our Affinity portfolio segment, with 2 million lives, which grew almost 5% year-over-year, and our portfolio of beneficiaries of Corporate and Other segments, which grew 19% year-over-year to 3.2 million lives, mainly due to the acquisition of CRC-Gama.

Now I would like to give the floor to Natalia Lacava, who most of you present already know, and as mentioned in the conference call about the new structure, she will be the main point of the contact between this company and the financial market, assisting us in this new challenge, following the strategic plan for the future of the company. Natalia, please?

Natalia Lacava {BIO 17175216 <GO>}

Good morning, everyone. So now let's go through the presentation of our main financial and operating results that you guys received last night. During the presentation, I will emphasize some points that I believe are more important, but feel free to ask in the Q&A if there is anything I left open, okay?

Since Grace already included in her opening remarks our main indicators, let's skip to slide 5 where we will talk about our portfolio. So, we reached 5.2 million lives in our total portfolio, and you can see the details on the following slide where we can open our net adds.

So I think it is worth highlighting here that our gross addition in Health Affinity Lives reached 92,000 lives. That was within our initial expectations and we have been sharing it with you since we started talking about results. Remember we have guided between 30,000 to 35,000 lives per month. So, this is within our expectations and should keep on throughout the next following quarters.

Regarding the churn, which I think is a relevant point to you guys, we reached 91,500 lives and I think there are important factors here to highlight. The first one relates to the cancellation of some associations with a healthcare operator. This contract reported around 5,000 lives were due in March, and I think here, just to contextualize everyone, although most of our contracts have adjustments in the middle of the year, in June, I have around 20% of my portfolio that I renew throughout the year.

So in this quarter, specifically, we had some cases that due to the economic and financial imbalance, the decision was not to renew it and to keep preventing the rest of the portfolio from higher readjustments and increase in churn.

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The second point that is important to highlight on our churn number is related to contracts that Qualicorp sees [ph] only as a broker. Here it is worth remembering that despite the loss of 7,000 lives, the contribution in revenues and margins is significantly small. And these are old contracts from the time that Qualicorp was still only a broker and did not view offers by any administrative services. We were working just at brokerage. These contracts that were lost were within a number of entities, not only a single one, it is a combination of several associations that amounted to 7,000 lives.

So with that, we closed the net adds with 609 lives, and remembering here that the retention strategies are at full speed. In this quarter, we were able to recover 8,500 lives. In the Other segment, I just want to highlight here our continuous focus to monetize some of the contracts and that explains part of the fall in the Corporate portfolio.

So, jumping to slide 6 where we talk about our net revenues, I just want to call attention for our growth of 20.3% in our net revenues. And I just want to make sure that we continue working hard on the retention through alternatives and offering different products, downgrade corporate audits [ph] to make sure that our clients have enough options to keep on with us, which allowed us to grow our revenues.

On the CRC-Gama, it is worth mentioning here two points. You guys saw that there was a 39% decline in our revenues and there is a point here that we want to mention. The first one relates to a bridge contract that was done only during the migration process of Tempo Seguro Saude to Unimed Seguros. This contract had a time to finish and it was in December, and we were just making the transition from Tempo Seguros to Unimed.

As soon as Unimed got it consolidated in its operations, the CRC services were no longer needed, and that was totally expected. Furthermore, the company had contracts that depended on the level of MLR, Medical Loss Ratio; depending on the utilization of those contracts, revenue may fall or may rise. In this case, specifically in this quarter, utilization reduced and therefore revenues declined.

So, skipping to the next slide where we talk about cost. We wanted to emphasize here the improvement of 150 bips in gross margin year-over-year. Here it is worth mentioning the drop in third-party expenses due to a lower volume of calls in our call centers. This is a result of several initiatives in the operational front to decrease customer recurrence and increase effectiveness on the resolution of our clients' problems. We had a very successful outcome and we were able to reduce incoming calls in the call centers. I just want to remind everyone here that we are getting close to the price readjustment moment and we are internalizing another piece of our call center to deal with the high NPV customers during this moment. We already had a very positive experience with the Black customers. You guys all know that we have build up a specific group of people just to deal with Black customers and we will now test the effectiveness of this with the Platinum clients. So, that should make my cost rise in the next quarter because I have to run this structure duplicated until I train everyone, everyone gets ready, but we believe that this could bring us a great benefit on retention.

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Going to the next slide where we talk about G&A. I want to remind everyone that the reduction is mainly related to third-party expenses due to the absence of extraordinary events that happened in the last quarter, fourth quarter results. So, we went back to the level of 24% of revenues in G&A and that was an important contribution for our margin expansion.

Following on slide 9, going through the commercial expenses, there was a reduction of 20% sequentially, and that is linked mainly to a drop in production. But we also want to remember that we did have an institutional campaign in first [ph] quarter last year, which was not repeated in the first quarter of this year; and also to the fact that in 2015, the campaign started in late February, hitting only one month of the quarter. So, that should be intensified in the coming quarters, and just a slighter reduction in commercial expenses. I just want to remind everyone that this line is totally related to our production, to the sales level. So, if we increase our sales in the following quarters, you are going to see that line going up again.

Skipping to the following slide where we talk about PDA. We are very pleased to announce the maintenance of this indicator close to the 5% level even in the current economic scenario, which is proving to be very challenging. This is result of the recovery actions that remain close to 5 million per quarter. I want to open to you guys here that even though my old receivables have been treated and we do not expect the same level of recovery in the coming months, we will continue to seek alternatives to increase our effectiveness through tools like SERASA, which is the blacklisting here in Brazil, and anything we can find to improve the recovery.

We are working hard in this environment and we hope that we can keep on with very healthy bad debt. When we look to the Other Expenses line, that contributed negatively with R\$3 million and primarily reflects the expenses related to contingencies and it is totally in line with our business. This is very common; it's part of the day-to-day activity here.

On the next slide, we will talk about financial expenses and income. Here it is just worth mentioning that we increased our debt in 2014, however, at a lower spread, even though due to the increase in our basic rate, the Selic rate, we saw an increase in our expenses. On the other hand, the cash flow was higher this quarter, making our financial revenues also to increase.

Turning to next slide where we talk about the EBITDA, we achieved 41% of consolidated margin with CRC and 44% on a comparison basis without CRC. This performance is tied to revenue growth, but mainly to a reduction in our expenses. Our focus for 2015 will continue on better servicing the clients through initiatives that bring results, but also we will never leave aside the austerity in treating our expenses. With respect to the negative EBITDA we reached on CRC, that was 7 million, this refers to the decline in revenues I mentioned earlier and also to the internalization of part of the call center to meet some requirements demanded in the new contract, and also to the bad debt. But as revenue of new contracts start to come, we expect this performance to improve in the coming quarters.

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Going to the next slide, number 13, where we talk about net income; we closed with a R\$45 million net income, a significant increase of 70% year-over-year, and that makes us very optimistic that we will be able to increase our dividends this year, increasing the return for you shareholders. Next, we are getting close to the end, on CAPEX, we reached R\$38 million; here part is software under development. As you already know, we started our operational improvement program and we also have PP&E that still reflects the investments we are doing in the new headquarter of CRC in Barueri, but that should reduce over the next quarter. So, these R\$5 million are not a recurring base of PP&E.

And finally, on the intangibles, we reached R\$16 million. This was an investment made to extinguish the existing S&P contract between GA Consulting, the brokerage firm of Alianca and Dantas [ph]. So, to clarify here, the S&P cost was around R\$4 million per year and we share the results of this contract. So, from now onwards, we will not share it. We will hold 100% of the cash flow and we will stop paying that R\$4 million annually; that could actually increase over the next two years. So, the company believes that it made sense to absorb that contract and maintain the partner only as a lead broker.

Finally, on the last slide, number 15, we end with our cash flow table. We achieved operating cash flow generation of R\$116 million, which, after investments, would have reached R\$89 million. Here it is worth mentioning two factors; the first one is that our interest on debt is paid on a semi-annual basis. So, if we were to pay it in proportional, my cash flow would have been even higher. The second thing and that probably calls the attention from you guys in respect to the working capital, here I just have to mention two factors; number one is the seasonal factor, since our bonus is paid in the first quarter. And also, my prepayment account usually rises in the end of the year because people pay before their vacation, causing a negative effect in the first quarter when I do not have the same situation of anticipation. But even with those factors, we believe that cash flow was high. Comparing to the same period of last year, our operating cash flow generation increased 176%, and that was a great achievement for us.

With this, I conclude my presentation and I turn the floor over to our President to make some closing remarks. Please, Mauricio, go ahead.

Mauricio Ceschin {BIO 18750717 <GO>}

Good morning, everybody. Before going to the Q&A session, I just wanted to anticipate some issues with you shareholders. Our expectations with the estimated level of gross sales for this year; we believe that even in this adverse macroeconomic scenario, our growth strategies will allow us to achieve this level of production. Regarding churn, on the other hand, we have felt the influence of external environment, as in a punctual cases of the termination of contracts due to severe economic imbalances which we observed in this first quarter in some clients, or even arising from the difficulty of the client to maintain a health plan for economic reasons.

We continue to work in all fronts, negotiating with the lowest possible price adjustments with health operators, or offering alternative products to customers with difficulties and working hard on customer retention and recovery. We have also made the necessary adjustments in the structure and we are not measuring efforts to deliver a consistent and,

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above all, a sustainable result. However, as we have spoken in the last month, internally we are very focused on creating alternative products especially and mainly in CRC-Gama, and especially in our geographic NPV expansion strategies, whose objective is not only to increase sales, but mostly to retain the best customers and brokers, searching for the better and higher contribution margins.

And it feels that even if our portfolio business growing at such fast levels, I can still maintain my expectations of revenues and profitability in a much more sustainable form for the long term. So, the commitment to reducing cost and expenses, gaining efficiency, remains, as well as the expectations of growth in revenue, EBITDA, cash flow generation and margin expansion for 2015. So now, we can go to Q&A session. Thank you very much.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions)
This concludes our question-and-answer session. I would like to turn the conference back over to Mauricio Ceschin, CEO. Please go ahead.

A - Mauricio Ceschin {BIO 18750717 <GO>}

Again, thank you everybody for being in this call with us, and if you have some doubts or any questions, you can contact us whenever you want to. Have a good day, everybody, and have a good weekend. Bye-bye.

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