Conference Call Transcript

Hapvida

3Q24 Results

Operator

Hello everyone and thank you for waiting. Welcome to Hapvida's third quarter 2024 earnings conference call. Joining us today, Mr. Jorge Pinheiro, CEO and Mr. Luccas Adib, CFO. I would like to inform those who need simultaneous interpretation that the service is available on the platform. To access it, please click on the button's interpretation and choose the English option.

This event is being recorded and will be made available on the company's IR website along with the full results materials. You can download the presentation by clicking on the icon in the chat and please note the disclaimers at the end of the presentation.

During the company's presentation, all participants will be in a listen only mode. After the company's remarks, there will be a Q&A session. To ask a question, please click on the Q&A button on the bottom of your screen and write your name, company, and language to join the queue.

Now I would like to hand the floor over to CEO Mr. Jorge Pinheiro, who will start the presentation. You have the floor, Sir.

Jorge Pinheiro – CEO

Hello everyone. Thank you so much for joining us for our third quarter 2024 earnings conference call. We're gathered here in Sao Paulo, Luccas, Guilherme, the entire IR team and I to share details of our results with you.

Let's get started with slide number two of the presentation. Here you can see an overview with some financial highlights that we will explore in greater detail later. I'd like to comment on a few of them.

As everyone knows, the third quarter is historically marked by higher MLR's due to increased use volumes as compared to other quarters. Our cash MLR in Q32024 reflected the expected use levels in the segment for third quarters but also worsened by prolonged periods of droughts and sharp temperature changes this year, as well as indirect effects of elective procedures postponed from the second quarter of 2024 due to a significant rise in dengue fever cases in some regions during that period. However, the company was able to overcome the historical seasonality for the quarter, showing a 0.1 p.p. improvement against Q22024. This was achieved through various successful margin recovery strategies in place since the beginning of 2023. This is the strength of our vertically integrated model, our commitment and discipline in each one of the verticalization strategies implemented over the last few years combined with other initiatives such as preventive programs and standardization of best practices and strong investments in technology are yielding positive results. Looking back, our own network has gained more representation in the overall cost structure, not only due to the verticalization process I mentioned, but also as a result of revitalizing our member portfolio with new sales attracting more clients choosing verticalized plans.

Speaking of our own network, expanding our healthcare infrastructure will be a priority for the next two years. We will be expanding and upgrading several hospital units across Brazil, we are investing in new hospitals in Sao Paulo, Rio de Janeiro, Fortaleza, Recife, Manaus, Belém and Campo Grande. Increasing the number of hospital beds as even mature markets continue to grow in number of members. For example, in Manaus we have leased one of the city's largest hospitals, Nilton Lins, which will add around 250 beds to our own network in the coming weeks. In Fortaleza, we leased the newly built Santa Maria Hospital, which has 130 beds and will also begin operations in the coming weeks. Our investments also include increasing and modernizing therapy rooms, clinics and diagnostic units nationwide. In Sao Paulo and Rio de Janeiro our investments are intensifying and are expected to remain high in the coming years. We will soon release an announcement detailing our development plans for these two cities. In summary, our verticalization strategy remains strong and shall be intensified now that this period of intense integration we have experienced is almost over.

A key point I must mention is our increase in the number of lives this quarter. Those too modest, we believe it demonstrates a dynamic we are proud of and excited about, indicating we are on the right path towards finding the right balance between readjustments and our commercial strengths. We are committed to this new cycle with appropriate readjustments and a responsible and sustainable underwriting policy. This has helped us show significant improvements quarter after quarter. Our EBITDA reached R$763 million, significantly impacted by a broad reassessment of all our civil lawsuits related to healthcare, which led to a substantial increase in provisions.

This right to health litigation issue or judicialization of healthcare is significantly affecting the entire healthcare sector, both public and private. Judicialization has increased markedly over the last 12 to 24 months and the company is working on several fronts. On the institutional front are Abramge, the Association of Health Plan Operators, has been facilitating meetings and dialogues with the key state courts, presenting the contexts of rising judicialization and fraud to raise awareness about the damages caused by inappropriate judicialization and to seek greater deference to the regulations and opinions from the Centers for Technical Support to Justice. Abramge has also been conducting awareness campaigns, educating both the public and opinion makers about the systemic arms generated by improper judicialization. Internally, we have created working groups to revisit our approach to the issue in light of these new pattern in judicial decision making to understand which cases require firm action and which are suitable for settlements or other forms of resolution. Lastly, we are reevaluating pricing models that can effectively absorb the effects of judicialization including slight price increases for new quotes, new sales tables for mass products, readjustments to collective contract renewals and internal cost tables, sensitizing claims and copayments, which will be sufficient to meet this new reality. The topic of judicialization will be specifically addressed and detailed at the end of this presentation.

Disregarding this extraordinary impact, our Adjusted EBITDA would have been around R$843 million up 13.6% against Q32023.

From a financial perspective, in October the company’s risk rating was upgraded to stable confirming happiness robustness. Shortly afterwards we announced another capital raising operation, our 8th issue of Debentures, raising the amount of R$2 billion. This issue also obtained the highest investment grade rating AAA. The proceeds from these operations are being used to optimize the company's debt profile. It's also important to mention that our gradual and organic deleveraging process continues with our indicator reaching less than one times net debt over EBITDA. This is the lowest level in the last 11 quarters that is almost three years, this is a very healthy and comfortable level.

We're very close to the end of our integration journey with our 4th and final wave in Sao Paulo having started in October and being completed in the coming weeks. This gigantic integration has lasted just under the three years we anticipated our observation and Control Center, which is the sector responsible for monitoring all of the more than 100 care quality indicators in real time, is already monitoring all of our units. Confirming what we have already said in other quarters, all of the waves of integration of the care units in Sao Paulo have been carried out efficiently and effectively with no impact on customer perception of quality of care and therefore no impact on cancellations. As a matter of fact, NDI operator which covers the greater Sao Paulo area, reached one of its best ever IGR levels. IGR is an indicator that measures complaint levels with the sectors regulatory agency.

When we look at our quality of care indicators, we continue to stand out. Let me give you 2 examples: Natural child birth and SMR. In Natural childbirth are rate in the quarter for the regions where we had our Nascer Bem program was over 39%. Note that the national benchmark is an ANAHP which is of 25%. Our SMR standardized mortality rate in ICU was 0.58 in Q324 much better than AMIP's benchmark, which is of 0.76. The company has been investing heavily in quality and our satisfaction rates per operator have been improving consistently.

Before I hand over to Luccas, who will go into a little more detail about our results with you, I would like to remind you of the message I gave you last quarter. All of our quality of care efforts remain a priority for the company. Our preventive medicine programs, such as Nascer Bem, which is our prenatal care and safe pregnancy program, Viver bem, our program for diabetes control and Viva Leve, which encourages lifestyle changes and promotes dietary reeducation, have been expanded to new regions and continue to show satisfactory results. After this more intense period of integrating assets and systems, we're going to focus even more on automation and digitalization in many cases with the help of artificial intelligence tools. Research, development and education are already constant issues at the company and are seen as solutions to improve the quality of care. On this front, for example, we have 587 medical students in our medical training programs, 7 research centers of our own, 123 scientific publications, among other achievements.

In short, we are reaffirming our commitment to the health of Brazilians by providing quality, comfort and accessibility. With the completion of the integration process, a controlled MLR, even though we still have opportunities for improvements and gains, leverage at very comfortable levels, good cash generation, successive improvements in our complaint rates with ANS, our resumption of organic growth in our member base, we look ahead to 2025 with two priority agendas having our customers in the center of our strategy, expansion and qualification of our own network and digitalization of our journeys. We remain focused and disciplined to continue implementing our strategy, strengthening our operations and seeking a healthy balance of our margins.

I would like to thank all of our employees, doctors, dentists, brokers, suppliers for their contributions and the trust, and attention of our Board of Directors as well as our shareholders and above all our customers who are the reason for all of our efforts. We reaffirm our commitment to serving Brazilian people, taking care of their health with the highest quality and affordable care they deserve.

Luccas, you have the floor.

Luccas Adib – CFO

Thank you, Jorge. Hello, everyone, and thank you for joining us. It's a great pleasure to be with you for another Hapvida's earnings conference call.

Let's get started on slide 3 about net revenue with this chart here in the top left-hand corner, you can see that consolidated net revenue grew 6.6% in the quarter of 2024 against the third quarter of 2023 and 5% in the first nine months of 2024 compared to the same period last year. Moving on to the chart on the at the top right, our gross revenue from healthcare plans which increased 7.9% compared to 3Q23 and 6.2% compared to the first nine months of 2023, driven by the 9.6% increase in the average ticket in dental at the bottom of the slide, revenue grew by 3.5% and 4% in the periods on the same basis of comparison, also driven by the increase in the average ticket.

In the line of revenues from sales of medical services and other activities, we saw a 30% reduction in Q324 and 22% in the first nine months of the year. The main reduction comes from the sales of medical and hospital services where we have been more selective with the aim of reducing exposure to credit risk and prioritizing our hospital capacity to serve our members with increasingly verticalized products. That is, those that prioritize our own care network. As for other activities they were discontinued after the sales of Sao Francisco Resgate and Maida, both of which were discussed in previous calls.

On slide 4, we see a net growth in our health plan member base increasing by almost 8,000 lives. As Jorge mentioned, although this growth is below our ambitions, we are excited about this potential trend reversal. Significant changes were made to our operations last year, including initiatives to optimize our customer base. There were necessary measures to correct MLR levels that were put in place, and now we can return to healthy, gradual and sustainable growth.

In qualitative terms, the HMO portfolios have performed positively in the North, Northeast and Center West and the good news is that Sao Paulo is growing again, in line with the end of the portfolio optimization process in the region. On the other hand, the South of the country and the state of Minas Gerais are still losing lives in this lower portfolio, turn around process in the slightly tougher competitive environment. The PPO portfolio was also further reduced following the repositioning a distribution strategy for this portfolio. We have been focusing on high quality contracts selling more verticalized products, those that favor the use of our own network. In line with our paradigm of portfolio sustainability and long term vision.

At the bottom of this slide, we can see the evolution of the average ticket up 9.6% between the third quarter of 23 and the third quarter of 24. We see a 9.2% increase in net price, which takes into account the effects of increased verticalization and co-participation in existing contracts. In the second block mix which represents the net difference between the average tickets of incoming contracts, gross sales and outgoing contracts cancellations contributed with an increase of one percentage point mainly as a result of reviews to the sales table and the portfolio mix.

Now on the next slide, we're bringing you additional information recently released by ANS. This is the interesting data that demonstrates the strength of our vertically integrated model. You can see that we have consistently required lower levels of readjustments than the market average and much lower than the other large healthcare operators. Even so, our MLR is the lowest and the most controlled of all. We'll talk more about these concepts and future vision later. Here you can see an MLR of 70.4% for the quarter, a significant improvement of 150 basis points compared to the third quarter of 2023. The third quarters are seasonally the most pressure of the year due to a higher frequency of use. In our historical average before the pandemic, we were usually around 40 basis points above the second quarters. This year, some exogenous factors impacted our operations such as elective treatments postponed from the second quarter of 24 due to the dengue epidemic as well as long periods of drought and sudden variations in temperature, which are harmful to respiratory conditions. Even so, we overcame the historical seasonality in relation to the second quarter of 24 with the verticalization repricing and readjustment efforts necessary to maintain the trajectory of margin recovery. Year to date, MLR fell by 3.1 points year over year, an impressive improvement.

In Q324 the verticalized plans, HMO, have maintained their high levels of verticalization since the first quarter of 24 with 81% for appointments, 79% for hospitalizations and 72% for tests carried out within our own network.

Here on the next slide we talked about cash, admin expenses and the percentage of expenses over revenue increased by 2.3 percentage points both quarter on quarter and year over year.

Namely, Q3 had an increase of R$186 million, mainly due to:

- R$151.7 million in the contingencies and taxes lines, reflecting the increase in judicialization of the sector and its impact on the company, reflecting a greater number of civil lawsuits, a greater number of requests for blockages and judicial deposits and higher average blockage amounts throughout 2024, a new level. Part of the amounts provision this quarter relates to reinforcements of provisions from previous quarters R$80 million. This is the result of strengthening our internal governance on the subject and a reassessment by our legal teams, as we'll explain later.
- Another point that pressured this line is the R$24.1 million in third party services mostly explained by the absence of one-off events that favored the second quarter of 24, such as capitalizations and reclassifications explained in our previous call affecting comparability.

I said this in our previous call and I continue to reinforce that we should see erratic behavior in G&A. This is to be expected since there are expenses related to integrations in addition to the judicialization issue itself, which I'll talk about later, we are confident that there is room for improvement through initiatives that we will undertake once the integration of Sao Paulo is stabilized. These are initiatives that cut across G&A lines, and we hope to reap the benefits of this in 2025 and beyond.

On slide 7, we see a dilution of 80 bps and selling expenses in Q324 compared to the previous year and stable at 6.9% of net revenue compared to the second quarter of 24.

In the chart at the bottom left reinforces our efforts to prevent and control PDD, bringing important improvements with:

- R$35 million positive impact in second quarter, 24 from the bank reconciliation of receipts from previous periods and credit recovery campaigns which was not repeated at the same level in Q324 affecting comparability;

- R$7 million from the credit recovery campaign, which had a positive impact on Q324 and,

- R$22 million improvement in the delinquency profile as a result of our maximum prioritization of credit recovery and analysis.

On the next slide, you can see our Adjusted EBITDA was R$763 million in the quarter and R$2.7 billion year to date, an increase of almost 40% in the year-to-date figures due to all the facts we've seen so far. It's a more pressured result than we expected as it reflects an increase in provisions, including those relating to previous periods, but it's still a strong result, reflecting the resilience of our operation and demonstrating that we're on the right path to regaining our margin, which has been getting closer and closer to our historical levels.

It's also worth mentioning that our IFRS 4 adjusted net income rose 24% in Q324 against Q323 and more than 150% in the year to date figures compared to 23 due to the factors we mentioned in the previous slides.

Moving on to slide 9. In Q324, our net cash consumed was R$418 million mainly due to the payment of R$1 billion in principal and interest on Debentures and almost R$100 million from the M&A deal explained in our previous call, which were partially offset by free cash flow generation of R$470 million.

In free cash flow starting from the R$763 million of Adjusted EBITDA we have:

- R$121 million from Rents;
- R$52.2 million from the SUS Provision, net of monetary restatement;
- R$43.3 million from SUS Judicial Deposit, net of monetary state whose deposits are necessary for the company to carry out its judicial defense without incurring late payment fines and charges, a proactive deposit;
- R$176.8 million in Provision for Contingencies, net of payments and monetary statement reflecting the impact of increasing judicialization;
- R$163.2 million in Civil Tax and Labor Court Deposits and Blockages also net of monetary statement and
- R$37.3 million in Cash Generation from the company's recurring activities.

Income tax and social security for the quarter amounted to R$48 million although the current figure was R$90 million, there is a shift between calculation and actual disbursement. In addition, there was a rebate of the tax already withheld during the year on revenues that are part of the basis for calculating tax due.

CapEx was R$181 million with the reception of a stronger pace of investment in IT and verticalization. Our historical CapEx was around 2.5 to 3% of gross revenue. It's worth noting that the company has interesting opportunities to accelerate the projects that are in the allocation timeline. All within a prioritization regime that takes into account maintenance in line with the depreciation regime, return on invested capital, care sufficiency and improvement of our service with members at the center of this ecosystem. Our CapEx projection for 2024 in the sense should be between R$700 and R$800 million respecting our continuous journey of prioritizing the reduction of leverage.

On slide 10, you can see that M&A activities consumed around R$97 million, of which R$50 million were payments of retained installments broken down for each of the assets. There was also R$46 million of the monthly installments of the M&A agreement we mentioned earlier.

As for our financial activities, there was a consumption of R$790 million. We paid interest and principal of R$1 billion as I said earlier, using the funds raised from the 7th issue of Debentures conducted in May. We also had R$200 million in income from financial investments slightly above the CDI rate for the period.

Finally, in addition to Jorge's comment at the beginning of the call, we raised a net R$2 billion in the companie's 8th Debenture issue held in October divided into two equal series with a cost of CD 1 + 1.10% and CDI plus 1.20% and maturing in 2031 and 2032 with this issue we lengthen the duration of our data that from 3.3 years to 4.65 years and reduce the weighted cost of debt from CDI + 1.44% p.a. in the second quarter of 24 to CDI plus 1.39% per annum optimizing our cost of capital.

This is what we want to pursue in the company's financial management. Conversion and robust cash generation, important investments to increase our level of verticalization and qualification of our own network in strategic locations with appropriate return on invested capital and supporting our commercial strategy, maintaining our gradual pace of deleverage quarter after quarter. This quarter we reached. 0.97x over EBITDA in the calculation of our contractual financial covenants below one for the 1st. Time.

Now let's see the regulatory requirements. Note that they are only applied to individual operators, meaning that when trying to compare with the consolidated company, there will be differences.

On the left, free cash decreased by R$489 million, mainly due to the R$418 million reduction in the cash position and not the unfavorable side.

It's worth mentioning the R$87 million increase in the technical provisions required. This increase is broken down as follows: Medical claims received at the end of the quarter, putting pressure on PESL and increase in provisions for reimbursement to this SUS in accordance with ANS rules and timetable, and an increase in the IBNR for the period as a result of stability in internalization levels, growth in the member portfolio in relation to the second quarter 24 and evolution in the average cost per capita.

In regulatory capital, we had a substantial net increase of R$280 million with R$420 million from surplus operating results, offset by an increase of R$90 million in intangibles, basically IT and R$40 million from risk-based capital.

Ok, having gone through the company's results will now open a specific session to talk about the increase in the provision made and the issues of judicialization and judicial blockades.

I'll start by giving you some background information. You can follow along with me on the slide, which shows the traditional path starting with a complaint to the customer call center. At Hapvida, every complaint filed is forwarded internally to the areas involved in an attempt to resolve it. However, certain complaints, as we'll see later, may concern demands that are not covered by the respective contracts. So, at the end of the day, a health plan is an insurance contract. If this demand is not met, the member can file a formal complaint, which is called NIP with ANS, the Regulatory agency. The member can also take legal action against the operator, these legal proceedings mean from the outset or after they have been processed, be accompanied by positive judicial satisfaction, including a judicial blockade. The judicial blockade is usually based on the value of the claim, which can include more damages, succumbence fines and interest, as well as the underlying dispute that is the actual contractual coverage under discussion. Once the judicial blockade has been carried out the amount leaves the company's account from for a judicial account created specifically for that particular case and administered by the respective Court of Justice. In the end, it's a mere reclassification between asset accounts.

This blockade is converted into a judicial deposit, which remains there until the lawsuit is resolved for good or the magistrate deems it appropriate to release it early, either by returning the funds to the company or by releasing them to the plaintiff.

Once the judicial deposit has been set up, we have 3 possible scenarios: Scenario one, when the deposit is withdrawn by the member after an unfavorable decision to the company or scenario 2 when the deposit is redeemed by the company after an agreement between the parties. In scenario 3 when the deposit is redeemed by the company following a favorable decision.

In terms of traffic in the financial statement, the blockade does not impact the result a priori, only projecting repercussions in the asset accounts, as I mentioned earlier, and by sequestering cash repercussion, a cash consumption reflected in the statements. The blockade will affect the results in two situations. Firstly, if it's released to the member or when a provision is made for it. In both cases the impact will be on the contingencies heading of the admin expenses in our financial statements.

On the next slide, we aim to show that judicialization in healthcare is impacting everyone. Private healthcare has been suffering from a sharp increase in the number of new lawsuits over the last two to three years, and this is impacting all healthcare operators in the country. The increase in judicialization in our view is mainly a consequence of the regulatory change that transformed the list of procedures from exhaustive to exemplary, opening up more room for discussion. The regulatory change and removing the ceiling on therapies with the sector experiencing a lot of fraud and abuse, the increase in verticalization and consequent network changes, a basic regulatory prerogative of health operators and finally, we are more exposed than other operators because we're the largest health insurance provider in the country and one of the largest in mass plans which concentrate a significant part of the lawsuits with discussions that come up against criteria for grace periods and coverage, for example. The chart on the right shows that this phenomenon spares no one with increases in blockades from group medicine to philanthropic organizations.

In the next slide, we present the main demands that are the subject of lawsuits against health insurance companies in recent years using public data from the National Council of Justice. Mostly these are demands for the execution of procedures for members during the grace period, requests for home care, as execution of procedures outside the contracted network, execution of procedures outside the region covered by the contracted plan, unlimited therapies or outside our own network or with uncover techniques and more significantly, from a financial standpoint, requests for the supply of experimental drugs off label use and drugs not included in the guidelines or not registered by ANVISA in Brazil.

In the next slide, an analysis of the largest health insurers in certain regions of the country, we see that the absolute number of lawsuits has grown more strongly in the last 12 months. Now look at the number of lawsuits per 1,000 members in Sao Paulo for example, in the chart on the left, NDI has a number that is less than half that of the operator with the highest number of lawsuits. In Rio de Janeiro in the same comparison, we don't even appear among the top three. This is also true when we look at Ceara, Pernambuco, Bahia, and Rio Grande do Norte combined. Regions where we have a strong presence. So again, this is not something affecting one operator or another, but a widespread problem.

Having presented this scenario, let's talk about Hapvida more specifically.

As we explained earlier, there was a sharp escalation in judicial blockades in the first half of 2020. Therefore, provisions to address these issues arising in the judicial environment were adjusted to the new reality of judicialization with our legal team reanalyzing all lawsuits with ongoing blockades. We initiated a review of our civil case base also with this new adjusted view of the new reality of judicialization to reach this level of provision that we believe is appropriate for the moment, considering that we'll continue to closely track this line over the coming quarters. There was a difference of almost R$200 million between blockades and deposits in the second quarter of 24. At the end of the third quarter, this difference was just over R$100 million.

A drop from R$200 million to R$100 million. The question is why isn't there an immediate 100% coverage between blockades and provisions? Why is there a mismatch? Let's look at the explanations of how this recovery movement is being done.

- The first is the new reality of the matter, which increased abruptly in 2024 and required a deep reanalysis that has been going on for over 40,000 lines related to processes with judicial blockades expected to be completed by the end of the month, not only the view of the base as a whole, but breaking down in to nature, region, type of portfolio, request and cost of action, financial impacts and the like. This has helped us to put together more targeted strategies. We also reviewed the governance of the matter with the new criteria related to possible and probable processes in this new internal improvement process;

- Second, in the view of our legal team, not every process with a blockade requires a respective provision, since we can reach agreements outside the Court with that are usually worth lower amounts than those that are settled in court;
- Third, a portion of the balance of blockades ends up being infected by duplicities, which hinder the analysis of coverage.

Thus, in our view, the provision made now adequately reflects the coverage we need. This is because we want to observe the trend in the coming quarters to assess the need for increases. Having said that, we do not expect there to be over 100% coverage between provisions and blockades for the reasons explained above. We are going to track this closely and make decisions based on data. Looking ahead and this is not a commitment or guidance, but from a more in-depth perspective, we can say we do not expect this line to continue showing the same dynamism of the last four quarters and this is justified by the fronts and initiatives that we are implementing and whose results we expect to capture in the coming quarters. However, these are not initiatives with immediate effects. The balance of civil provisions went from R$548 million at the end of 2Q24 to R$753 million at the end of Q324. This R$205 million increase is broken down in the table on the left, including provisions for lawsuits received in periods prior to the prior to the third quarter.

The next slide I will tell you what we're doing and why we have to do that and even more as usual. On the institutional front, as Jorge mentioned, we have two fronts being led by Abramge which you can see here on the left hand side of the slide. On the corporate front, which is more under our control, we have come a long way. We created working groups that have been analyzing lawsuits early on with daily meetings for quick decision making. We focus on a quick decision of blockades or post blockades negotiations. We now monitor the topic daily in a dynamic way with teams exclusively dedicated to this in these groups with daily reporting to the President, we expect to reduce the volume through this increasingly databased and interdisciplinary approach. We have a qualification journey to take, but we are confident that we have the necessary tools and we know the path we should follow to control this line.

On another front, considering the more accentuated level of judicialization we are passing through new quotes for group plans and changing the new sales tables of mass products with the current information, we hope it will be enough to increase our prices with a small readjustment of one and a half point to offset this effect on the company's results. Naturally, this leads to a temporary mismatch, since the movement of blockades, provisions and write offs follows its flows and the ability to readjust the portfolio has a certain latency, but it should not be more than three to four quarters until we go back to a neutral cycle.

If we're successful in one or more of these initiatives, prices can be changed again, either up or down, but still at lower levels than those of other operators and we'll also continue on an even more intense agenda of cost optimization to accommodate the mentioned impacts. This topic has taken over our day-to-day operations in recent months, but we want to tell you that we're confident that the remedies implemented will help mitigate the effects.

See, for example, how we qualified or service in our network by prioritizing the treatment of NIPS and improving the IGR and the South and Southeast operations which in the best historical level. And that's not all. Our service is increasingly improving, and we have our members at the center of everything.

This topic is not appropriate considering the vitality of Hapvida. Next month will be a widely integrated company with a complete view of all the necessary controls over the Southeast operations. We hope to have entered a point of commercial inflection which gives us confidence that we'll be able to follow this trend in the coming quarters. We're doing everything we need for this. We reviewed products, networks, service, support, journeys and have taken hundreds of actions to grow in key locations. Meanwhile, we continue to generate cash in a robust way with solid conversions and gradually deleveraging the company. We are optimizing our capital structure with strategic partnerships to release CapEx for projects with greater impact on the business, investing billions in the operation. Well, our explanation was longer this time, but we felt it was important to express our confidence to you. Thank you once again for your patience and I hope these details have been useful.

Now we're open for questions. Thank you very much.

Q&A

Operator

We'll now start the Q&A session for investors and analysts. When your name is announced, a prompt to unmute your mic will pop on your screen, and you must then unmute your mic to ask your question. We kindly request that you ask a maximum of two questions and that you ask them all at once.

Our first question is by Gustavo Miele, sell side analyst at Goldman Sachs. Gustavo, please unmute your mic and ask your question.

Gustavo Miele (Goldman Sachs)

Good morning, doctor Jorge, Nahuz, Luccas, thank you for your presentation.

I have two questions related to the issue of judicialization or right to health litigation in the industry. On slide 13, you show a flow chart from a complaint to a judicial deposit in a hypothetical case, can you let us know what the times are for each one of those stages? Because when we look at Sao Paulo, for example, NIPS of NDI have been going down in recent months, but I don't think this is the trend of judicialization in Sao Paulo, so I understand there is a time gap here. Can you give us some color? On this, this is going to help us in our modeling for 2025.

Now the second question, can you tell us a bit more about the provisions for October? I heard Luccas saying that you don't expect great volatility on this ahead and since coverage is not going to increase, this is what I understood for from your comment, so this R$75 million of provisions for the care side is that enough for the coming quarters? Do October numbers confirm that? Thank you very much.

Jorge Pinheiro – CEO

Gustavo, these are great questions. Thank you. I will start by answering your first question and then Luccas will take the second.

With regards to this process that start at the customer center and then gets to the judicial deposit, this is actually quite impactful, but we have rituals at the company to track all of the cases once a week, we sit down and we talk about each one of them and analyze the reasons and we have around 92% of cases that are what Abramge classifies as undo or inappropriate.

It's either related to grace period or request for use off label medications or requests for use of providers that are not part of the contracted network and only 8% account for other types of complaints such as a doctor that was absent in an appointment that was scheduled or other operational complaints. If we solve 100% of our operational complaints, then we're only going to be able to address 80% of the cases, but we have implemented a series of important care improvements. For example, our customer service for the whole country is working day after day with 100% resolution of the cases that refer to what is under request related to things that are contractualist.

Our whole regional 2 now has a target to provide service within 15 minutes. Of course, we had to hire many doctors to be able to provide that service within 15 minutes, but today almost 80% of all of the service provided in our ER's are provided within 15 minutes and this is completely different from the reality of the industry in private hospitals throughout the country, as you know, so we have implemented many improvements and for what is contracted, the numbers have been positively impacted and you can see that in terms of NIPS, we started the year with 7,200 NIPS and now we have a bit over 5,000 NIPS. Those formal complaints filed at ANS and the company is consistently improving in all care aspects, and that's a major accomplishment. Now about those cases and lawsuits, I'm going to turn the floor over to Luccas in a minute, but just to reinforce that 92% of the cases are inappropriate. We have taken institutional measures and internal measures in order to be quick and responding to them and of course, we're passing through the price 1.5% in all of our tables and in less than a year we would be able to address that based on the data we have today with that 1.5% increase. But we are confident about the actions we're taking and we believe that through all of these actions we'll be able to navigate these waters and we might not even have to pass through this cost forward.

Luccas Adib – CFO

I agree with what Jorge said, Miele, I don't think it would be productive to talk about October or to talk about a short term trend since this is still very recent, but what we see is a stabilization taking place, but I don't know how this is going to behave in Q4 or in 2025. What

I'm confident about is that if we're implementing many initiatives and prioritizing a topic that didn't used to be a priority and we have many initiatives to control this line, I expect this to change from now on, right? We won't see the same behavior we saw in the last three quarters, we'll see this more under control after all of these initiatives are taken, but I cannot tell you what's going to happen in Q4 or 2025. This is still very recent, so we need a longer horizon in order to be able to define any type of trend but we want to express how confident we are, just like Jorge said that the plans are in place, we are now prioritizing this issue and we do not expect the same behavior to be seen in the next quarters as a result of all that.

Gustavo Miele (Goldman Sachs)

That's very clear. Thank you very much.

Operator:

Our next question is by Samuel Alves, sell side analyst at BTG Pactual. Samuel, please unmute your mic and ask your question.

Samuel Alves (BTG Pactual)

Good morning, Jorge, Luccas and everyone. I have two questions here on my side.

The first is a follow up on the chart that you shared on slide 17 with the curves of deposit, judicial blockades and other provisions. It was clear to me, based on Luccas's presentation, that you do not expect the gray curve to be at higher levels than the blue curve. So, my first question is about the blue curve or the blue line on the chart. Do you expect this to continue worsening? From now on, as far as I understand, you do not expect any stabilization yet, so the blue curve will continue to worsen but the initiatives that you have put in place can help mitigate that, and now my second question. I would like to understand the historical reasons why is it that during Q422 and Q423 the gray curve was above the blue curve? Thank you.

Jorge Pinheiro – CEO

Hi, Samuel. Thank you for your questions. So the reasons why there was a change was mainly due to the changes of the ANS lists changing from exhaustive to exemplary, this opens opportunity for discussion and in order to anticipate things correctly, you have to know what is included in that list and about new therapies we have been working to define use guidelines in order to have a better regulation because we see a lot of fraud and poor practices that have damaged the whole healthcare industry. So I think that these are the two main reasons that led to such rise in the number of lawsuits, but this affected the private healthcare sector and the public healthcare sector equally, but we are confident that the institutional and operational measures that we have taken along with new pricing will be enough for us to address that and now Luccas is going to answer the second part of your question.

Luccas Adib – CFO

Hi, Samuel. Thank you for your question. Yeah, it's great to be able to answer questions like that in order to clarify certain issues that we used to have a certain coverage and now we have a different perspective outlook in term of blockades and provisions. This is about a changing level related to the discussion involving blockades and how this has been addressed by the events we mentioned earlier, Jorge mentioned the vectors on which the blockades are based, this led to a higher level of blockades for the company, so this change what was happening in Q422 and Q423.

Changed our prognosis and in this new review, now that we see a new level of judicialization, we understand that the coverage that would be up to 100% and we're not saying we're going to do that right now. What I wanted to say is that now we have the provision which we find is necessary to cover all of that, and of course, we have an independent auditor reporting this to the admin departments and now, since the level has changed and this happened in Q423 now spilling to Q124 and Q224, we said well, let's review our paradigm because we now have to change what we considered contingency and what we considered provisions. So after this review of the technical criteria for that will lead to the setup of a provision we now believe that we'll have to get to a scenario in which we have to mitigate those by having a 100% coverage and I told you that we have processes that have a blockade, but that do not need a provision. We can have a bilateral negotiation even before we have a judicial blockade. If we see that the case is probably going to lead to a judicial blockade, we can try and have this discussion outside the Court and that decreases the costs and our legal team has been working in a very competent way with due diligence to analyze all of the cases. This is being monitored by our VP, which is one of the most competent people in this area, and he has also a very competent team to support him, so this thorough analysis makes us confident that if we need to recompose even more than we have recomposed, this is going to be close to 100%.

Now about your first question, I think it's really hard to talk about trends with you and we don't want to start talking about trends for Q4 or 2025, but my speech gave you ideas for you to project and model 2025. In our view, the information you need to understand the judicialization of the company has been conveyed to you in my speech and in our release documents. We have enhanced many mechanisms to control that, if we have sophisticated governance that is being monitored by the President of the company, I don't think that this line will continue behaving like that in the coming quarters but of course we have to see how this unfolds in the coming quarters.

Our history is still very short. Do I see stabilization? Yes, I do and we're going to work really hard for this to be seen in a more positive light in our balance sheet, so this is our message to you. We don't know about Q4 or the trends or projections for 2025, but we have given you enough information to run your modeling for the near future, without giving you any guidance or any commitment toward anything.

Samuel Alves (BTG Pactual)

Ok. Thank you, Luccas, and thank you, Doctor Jorge.

Operator:

Our next question is by Mauricio Cepeda, sell side analyst at Morgan Stanley. Mauricio, we will open your mic, please ask your question.

Mauricio Cepeda (Morgan Stanley)

Good morning, Jorge and Luccas. Thank you for this opportunity. I have two questions. But changing the angle here on judicialization: the first is what would be your commercial strategy for mass plans? Because we see more lawsuits coming from this type of contract, so from a commercial perspective, what do you intend to do within the regulatory environment, is their way to address that?

Now my second question, you talked about pricing and about your aim to reestablish balance through readjustments. How can this be put in practice? Because you have different portfolios like you have a corporate portfolio with claims, specific claims related to that and that's a sub segment that the market has balanced well, individual has regulated prices. You talked about new sales. Are you going to do that only with new sales? And small and medium businesses? We would have to adjust all contracts at the same time. So, how are you going to rebalance this in the different segments? Thank you very much.

Jorge Pinheiro – CEO

Hi Cepeda, thank you for your questions. So from the commercial perspective as we said earlier, based on our calculations we're going to make a mild readjustment that includes no sales and all the readjustments that are not regulated. This readjustment is going to be around 1.5 percentage points and as we said repeatedly here this would be enough for us to face this whole new level of lawsuits in three to four quarters and the good news is that the readjustments that we were planning for 2025 even with this small increase will still be lower than the readjustments we made last year and this reinforces the slide we shared with you showing that our readjustments are much lower than the those of the rest operators, the rest of the operators. Inflation is around 3 to 4% a year, so well controlled and our tickets last year had 12% readjustments. So this year are readjustments going to be lower than that even with that one point increase, so we'll be able to keep our historical competitive and in three quarters, we will be able to create this pricing buffer, not even sure we're going to have to keep that for a long time, but this is going to help us meet this new reality.

Now about requests for plans outside this new pricing we've been studying co-participation or franchise models that can alleviate these extra contractual requests, so to speak. And in Q4 we may make contractual adjustments to protect us from this type of request, products that are not under our coverage will request greater co-participation from users. Several measures have been taken and the most important of all is the continuous care improvement that has reduced all complaint levels and we are addressing judicialization with these one off or more specific remedies that we mentioned in our presentation.

Mauricio Cepeda (Morgan Stanley)

Very clear. Thank you, Jorge.

Operator:

Our next question is by Leandro Bastos, sell side analyst at Citi. Open your mic so that you can ask your question.

Leandro Bastos (Citi)

Good morning, everyone. I have two questions about judicialization. The first is about the judicial deposits. What is active deposit? In your prioritization of the issue have you changed your strategy? In assessing the assets, can it help this line in the future?

Now my second question, you shared interesting information about how this is affecting the industry, other companies and the possibility of extrajudicial agreements. Do you see part of these costs as a new reality? You're talking about passing through part of that cost in price and how do you deal with those claims? Thank you very much.

Luccas Adib – CFO

Hi, Leandro, thank you for your question. Well, first of all, we need to understand that the judicial deposits, those that we make a deposit in order to avoid any type of fine or interest rate we're usually talking about RESUS. Now, for the judicialization per se most of them are blockades, I just wanted to make that clear so you understand that difference in terms of the nature where we are more proactive and where we are more reactive.

Now about your second question, when you talk about the extrajudicial agreements, yes, we have been assessing this topic in order to start considering this as a structural cost and to create MLR reports this is going to be a part of the cost of the individual portfolio and this will be sent to ANS and may lead to a technical adjustment. In our view, we don't change practices within the same fiscal year, this is something for the future, but yes, we are having an internal discussion here with certain areas and we've been considering the repercussions of these agreements to include that in the company cost. Looking ahead at 2025, this is not going to happen in Q424, but in 2025 yes. Thank you for your question.

Leandro Bastos (Citi)

Thank you, Luccas. Have a great day.

Operator:

Our next question is by Vinicius Figueiredo, sell side analyst at Itaú. Vinicius, we're going to unmute your mic. Please ask your question. Vinicius, go ahead.

Vinicius Figueiredo (Itaú)

Hi, good morning, everyone. Thank you for taking my question. I will start with a question that is not related to the judicial deposits about ticket along with cash generation, that was one of the positive highlights of your results and you have a mix effect that was paramount for the growth this quarter, although the PPO is less relevant in your portfolio. I want to understand the mix in the HMO product, was that boosted by the growth in Sao Paulo?

And my second question, I want to ask about the judicial blockades here as well just like my colleagues, and this is more of a conceptual question, how long does it take from when an official complaint is filed to you have a judicial blockade how long does it take? Do you have any type of pattern? Because there seems to be a stabilization here in new lawsuits with lower judicial deposits right now, just so I understand what the delay in these numbers are?

Jorge Pinheiro (CEO)

Ok, Vinicius. Thank you. About ticket, as you know there are many variables that affect ticket if the growth is in retail or if it is in cities where the medical cost is higher and so the price of our products is also higher and the ticket increases or if we have lower copayments, then the ticket increases. So the average ticket depends on many factors. We cannot say it was a specific reason for sure not only readjustments in price tables impact average ticket, but also all of these other variables that make up the average ticket, but the good news is that this has been helping us and the company has been expanding in retail, which is great news. In many cities where the retail sales were slow, I see retail growth in Minas Gerais, in the greater Belo Horizonte area and retail picking up in Parana. North and Northeast regions are doing really well and retail as well, in Sao Paulo retail is better than it was in the beginning of 2024, so this pushes the average ticket up. Now Luccas is going to take your second question.

Luccas Adib (CFO)

Hi, Vinicius. We are not disclosing certain information like you requested, but I can give you some overall idea, when we started discussing this way back then, I had a feeling that this had a longer tail. There was a greater latency until you started discussing the case until you had the blockade and loss of the asset. What we see here is that this is actually happening quicker than we first expected it doesn't have that long of a tail as we thought and that's why we have to be quick in our negotiations and in our active search to address this issue. The tail is not as long as we expected. This is what we think and we're very close to completing this type of work and then we're going to have all the answers we need, but the strategic plan is now divise and there's nothing new that will come up that is needed to make decisions, we now have the whole visibility and the strategies came from this very accurate diagnosis that was made by the company but we cannot yet disclose this information to you. We might be able to disclose this in our next earnings conference call. We might get to the conclusion that we have all of the methodology and rigor needed to disclose the information which can help you also in your modeling, but this is something that we cannot share right now, but we can say that the tail is not that long, it's actually quicker than we expected.

Vinicius Figueiredo (Itaú)

Ok, that was very clear. Thank you everyone.

Operator

This concludes the question and answer session. Hapvida's third quarter 2024 earnings conference call is now over. The IR team remains at your disposal should you have any other questions. Thank you for joining us.