

Q2 2015 Earnings Call

Company Participants

- Grace Tourinho, Chief Financial Officer, Chief Operating Officer and Investor Relations Officer
- Mauricio Ceschin, Chief Executive Officer
- Natalia Lacava, Investors Relations Superintendent

Other Participants

- Rafael Frade, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen and thank you for waiting. Welcome to Qualicorp's Conference Call to discuss the results of the Second Quarter of 2015. We have with us today Mr. Mauricio Ceschin the CEO; Mrs. Grace Tourinho the CFO, COO and IRO; and Mrs. Natalia Lacava, the Investors 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 Mrs. Lacava, who will start the conference call. Mrs. Lacava, you may proceed.

Natalia Lacava {BIO 17175216 <GO>}

Good morning, everyone, and thanks again for participating in our call. I'll turn the word over to Grace, so she can start with the opening remarks and then I'll go back for the financial highlights. Okay, Grace please.

Grace Tourinho {BIO 17244138 <GO>}

Good morning everybody. Thanks to listen to us into the general highlights. We close the second quarter with R\$154 million operating cash flow an increase of 89% year-to-year, may influence by its strong operational results inside of the company.

Our adjusted EBITDA grew 32% year-to-year, R\$166 million in the second quarter. 2015 reaching 41% of margin, which represent a significant increase of 426bps year-to-year.

Our adjusted EBITDA Ex-CRC/Gama grew 28% year-to-year to R\$162 million, which represents 41.3% of margin, 457bps better than the second quarter of 2014.

Also our portfolio of beneficiaries of approximately 5.2 million lives, including Affinity, Corporate and Other Segments grew 14% year-to-year in the first quarter of 2015. Mainly because of the Affinity segment that we had 1.86 million lives that decreased 0.5% year-to-year, but when we exclude the sales of the Potencial, the effect really reaching the Affinity 8.9% year-to-year and a positive almost 4% for health products. And also in the Others Segment and the Corporate, we grow 25% year-to-year.

Now I turn the words to Natalia.

Natalia Lacava {BIO 17175216 <GO>}

So, good morning guys. So let's start jumping to the slide number five, where we can discuss our net adds. So here I wanted to comment on the improvement we had on the net sales. So we had a 12.6 improvement in our gross sales this comes from a good strategy under the product diversification to attend clients in different segments. So it was a very successful strategy that we did during the second quarter and we are bearing fruits at this point.

The second thing is on the churn. We saw a reduction in our churn on a sequential basis. As we mentioned in the last quarter, we had some extraordinary cancellations that did not happen this quarter again, and on top of that we have been very vocal on our retention strategy, building our team preparing, making a real (inaudible) and to be prepared for providing alternative to our clients and serving them as best as we can.

So with our business strategies we were able to reduce our churn during this quarter. So, all combined, we had a 17.6 thousand net adds, and if you were to exclude the effect of Potencial, that would translate into over 19,000 net adds, which we believe is a very good performance in considering the macro environment that we are leaving.

Jumping to the next slide, slide number six, we will talk about our net revenues. Here I wanted to make two comments. The first one on our Affinity performance. We have 15.9% year-over-year increase. This comes from the portfolio increase, the mix effect and our price readjustments, as everybody knows.

And the second point on CRC/Gama results, we had the entrance of revenues from the new contracts that are being implemented. So this justifies the increase on a quarterly basis and this should be the level going forward.

Jumping to the next slide, slide number seven, going to discuss our costs. Here I wanted to call attention to you guys in our third-party services. As we have been sharing with you guys over this a month ago, there are lot of operational improvements in our call center that are reverting into lower costs. So what it means is because my client is being answered in the proper time, with the proper answer, he doesn't become a recurring client in the call center. So the number of clients reducing both year-over-year and

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sequentially, which means that might cost this call center is going down. So this is the indicator debt, the operational area is improving and starting to bear fruits. Comparing to the last quarter, the increase that you guys see is related to our preparing for the price readjustments. So, we created special areas of retention, we hired over 160 employees to deal with their retention moment.

So we prepared the company for this period and that justifies the increase year-over-year. We are very confident with that strategy and we are seeing no clients receiving the proper treatment, so we believe we made the correct decision to prepare the company for the price readjustment with some anticipation.

Another thing I wanted to call attention to you guys, you're going to see that throughout the presentation in other lines, -- some of you might find it strange the performance on occupancy expenses. What's happening is, during the second quarter of 2014, we changed our headquarters, and in the second quarter, we didn't split the costs between the areas. So everything was expensed either in the admin expenses.

So now in 2015, we have the proper decision and that's why you see the occupancy expenses an increase in commercial end costs and a decrease in the administrative expenses, but if you combine everything you're going to see that there is a reduction in this line.

Then moving to the next slide, slide number eight, let's talk about the administrative structure. I wanted to highlight here third-party services again. This line besides our extremely strong commitment to control this line, there is also the absence of extraordinary projects that helps this line to go down. On top of that, on the personnel expenses we've recognized the layoff expenses; if you were to exclude that affect our admin expenses on the personal line would be flattish. So, which translates into very, very stability in our admin expenses in our, the continuation of our strategy to keep this line under control.

Moving to the second line, when we talk about the commercial expenses, which were big contributors for our margin expansion. Here I wanted to highlight that we didn't have the World Cup expenses like we had last year. So that justifies the reduction on a year-over-year basis and a part of that the company has been adopting a strategy to look carefully each line of the commercial side and focus on the expenses that we believe have a higher return in terms of sales. So you might see some increase in some lines reduction, in some other lines like for example campaign. And this comes from our strategy being very, very restrict on the cost and focusing only on the strategies that we believe have a better return for our sales.

Moving to the slide number 10, I will talk about bad debt and other expenses. Here we reached a 5.6% of revenues already considering the impact of the reversions, which are contributed for the maintenance of bad debt under control. Here we always talk with you guys about the level of bad debts in the following quarters, because we are cleaning up our backlog of that payer. We always have alternative to improve that strategy, so every quarter we think what we can do differently to improve that performance. So every

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quarter we try to do something different and we have been successful in that strategy and every quarter you are seeing a good level of recoveries.

You should not expect, as I always said the same level of recoveries because the backlog is going down, but believe us that every quarter we try to find something different to do and that's the reason why we are posting the bad debt extremely under control. On top of that remember the bad debt on CRC/Gama; we have commented with Grace a couple of times already about how this line is provisioned. So the same time that you might see a negative effect, on the other side you can see reversion of this line depending on the client delinquency level. So, this quarter specifically we had R\$4 million benefits. You should not expect that this is the recurring level, it's just a reversion from our client that we had to right off a couple of quarters ago.

The second point on the other expenses, we have here two comments to make. The first one on the impairments of Newport. This was an acquisition done in 2011 in the Corporate segment, where we have been amortizing for a while, but giving the loss of a contract there was the leaps [ph] to reduce that intangible, but it was a partial write-off, and there is no comparing to the overall price we paid in 2011.

The second point is on the capital gains from the sale of Potencial. We've recognized all the gain this quarter, but the payments going to be then in installments. You probably noticed, the reduction in the value, what's happened is, we noticed that after we announced the sale, we saw an increase in the churn level, this portfolio combined with the reduction in the sales. So, because we had the necessity to make an analysis of this portfolio until the end of the migration, we had to adjust the sales of this portfolio.

Going to the next slide, slide number 11. Just wanted to mention that due to the increase in our leverage and the dividends payment our financial expenses reduce it, but it would over compensated by higher financial revenues giving the average cash position that the company had in the balance sheet. Bear in mind that after the capital reduction we're going to have much lower cash balance, which should impact this line.

Next, when we talk about our EBITDA. I mean, all the comments that I made before combined and mix margin to be extremely positive for us. So, we did a 41% margin during this quarter. The maintenance of this margin, which we consider to be extremely good level reflects all the strategies from a very strict cost control, and in the view of the current macro environment, we believe that we have achieved a very good performance.

Moving to the next slide, slide number 13, where we talk about our net income. Here I wanted to call attention to our R\$70.8 million in net income, which comes from the sale of Potencial positively affecting this number. Even though is a one-off, it helps us to accumulate more profit to either distribute dividends or do buybacks. So, even though one-off, it's going to be positive for us, because they're going to allow us to improve the return to this money to our shareholders.

Moving to slide number 14, we talk about our CapEx. We had an increase in our IT CapEx giving the projects that we are implementing this year. To ask the projects are being

implemented we pay, so given the fact that the new system is starting to be up and running, we are making the payments. So this is totally in line with our initial expectations.

And also in terms of capital structure you see an increase in our net debt, but very small comparing to the fact that we distributed dividend. So this shows how we have ability to generate cash because even paying dividends these lines did not increase much, which will show how big is the company opportunity for cash flow generation.

And then on the next slide, slide number 15. There we talk about cash flow generation. We've reached a record cash flow, operating cash flow of R\$154 million. After CapEx this level was too very high over R\$100 million, R\$116 [ph] million. So, we believe this is a great achievement; it was a record level for the company. The conversion of property with our 70%, which is extremely positive as well. So we are very confident in our cash flow generation ability and we intend to keep on creating alternative return the money back to our shareholders, either through dividends or buybacks.

Another thing I wanted to comment is, even though the capital reduction was something punctual in the form that we do, because we don't normally do capital reductions every time, but we wanted to make sure that you've guys understand that it's a punctual thing in the form, but the idea is to become a big distributor of the money to our shareholders. So it is going to be a recurring thing over the next years.

So, with this I finalize my presentation. And I'll turn the word over to our President, Mauricio Ceschin, he can make his closing remarks. Mauricio, please go ahead.

Mauricio Ceschin {BIO 18750717 <GO>}

Thank you, Natalia. As well we see a challenging external environment in here over the last 12 months, we have done quite a lot, and I'm in the company for a year now. So, in the operational area we are continuously searching operational improvements through processes changing, resource optimization, shortening debt lines, streamlining services, processes, just an example. We used to have 350 calls a month in our call center. Today, we have 170,000 for the same number of (inaudible) or even more. This reflects an improvement in our agility and as activeness on the client requests.

On the other hand, I'm quite confident that the definition of our proprietary IT system, it was the right decision. System being implemented through the second semester on 2015 like the building [ph] module. First and second phase already are delivered. The products mode, building operator's interface, they will be set in the second semester. And in the first semester next year, we will implement the third and final phase of the building mode, the legislative mode reconciliation of invoices and commissions. These systems are essential supplies to build the improvements in operational process, quality gains and flexibility of service to our clients.

On the sales side, we clarified market positioning of the company. We launch a new tablet for the sales force that is being tested in our internal sales force and we are going to put in place for all the sales force next year -- in the beginning of next year, so that they can

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help them on their sale with tablets, notebooks and even Android's. We have a better channeling sales budget through initiatives with higher sales conversion. We have a product diversification with co-participation in SMEs product.

In the financial and administrative area, you know that we need an administrative restructuring. We focus on the cash flow generation and value creation with retention strategies improving that involve all areas of the company. The NPV concept is new to be in the company. Being adopted throughout the operation and now we are involving into brokers there is -- in the meanwhile they will attack this second semester and next year.

The capital reduction scheduled for October to optimize the capital structure as Natalia already mentioned to you. We have a daily search of cost reduction here in the company. We are still focused on that and we will continuously look for chances to cost reduction.

In health management, we create foundations for the health management area together ahead in the active control of claims by creating a unified basis including all our clients of different areas and different segments. And talking about people, we conduct this year a complicated assessment for employers this year. Even via career opportunities within the group, internally moving a 115 people in the first semester.

Corporate University of Qualicorp is available now to all employees with various training, management, technical and behavioral and trains. We have developed an active and direct communication channels with employees through increments.

So we get a lot, but we see still lots to do and to improve. I'm sure that the companies directly repair to go through this challenging economic time, but we keep on -- the same path, we keep on working hard to give back better results to our investors. Thank you and thank you everybody. And I hope you have a good morning. Now, the question section please.

Questions And Answers

Operator

We will begin the question-and-answer session. (Operator Instructions). The first question comes from Rafael Frade of Bradesco. Please go ahead.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi, good morning all. Could you give a little more color on the initiatives that you should be taking in the second half of this year. In the beginning of the year you've mentioned a few rollouts that you expect for the second half less like for example, a stronger rollout in other regions we have new products with new partners. And also Mauricio briefly mentioned that now your VPL [ph] product should be rolling out to brokers. So how this should play out and what do you expect it could be the impacts on that?

A - Natalia Lacava {BIO 17175216 <GO>}

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Hi, Frade. Thanks for the question. So, regarding your first comment on the rollouts of our sales and strategy. Actually, I mean, we keep on this is a continue, this strategy is not something that we're going to start second semester, it's something that we have been doing for a while, developing new projects, new regions and this is something -- we don't see any specific event on the second half that could make a big change in the performance. So as we have been sharing with you guys sales has been holding quite well and we believe that you should sustain the second half of the year in the same level that we are doing.

So we don't see any major change in the second half versus first half, but as Mauricio was mentioned, I mean, strategies keep on, if that continues we are always searching for alternative new partnerships and it's something that we will always develop, but there's not been any major change in the second quarter.

And regarding the broker NPV, we should be, we are closing this project internally and we should be launching anywhere until the end of this year with more impacts next year and the idea is to the same way we did in our retention and in our sales the idea is to do with the brokers, incentivizing brokers to bring the sales that we want them to bring. So, making differentiation and giving benefits to brokers that are more in line with the strategy of the company. Mauricio, do you want to add something?

A - Mauricio Ceschin {BIO 18750717 <GO>}

Just to add one thing that we noticed due to the macroeconomic environment that we are facing here in the country. In other areas, Rio and Sao Paulo, we see that is a little harder to sell and the sales forces is harder to penetrate, than Rio and Sao Paulo do -- of the concentration of -- in these two states, the sales are keeping the same path and we are producing more, but other regions are more affected in the sense of the economic environment and affected in terms of sales.

So, it's not a matter of fact that we are not keeping our strategy of selling more outside Rio and Sao Paulo, but the macroeconomic environment is affecting more other regions than Rio and Sao Paulo in terms of sale. Okay?

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. That's great. Thank you.

Operator

(Operator Instructions) The next question comes from (inaudible) of Cornerstone Capital. Please go ahead.

Q - Unidentified Participant

Hi, thank you for taking the question. I was wondering, if you could just help us understand the types of -- adding up now? Is it people that have lost their jobs and therefore have lost their corporate plans and I was surprised to see a slight pickup in net additions, but I was wondering if you could give us more color there?

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A - Mauricio Ceschin {BIO 18750717 <GO>}

Hi, Carlos, I cannot evaluate so far that because in most of the cases, the company they will keep the plan of the -- when they filed someone, they keep their plan continuously at least six months, it's a regular way of behavior in the market. So maybe we will start seeing more that in the second semester.

So far, I cannot tell you this. I expect so, as you mentioned, but I cannot prove or I have no -- I cannot say so far. But we expect some more that, that when they are firewall they leave their job, they will come as an alternative to Affinity groups. That's my expectation, but I cannot put so far.

A - Natalia Lacava {BIO 17175216 <GO>}

And Carlos this is Natalia speaking. Another comment is that in the first quarter, we have a couple of extraordinary cancellations that did not happen this quarter again, so that's why churn reduced. And we have been improving our retention area as well. So we have more alternatives and more options to our clients, which has been helping us to control better to churn even in this difficult macro environment.

Operator

Thank you very much.

This concludes the question-and-answer session for today. I would like to turn the floor back over to Mrs. Natalia Lacava. Please go ahead.

A - Natalia Lacava {BIO 17175216 <GO>}

Thank you guys for participating in this call. As always, our team here me and Gabrielle will be open to answer all your questions throughout this afternoon and next week. Jose has leave for maternity leave, so she is taking care of her baby, but me and Gabrielle will be here helping with all your questions. Mauricio, do you want to close.

A - Mauricio Ceschin {BIO 18750717 <GO>}

Thank you, everybody, and hope you have a good morning. We'll continuously -- we will keep on working hard in the company to deliver better results to our investors. If you have better ideas, please let us know. We are 24/7 to listen to your good ideas and have a nice weekend everybody.

Operator

The conference is now concluded. Thank you for attending. You may now disconnect.

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