Q1 2014 Earnings Call

Company Participants

- Adolpho Souza Neto, CFO
- Joao Patah, IR
- Vivien Rosso, CEO

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2014 First Quarter conference call.

Vivien Rosso, CEO; Mr. Adolpho Souza Neto; CFO; and Mr. Joao Patah, head of IR, will present the results.

This event is being recorded. (Operator Instructions)

This event is also being broadcast via Web cast and may be accessed through the investor relations Web site at www.fleury.com/ir where the presentation is also available.

Those following the presentation via Web cast may post a question in advance on our Web site. It will be answered during the Q&A session as long as we have enough time.

(inaudible) (let me mention) that our statements are based on the beliefs and assumptions of Grupo Fleury management and on information currently available to the company. They (involve a risk) in uncertainty because they relate to future events and their (thoughts) depend on circumstances that may or may occur. (inaudible) should understand that conditions related to (inaudible) (economic) conditions, (inaudible) and other factors could also cause (results) to (inaudible) from those expressed (inaudible) statement.

Now I will turn the conference over to Ms. Vivien Rosso, CEO of Grupo Fleury.

Thanks Vivien. You may begin your presentation.

Vivien Rosso {BIO 16579525 <GO>}

Good afternoon, (inaudible). Thank you for attending our First Quarter (results) conference.

In the second half of 2013, the company has pursued profitability rebound (targeting) to improve return on assets and operational efficiency while focusing on Fleury brand (expansion) plan for 2014 to (re-balance) the business portfolio.

During the last quarters, the main financial outcomes were strongly (effect) by structuring an initiative. Integration (inaudible) especially in (inaudible) (expenses). Revenues (qualifications) (inaudible) (grows our brand) and as a consequence, the short-term (inaudible) revenue.

Especially in the First Quarter, the company's final -- final (recoveries) (inaudible).

The first comment is regarding to the results improvement. As a consequence of actions taken in -- in 2015 to enhance profitability and re-balance the business portfolio as we show in slide three.

The revenue growth in Fleury brand achieved 12.6%. (inaudible) and the regional brand together (inaudible) (Rio de Janeiro) rose 5.4% and the hospital (inaudible) (sales) 9.4%. (Rio de Janeiro) began the recovery but (few) affecting total revenues (inaudible) (growth rate).

Extension plan for Fleury accelerates to capture growing demands for high quality services. (Center for Cardio and Neurovascular Disease) expands integration in diagnostic services (concepts). Fleury (inaudible) in San Paolo and (inaudible) adding a total of 3,000 square meters to the (inaudible) network.

Continued improvement (got) an expansive management together with an organizational, development and restructure initiative. This led to enhancing (output) efficiency and productivity. For example, total operational costs dropped 10% from Third Quarter of '13.

(inaudible) to when compared to the second half of 2013 even when excluding non-recurring items. Average revenue (per test) (rises) 9.8% in patient service centers as a result of services (inaudible) and contract renegotiation.

(inaudible) 26 (million). When new contract with the hospital (Santa Lucia) in Brasillia was signed to provide clinical analysis (inaudible) operations (inaudible) and expects to add about 3% to the hospital's business revenues annually.

On page 4, we (inaudible) about most recent quality brand recognition reward for Grupo Fleury and for (inaudible).

I would like to -- to end with -- and point out our strategy is to recover margins and profitability, guaranteeing the high quality of services and recognized by the clients and doctors as a (valuable) differential.

I (will turn it over) to Joao Patah, director of (Investor Relations), in order to proceed with the presentation.

Joao Patah

Thank you, Vivien.

I'll begin on the last slide highlighting the continued strong demand for (differentiated) quality services). (inaudible) First Quarter was lower (inaudible) internal and external factors including some capacity (inaudible) of Fleury brand.

We do not expect significant changes in the (inaudible) (level) for the Second Quarter. However I emphasize that the second half of the year, we will turn to the strong (inaudible) growth of the company not only driven by robust and stable demand on Fleury brand. But also by a better comparable (inaudible) to Rio de Janeiro and other regions.

On the supply side, in addition to the capacity expansion of Fleury brand, the design of new processes and the use of new tools in the company will bring even better actualization and increasing stature to the (inaudible).

They will not (inaudible) absorb the demand without pressuring the cost. In addition to expect an increasing volume in the second half of this year, we have the effects of higher average prices, caused by several factors, which I will comment later -- later on.

Some facts can be seen on the following slide. For example, going to slide eight, we see revenue per square meter in the (inaudible) basket in the short term. (We) called up the portfolio with adjustment in Rio. And this (inaudible) (edition) of square meters at Fleury brand made for (inaudible).

The gain of share in the Fleury brand, shown in the previous slide seven, keep on happening on this year and next the next year. Along with the maturation or (inaudible) for the centers already launched.

Regarding the growth in average revenue for (physical) center, also in slide seven -- it's -- we affirmed that movement of concentration of the revenue has seen bigger (inaudible) along the next (appearance).

This indicator, together with revenue per square meter, will keep it golden.

Augmenting now on the average price, on the same slide, we remind that it reflects several combined effects, including price adjustments, selection of the (coach volume), the needs of grants and the needs of (projects).

The case of the First Quarter of (Turkian) -- there is an increase of almost 10% over the same period of the previous year. Despite higher growth in clinical analysis, security in the beginning of the year, here compared to the end of 2013, there was influence of adjustments in Rio de Janeiro portfolio, remember that Rio is concentrated on emerging services.

Going now to (Beecho B) businesses on slide nine -- the posted news is the same as (Toseos), which grew up more than 9%, compared to the first Q of '13. (inaudible) in (Beecho B) has also shown good recovery as demonstrated in our notes and our earnings (lead), getting close to 20% margin again.

Urognostics in hostile contracts has a new operation in the federal capital that will begin in May, bringing potential for computer growth in the new business line.

I also remind you that the health assessment business line is also growing and an accelerated pace -- 16.4% this quarter.

Let's now talk about calculations and other divisions turning for us revenue. And its effect on the income on (inaudible).

Here, we have (inaudible) migrated to our most occupied level of calculations. Improvements are still needed. However, it's noteworthy that the total amount of cancellations and discount, which was 4.6%, would be already close to 4% if we exclude temporary effect of the canceled contracts. Meaning because negotiations after the contract cancellation usually leads to acceleration of the recognition related to the past invoices.

(inaudible) what to do is field. And the company has consistent projects that if you bring progress already in the field.

Talking about costs and expanses, before handing over to Adolfo [ph], some brief comments on the (inaudible) (fourth) quarters.

Firstly, I want to congratulate the company personnel for the strong commitment to control of cost and expanses with the use of tools and processes that reduce cost and fixes expenses when compared to the second half of 2013.

Thus, broad margin will continue onto the core trend, maybe in this coming quarter, where (seniority) is more favorable to the operational level -- sorry, to the operational leverage.

Secondly, I point out that we still have no (great) costs of some action plan that, in fact, hit the quarter, as well as preoperational expenses on (inaudible) that will be open along the year. And (inaudible) on July 12th.

But going on to slide 13 and 14, it's clear the beginning of the evolution starts to appear even including ongoing costs in the number.

The year -- on the year growth, total cost, (inaudible) and inflation.

Here, it's clear that improvements in resource and location has been part of our day-to-day lives and our action plan.

There are still variances and progressive improvements in the coming quarters, with the most critical (phase) of (inaudible) has already occurred. And we see the first time as a positive trend.

Also, provision expenses in slide 15 and 16 -- you were favored in this quarter by the recover of $8.7 million in provisions of taxes on imported equipment. After a favorable decision in the supreme court, which decided on the (inaudible) possibility of this (reboot).

On other expanses, there is increasing over the previous year. But a decrease when compared to the Fourth Quarter.

A greater delusion to the cure on the coming quarters, as a bold measure of internal controls over expenditure will benefit the bottom line, thus strengthening the progressive improvement in margin. As we are talking about seeing the end of 2013, it -- it is on the (planned) track for the coming years.

Now, I'll hand over for Adolfo, CFO of Fleury -- Adolpho Souza Neto

Adolpho Souza Neto {BIO 21636124 <GO>}

Thank you, Joao. And good morning to everyone.

Turning now to the results below the line, we start with the financial results.

They would be in line with our expectations if not for the fact of the reversal -- reversal of a provision of (DSNS), (effects) on imported machinery and equipment, already explained by (Badah), which improved the results in this line by 10.7 million reals, resulting in total net expense for the period of 4 million reals.

Our financial result is mainly driven by the interest on investment of our cash, which at the end of the period were at 532 million reals. And the interest based on other ventures, which had a balance of 960 million reals. And has maturities up through 2020.

Jumping now to slide 20, the rate of income tax and social contribution in the First Quarter of 2014 was 35.6%, all of it under deferred tax. The tax shield provided by the goodwill of our (physicians) led, again, to a cash tax rate equal to zero, resulting in improvement of our cash earnings.

Now, back to slide 18, considering our operating term of 44.4 million in the quarter. And the financial and income tax (guesstimation), the company generated a net profit of 26.1 million in the quarter, or 40.5 million, excluding the deferred tax, the so-called net income cash, which represented a margin of 10.2% in the quarter, compared with 7.7% in the same period last year.

Even if we exclude the impact of the 7 million of (de facto) net income of the effect on net income for the financial part of the reversal of the (ICMS) tax provision, the net cash profit margin would be at 8.5%, up 800 basis points over last year.

Now, looking at slides 21, our cash flow, let's start with the operating cash flow, which in the quarter was 30 million reals. Very close to the amounts needed to fund our capital expenditures, which were at 32 million in the First Quarter.

This cash flow of 30 million reals, despite the improvement in the management of our working capital, which (inaudible) which growth represented 12.5% of gross revenue, versus 15% in the same period last year.

It was lower than the recorded 39 million in 2013, mainly due to the lower participation in the variation of provisions in the 2014 results.

The (log) operating flow, the only highlight is the fact that in 2013 in the same period we made the issue of the second tranche of debentures in the amount of 500 million reals. And, therefore, the two periods are not comparable.

Now, moving forward to slide 22, we're going to give more detail about the most important item in our working capital, which are the accounts receivables.

We had in the quarter an increase of 44 million against the balance of December 2013, compared with an increase of 62 million in the First Quarter of 2013 versus December 2012.

Considering that our gross sales were almost identical in the two periods, there was an improvement of almost 30% in the management of these assets.

Our aging profile compared to the previous quarter and considering only the range up to 120 days overdue, remained stable at 72% of our total accounts receivables paid, which is, like, lower than the average of the total year of 2013 of 75%. But would be in the exact same range if it wasn't for a payment delay of a major health insurers that finally came in at the beginning of April.

Now, looking at slide 23, investments in CapEx, as mentioned before, were at 32 million, very focused on our expansion program on the (Fury) brand. In this quarter, the (Fury) business inaugurated the new integrated cardiology and neuro (inaudible) center and the focused (Diabla) patient service center.

We're presenting an additional -- we're presenting an addition of 3.3 thousand square meters. And you can see the pictures of this new unit on slide 24.

We now can analyze the section of comments on the results. And we will move forward to the Q&A session.

Questions And Answers

Operator

Ladies and gentlemen, we will go now to the (inaudible) in a procession.

If you have a question, please press the star key followed by the one key on your touchtone phone. If at any time, you would like to remove yourself from the questioning queue, please press star-two.

This concludes the question-and-answer session. I would like to invite Ms. Vivien Rosso to give a closing statement. Please go ahead.

A - Vivien Rosso {BIO 16579525 <GO>}

Well I would like to close this conference call highlighting our strategic focus for the semester.

(inaudible) to pursue this strategy, having (inaudible) last semester results. Those action plans effect -- keep pressuring the company to (inaudible) as first final of the (plenary) balance (inaudible) for the group.

They are mandatory to ensure enhanced (Grupo Floury) profitability for 2014 (inaudible) and to promote sustainable (inaudible) operations, enhanced (inaudible) and differentiation positions, preserve high standards of quality and brand (inaudible).

I would like to thank you all for the participation. And have a nice day.

Operator

That does conclude the (Grupo Floury) (inaudible) conference for today. Thank you very much for your participation. And have a great day.