

Q3 2020 Earnings Call

Company Participants

- Bruno Blatt, Chief Executive Officer
- Elton Hugo Carlucci, Vice President of Commercial, Innovation & New Business
- Frederico de Aguiar Oldani, Chief Financial Officer & Investor Relations Officer
- Pablo dos Santos Meneses, Vice President for Operations and Relationship, Director of Strategic Affairs

Other Participants

- Eugenia Cavalheiro, Analyst
- Frederico Mendes, Analyst
- Samuel Alves, Analyst
- Vinicius Ribeiro, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for holding. Welcome to the Qualicorp Conference Call to discuss the Results for the Third Quarter '20. We have with us today Mr. Bruno Blatt, the Company's CEO; Mr. Frederico Oldani, the CFO and IRO; Mr. Elton Carlucci, Sales, Innovation and New Business Manager; and Pablo Meneses, Vice President for Operations and Relationship.

Some of the forward statements made here may refer to the Company's assumptions. Once again, all of these represent risks, which means that they may not occur. This event is also being broadcast live and may be accessed through Qualicorp's website 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's presentation, ensuing this, we will go on to the question and answer session, when further instructions will be given.

We will hand the floor over to Mr. Blatt, who will begin the conference. You may proceed, sir.

Bruno Blatt {BIO 21352052 <GO>}

Hey, good afternoon to all of you and I would like to begin by introducing and thanking our team for their resiliency and for facing up to the challenges. It hasn't been easy and we have been dealing with several agendas during these last few months. And despite the pandemic, we continued to do our part. We have invested BRL13 million in social action

FINAL

and pandemic combat, the size what we did in the last quarter, we gave out the 110,000 disposable masks, many of them for students in the schools in Sao Paulo, 30,000 rapid COVID tests and we have set aside BRL2 million for the TamoJunto fund for the brokers that may be impacted by COVID.

I would like to highlight the effort that we're deploying in the Company with important names. We have the arrival of a new Operations and Service Manager, (inaudible), who in his 23 years of career has worked in (inaudible) SKY. He is responsible for 300,000 contacts per month through the telephone with our clients. In IR, you know the people we have. He has been for more than 15 years in B2W companies. In business marketing, we have somebody who has been in the company for 20 years and has gone through Vivo, Telefonica and others and he is responsible for enhancing Marketing Operation, Artificial Intelligence and maintaining things working supporting the sales operation in that company, responded directly to the communication and marketing director who is Ricardo.

We created a new board with Flavio (inaudible) people and culture. She has been through the (inaudible) and other companies. Besides the traditional contributions and people management, Flavia will continue on with projects for diversity and inclusion, that we launched recently. We have an incomparable distribution strength and we have a new Commercial Director with a focus on sales, but also with a regional focus to increase our penetration throughout the country. He has 30 years of experience and a very strong link with distribution channels. I would also like to refer to our cultural transformation agenda. Since the beginning of the year, we have delivered 64 initiatives to create diversity and 94 of these initiatives are underway besides the implementation of OKRs. We began our innovation program Inova Quali to overcome challenges as the situations that had been set forth in the social field, distance education training models, digital environment for distribution besides the Programa Ideias an in-house program with new ideas and Quali also works through the Incentive Law for Culture, carrying out actions and we teach marketing to prospects and the sales and create personalized projects that will reflect our Quali way of being and to offer tangible and measurable goals to the company, of course, enhancing our longevity and our relationship with stakeholders, clients and partners. We highlight our support to projects such as Museum of Modern Art in Sao Paulo, The (inaudible) Institute Cultural Projects fostered by the main client entities, the cancer hospital and the hospital called (inaudible). Speaking about awards, we're extremely satisfied to share our achievements. We're finalists of Melhores e Maiores from EXAME. We won great place to work in the third quarter and we are champions in Top of Mind for Human Resources.

To speak a bit about financial results, we had sound results in the third quarter despite all of the challenges. As I have mentioned on other opportunities we're focusing on the agenda for growth and innovation. Despite less adjustments, we readjusted EBITDA of BRL273 million in the quarter, the highest ever obtained in the history of Quali because of stringent control of costs and expenses with a drop of 11% year-on-year. We have a net income with the growth of 18% and the free cash generation of around BRL200 million, more than 20 products that will be launched, the cause and expectation that they will attain maturity in the coming quarters. We have point of sales, we have a channel, we're going to launch campaigns. And of course, relationship with the client in terms of

providing the product. Our strategy continues to be the same. We're going to grow focused on clients, closing products offering gaps and seeking greater regionalization with partnerships and M&A.

In the last few months, we did mention some portfolio acquisitions, increasing our foothold in the market. The acquisition of (inaudible) was 14,000 lives and now the Plural, they show our continuous quest for good assets in different regions. In terms of the Plural acquisition, I would like to share with you some highlights. Quali's acquisition in years with a portfolio of 96,000 lives and average ticket of about BRL300 with 21 new operators, 79 new entities, 13 branch offices and offices where did not and regions where we did not have offices and 5,000 Brokers and 500 platforms. We're not just acquiring client portfolio or increasing our foothold in new regions, we have a very valuable asset, which is the experience and experience of the executives of Plural and other companies.

With the experience of Quali, as we communicated in the new way of being of Quali, more than the search for acquisitions and portfolios, we're diversifying our regional growth platform and our diversification of products were convinced that this will only be possible with the strengthening of 43,000 brokers and 920 platforms and of course, we have great access to health plans for Brazilians.

With this I would like to give the floor to Elton Carluci, who will speak about our main commercial strategy.

Elton Hugo Carluci {BIO 21743831 <GO>}

Thank you, Bruno. Good afternoon to all of you. It is a pleasure to be with you in an other Quali call. I'll begin speaking about sales and perhaps respond to your main doubt this quarter, the negative evaluation of number of lives is the result of an exchange of portfolio with one of our main partners in the North and North eastern region. Because of the pandemic and the rates, it took us 45 days without selling this product, which of course had an impact on the number of lives for the quarter. Now this effect has been redressed throughout the fourth quarter. We observed a recovery and we believe that beginning of January of 2021. This will have been completely overcome, thanks to the new positioning. We don't deem that there will be any impact in the long-term dynamic because of this replacement of product that causes temporary effect. What I would like to highlight that in volume of premiums, we sold practically the same volume in the third quarter vis-a-vis the second quarter, which helped us of course to sustain our top line and we were able through a mix to sell products for the higher added-value and this helped us maintain our invoicing. Still speaking about portfolio, as you may have observed the churn continues to present an improvement vis-a-vis the same quarter in 2019.

Now this is a seasonal characteristic because of the adjustments that we have, that is the good news and it confirms our expectation of an improvement in this indicator throughout the year 2020. Very quickly, I will speak about IT and innovation, we're focused on improving our systems and our data front is quite accelerated more than ever before. We are able to plug in any type of data into our data link and we have a ultra robust system when it comes to data. We work with data scientists, statisticians and developers and this of course is giving us competitive edge for the long run. We spoke about the new Quali,

FINAL

an Innovation Program where we have six priority funds. We have ambassadors, mentors, everybody aligned with our goals of bringing in this option into our ecosystem. We hope that in 2021, we will have a strong positive impact in the company, thanks to this program.

Last point, before I give the floor to Frederico, I'll speak somewhat more about the Plural acquisition. This is a transaction with extremely low overlap of products, practically 90% of the Plural portfolio is made up of operators, we had no relationship with and Plural works with extremely good planning because they operate in regions where we were not active, and this should give us a great deal of synergy. The average ticket is of approximately BRL300 and I would like to underscore that we're strengthening some regions where we already have a presence and we're opening up a new front for growth in the Northern market Amazon and Rondonia and in the Center West. The Federal District Mato Grosso, Mato Grosso do Sul, here without a doubt we will expand our distribution.

Now as part of the portfolio, Plural does not have a heavy concentration on a single operator and a very interesting highlight is their presence in Unimed. The 21 new operators mentioned by Bruno, 11 are from Unimed regional operators and they also have operators that we have in our portfolio, which strengthens our relationship with present day partners. This is a highly synergic operation for the company. As Bruno mentioned, they have branch offices. We believe that this will aid and abet our distribution channel to continue taking accessible health plans to more Brazilians and this of course reinforces our mission of servicing the different areas of Brazil with an ever more regionalized approach as we have mentioned in the call.

And of course, selling quality products and generating savings for our clients, I would like to wish a great deal of success to the Plural team. I hope that you're very welcome and from now on Plural is Quali. I will now give the floor to Frederico Oldani.

Frederico de Aguiar Oldani {BIO 16665733 <GO>}

Good afternoon. I'm going to begin, speaking about the financial highlights on Slide number 9, and speak about the highlights for the quarter. We begin with lives and speak about the Affinity portfolio with a slight reduction in the quarter. Here we have two factors that are important. The improvement of churn, a significant enhancement of churn vis-a-vis the last quarter, the third quarter is always the quarter with higher churn seasonally because of the readjustments after the price readjustment, we tend to have a great loss of lives this year as the readjustment was suspended and because of the activities that we adopted in terms of retention, we have the significant improvement in churn vis-a-vis 2019 and vis-a-vis what we have seen in previous years.

As mentioned, we did have a specific issue of not marketing a particular product during 45 days. We offset this with a better churn and retention and we do have a slight drop in our medical hospital portfolio. We have the addition of 272 lives that come from SulAmerica that created that relevant growth of 21% in the Affinity portfolio.

We go to the financial results, net revenue reached BRL524.6 million, a growth of 8.5%. Adjusted EBITDA of BRL272.9 million, a 5.5% growth year-on-year and 200 basis points in

EBITDA. Net income, BRL130.9 million, a growth of 18.1% year-on-year. Now despite the low growth of revenue, we had a good performance in EBITDA for the quarter and we will speak about what underlies these figures through the presentation and finally highlight the cash flow generation, retain BRL195.7 million. Thanks to this, we ended up with very low debt that more than BRL390 million, approximately 0.45 times EBITDA, a relatively low and comfortable level.

FINAL

We go on to the following Slide number 10 to speak about the income statement. First of all, speak about the EBITDA performance that was driven by a reduction of 24% of SG&A in the quarter, now vis-a-vis the same quarter last year, it's important to highlight that despite having had part of the EBITDA growth this quarter because of the savings of expenditure, going forward, we believe that our growth will come from a growth in portfolio and number of lives. Of course, we do have several fronts for improvement for efficiency and enhancement in expenses. But we're going to work, a great deal in re-gearing the resources in the company towards growth and innovation fronts, bolstering the commercial team. When it comes to growth we had 18%. Two important points here, the growth of EBITDA itself and secondly what is worth mentioning is the reduction of the effective rate that we had last year and although we did not have an impact this quarter, at the beginning of the fourth quarter, we began to distribute interest on shareholders' equity and the intention is to continue to do this every quarter and this should benefit us in the coming quarters.

The suspension of readjustment for health plans by the National Health Agency had an impact on the figures of this quarter and we're going to speak about them on Slide number 11. When we look at the impacts that we had because of the readjustment -- price readjustment, although the readjustment was suspended, what the National Health Agency set forth is that operators and benefit managers should provision revenues for the readjustments, as this is due in truth. And by complying with the issuance of competency, the administration has provisioned BRL32 million of net revenues in the quarter, BRL34 million in gross revenue, we also had BRL2 billion in cost and services that were provisioned and there will be due by the partners once we receive this and the management decided to have a provision for bad debts of BRL17 million for the quarter, which once again will give us a net effect of BRL12 million in EBITDA for the quarter.

It's worthwhile mentioning here that the management has decided to be quite conservative in its estimations, why? Because part of the clients, when we improve work with the new prices in January, part of the clients will have left the company and we're still not sure, which will be our capacity to collect from these clients and if we will be able to recompose our capital, that is why we have adopted this conservative position and it is only the coming year, where we will discover the impact.

We go on to Slide number 12 to speak about costs and expenses and the performance. It's worthwhile mentioning the drop of 7.3% in the annual comparison in total costs and expenses and non-recurring effects. The total figure for costs and expenses this quarter is fully aligned with the same quarter last year, although we have that additional provision of BRL18 million for bad debts. Myself and Bruno have remarked about this and this is very good for the quarter. Now if we look at the figures in greater detail, first of all, a reduction of personnel with two effects mainly first, a correction in our accounting since last year

with impact of displacement of expenses between 2019 and 2020 and we can also observe that there was a significant reduction in management remuneration showing the new level for this type of expenses going forward.

We would like to mention reductions and other important line items, especially third-party expenditures and in other expenses, the issue of fines relating to the National Health Agency. During the quarter we had BRL4.3 million in non-recurrent expenses and of these BRL3.6 million in donations for activities to combat COVID as we had done in the second quarter. We continue on with these activities, they were mentioned at the beginning of the call and we also had a non-recurring effect of BRL1.7 million for the quarter because of betterment write-offs in buildings that we have left during the third quarter.

We go on to Slide number 13, which is the last slide of the presentation to speak about our strong free cash generation for the quarter. As mentioned that it was quite strong of approximately BRL196 million for the quarter, reinforcing the capacity of our business to generate cash and converting this result in an effective cash generation. We have two impacts here that I would like to remark on first. The negative impact in cash flow of BRL12 million net of the bad debts, because of the suspension of the price readjustment. This is a negative effect. On the other hand, we had a positive effect, non-recurring one that will be withered again in the fourth quarter of BRL65 million and working capital change because of one operator that delayed the sending of invoices that should have been paid in September and ended up being paid in October. This represents BRL53 million of gain, a non-recurring gain for the third quarter and part of this of course will be normalized in the fourth quarter, we hope.

With this I would like to end my part of the presentation of results for the third quarter and we would now like to open the floor for the Q&A session.

Questions And Answers

Operator

Thank you. We will now go on to the Q&A session. (Operator Instructions) The first question is from Samuel Alves from BTG Pactual. You may proceed, sir.

Q - Samuel Alves {BIO 18720076 <GO>}

Hey, good afternoon. Bruno, Fred and everybody else. I have three very quick questions. The first is, which will be the invoicing of the companies, if you could disclose this? The second question to understand, if the 96,000 lives part of the Affinity Group, the medical hospital Affinity Group and which is the agreement for the purchase of the 25% that remain? Will there be an evaluation or will you be doing something different in the future? Thank you.

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

Hello, Samuel. This is Elton Carluci. Thank you for the question. Now, we purchased this portfolio, most of them are part of them are Affinity Group. This is the company portfolio,

the running rate for invoicing is of approximately BRL60 million and we do have a call option in the fifth year, a put-call, so basically this is what has been agreed upon. There is no trigger or anything that will anticipate this trigger or whatever it is the profit or the number of lives. Thank you very much.

Operator

Our next question comes from Fred Mendes from Bradesco Bank. You may proceed, sir.

Q - Frederico Mendes {BIO 19832788 <GO>}

Good afternoon to all of you. Thank you for the call. And I do have two questions, the first is more strategic. We know that other operators can do this kind of sales. So what are you thinking of doing in the small and medium sized enterprises? The second question, what draws attention is a relevant reduction of BRL6 million in what is owed to the National Health Agency, I think this is relevant and I would like to understand if you can work somewhat -- wait somewhat more in this line item?

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

Good afternoon. So let me speak about small and medium sized enterprises and then we distribute this through our team. We know that some operators -- the regional operators tend to do this, but we are competing with both teams when we have the product and we have been expanding this strategy not only offering SME in our base of cancellation, that's something we used to ignore. We were somewhat hesitant in doing this type of offer and we have some in our base that are ineligible for this offer. And if we did make the offer we would lose to the channel, which did make sense, because we could have done this in-house and so we're using business intelligence and we do believe that we will expand this position. We tested it, it has worked, it has been efficient. We see the figures, it has been growing monthly year-on-year with an expressive growth, not only in premiums, but also in lives and we are going to expand this SME regionally, where the regional teams making this offer in each different region. And of course, without neglecting the possibility of an M&A, we continue assessing the opportunity of an M&A for SMEs.

I will now give the floor to Pablo.

A - Pablo dos Santos Meneses {BIO 21824064 <GO>}

It's a pleasure to speak to you. And the first thing we did here was to implement the culture of priority. The client has a priority to look in-house and see where our operation was failing and perhaps this flaw was not good for the client and then it led to a fine. So what we did was to look in-house, see what we could redress, we found several opportunities for enhancement, opportunities in the service or the client and this has generated savings.

The second aspect, which I deemed to be very positive is that once that we are called upon by the client because they have a problem or a pain, we try to resolve this in-house. We put all of our qualities, so that they can resolve the problem. And the third aspect with good results is that when eventually we do end up having a complaint with the regulating

agency, we act very strongly to attempt to resolve the problem and avoid the cancellation of the plan. All of this has generated positive results. We have great expectations and we're working arduously, so that this reduction can be ever more significant, so that we can bring you novelties in the coming quarters.

Q - Frederico Mendes {BIO 19832788 <GO>}

Thank you very much, Elton and Pablo. If you allow me one more question, in terms of Plural, are you thinking of working with the specific partner from Plural and if you are thinking of this partner and if you are able to hold this relationship, what is it that you would plan to do and which region? This is my third question.

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

I think that the main characteristic is that we have synergy and that we are very complementary companies. So we end up having access to several regions that we did not have access to following several -- several of the products that we have and a ticket of BRL350 that can be sold is a -- this is a high-ticket for some regions and so we're expanding this --we're expanding our portfolio in a very relevant way, and this is how we're also going to expand access to health plans. As I mentioned before Plural was very strategic. It did very good planning and is in regions where Qualicorp was not, so we're gaining something absurd without counting that we have just added 96,000 lives to our portfolio in a normal synergies as you can see.

Q - Frederico Mendes {BIO 19832788 <GO>}

Thank you. Thank you very much and very interesting.

Operator

Our next question comes from Eugenia Cavaleiro from JP Morgan. You may proceed, ma'am.

Q - Eugenia Cavaleiro {BIO 20781536 <GO>}

Good afternoon. Thank you for the call. I have two questions, the first, if you can give us an update and the churn and cross-selling in the month of October and up to mid-November? And then another question about M&As. I know that you cannot disclose too many details, but what can we expect on that front. And how will the company be behaving, which are the kinds of companies that you're considering? Thank you.

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

Let's speak about gross adds then. We're working at both ends and we saw October, November as being better than September. So we continue to see an improvement in churn and this continues, thanks for the work that we have been doing. We are in a pandemic, of course, and people are very fearful of losing their health plans. So we have been recovering that deficiency and some of our products. We did operate with a partial product in October with that partner where we ended up replacing the portfolio and the situation is improving. And of course we should have growth adds in the fourth quarter as

FINAL

well. This is the outlook. Everything will depend on the dynamics of this month and the month of December that we're following up on closely.

In terms of M&A, we continue to look out for opportunities anything regional that will bring an advantage for Qualicorp or product expansion as we spoke about SMEs and of course what we want to do is to bring to Quali and bring to our team, people like we have brought in lately. We have Andre Vianna and Sergio, who became partners and who founded Plural. They will continue working with us in distribution. And we also did this with other companies to help our expansion team, we brought in Antonio Carlos come from health. So this is the type of M&A that we're seeking. M&A, that will not only bring in new portfolio or other operators, but that will bring in new people, that will help us in the expansion, very robust bold and varying. This is what we are seeking.

A - Bruno Blatt {BIO 21352052 <GO>}

Hey Eugenia, this is Bruno Blatt to complement your question about churn, for 2021 what we imagined is that Brazilians will be very hesitant of being left without private health coverage, this pandemic will extend itself until in April or May, we truly have no visibility, when we will be able to allow the population to feel calmer. So this concern -- this purchase of health plans will continue to be very strong, which could give us good news in terms of churn.

Q - Eugenia Cavalheiro {BIO 20781536 <GO>}

Thank you Bruno, very clear response.

Operator

Our next question comes from Vinicius Ribeiro from UBS. You may proceed, sir.

Q - Vinicius Ribeiro {BIO 19720178 <GO>}

Hey, good afternoon to all of you. Thank you for taking my call. I have two as well. If you could speak about the gross adds? And which are the open entities, which were not open, if you could give us a regional breakdown perhaps or base yourselves on your own division in terms of which has been their commercial behavior and what it is that you expect in terms of M&As? You I mentioned in the past that (inaudible) would be dealt with when you would get to a point of greater stability. Now, if going forward, can we expect you to maintain your margins or -- can the situation be even more productive than it was this quarter? Thank you very much.

A - Frederico de Aguiar Oldani {BIO 16665733 <GO>}

Vinicius, this is Frederico and I'm going to begin speaking about the SG&A, this quarter it was very strong and we don't expect this gain. Well, we hope to be able to maintain these levels during the coming quarters we still have some fund where we can continue to generate savings but we're going to use all of those savings and reinvestment in quality and growth and in innovation, don't count upon an increase of margin as being our value drivers.

FINAL

Our value driver is the growth of portfolios and the growth of margin, while we don't have a very clear scenario until we come to a more positive and consistent situation for some time, this is something that we're not going to discuss internally, SG&A gains, which doesn't mean that we're not going to continue working as we have to seek even further savings we are doing this. But we do have a pipeline of things that will have to be funded by the savings. So once again do not expect additional margin gains. I'll give the floor back to Elton.

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

Now in terms of gross adds to give you a breakdown, I think this is strategic information. Competitors almost always listen to our call. Now, we're working with those multi-professional entities and entities that represent a single profession. What we have observed is that because of our family products and some of the things that we have done in terms of our rates, we end-up bringing to these entities that represent a single profession, one type of client that formerly would buy SME and when we launch, as of the second life a discount, we observed that there is a transition from those that had companies if they can resort to SMEs, they can work with other entities. So, that represent engineers or architects and this is where they're going to buy a synergy plan. We know that there is a gap in terms of SME, why? They want to hold on to that product six or eight months, then going to return to the labor market and things will change. So we see a change in the dynamic of people who formerly would opt for one entity or another and this is changing in-house without giving you any figures. We have observed a change, especially because of the competitiveness with Affinity that has gained a great deal, compared to some of the SMEs in the market. This is all that I can disclose to you at this point in time.

Q - Vinicius Ribeiro {BIO 19720178 <GO>}

Thank you very much. That's excellent, thank you.

Operator

As we have no further questions, we're going to return the floor to Mr. Bruno Blatt, the Company CEO for his closing remarks.

A - Bruno Blatt {BIO 21352052 <GO>}

I would like to thank the brokers, the 43,000 people who sell our health plans and who help us expand access to quality health in Brazil and thanks (inaudible) partner operators their trust in Quali and work towards distributing its products. And thanks to the entities that put the life of the associates in the hands of Plural and Quali and thanks to 50,000 and more investors that deposit their trust in the Company. We also have 2,300 employees from Plural and Quali, which is the fuel that moves the Company day after day and thank to the more than 2 million clients and lives that have a health plan with us.

Our mission is to care for their lives and to do things ever more better and for this we need to grow. We have a good positioning and in the face of so many challenges, we have been able to make strides. I'm convinced that the year 2021 will be better for all of

Bloomberg Transcript

us. And you can be sure that we have several novelties going forward. Once again thank you all for your participation.

Operator

The Qualicorp conference ends here. We would like to thank all of you for your attendance and wish you a very good afternoon.

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

FINAL

Bloomberg Transcript