Conference Call Transcript
Hapvida
3Q23 Results

Operator:

Good morning, everyone, and thank you for waiting. Welcome to Hapvida's third quarter 2023 earnings conference call. Joining us today are Mr. Jorge Pinheiro, CEO, Mr. Mauricio Teixeira, VP of Finance and Mr. Guilherme Nahuz, IRO.

Should you need simultaneous translation into English? Please click on the interpretation button on the bottom toolbar and choose the English option. This event is being recorded and will be made available in the company's IR website along with the earnings release materials.

You can download the slide deck by clicking on the icon in the chat. Please refer to the disclaimers of this release at the end of the deck. During the company's presentation, all participants will be in a listen only mode. After the company's remarks, there will be a question and answer session. In order 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 enter the queue.

Now I'll turn the floor over to CEO Jorge Pinheiro, who will start the presentation. Jorge you have the floor.

Jorge Pinheiro

Hello. Good morning everyone and thank you very much for joining us for another earnings conference call. We are reporting on the third quarter of 2023. Mauricio, Guilherme and I along with our IR team, Candido Neto, Bello, Gleycianne and Paloma are gathered here today to share with the market some additional details about this quarter's results.

We remain firm and disciplined in our path towards margin recovery quarter after quarter, consistent with the strategic plan that we shared with you early this year. Our recovery reinforces the confidence we have in our business model so let's get started on slide two of the presentation here is an overview of the quarter.

During this period, we remain loyal to our margin expansion commitments with a significant improvement in MLR. This improvement was the result of the great efforts of an engaged team committed to our philosophy.

The MLR was positively impacted by ticket recomposition through both the readjustment to existing contract that were necessary for their financial balance and new sales that have been bringing in new contracts with profitability levels in the range we are aiming for.

The MLR also benefited, of course, from initiatives to increase verticalization and redesign products. We also saw dilution in admin expenses in line with what we expected in terms of efficiency gains and synergies.

On the financial side, we remain diligent in reducing our leverage by maintaining a healthy cash generation. Our conversion of EBITDA into cash is aligned with our historical levels. In addition, we completed the process of disposing of the company's non-core businesses that we announced earlier this year contributing to deleveraging.

Moving on to slide three, in October we delivered 2 new hospitals, Rio Preto Hospital to take even better care of our members in the São José Rio Preto region, where we acquired HB Saúde and the Rio Solimões Pediatric Hospital in Manaus, Amazonas, a modern and specialized hospital in the city that is so important to us.

Our investments and efforts to qualify our own network with our 87 hospitals has enabled us to present healthcare indicators that are above ANAHP on average. ANAHP is the association that gathers the top Brazilian hospitals.

Now moving on to Slide 4, I'd like to share a little more about the progress we've made in relation to what we presented at Hapvida's Day in June. Our accumulated readjustments from May to September for all portfolios are around 15%, 14.8% for large companies and 14.4% for corporate.

In other words, we are maintaining the pace we started off at. In autism spectrum disorder, more than 50 new rooms have already been delivered this year. We have reached 85% verticalization in regional one above what we had estimated and regional two has made important progress.

In terms of systems, in addition to the implementations we had in May, July and August, we are planning the NDI turn around in Minas Gerais for December. Already covering everything we have learned so that we are even better prepared for this new deployment.

In the meantime, the timetable for NDI's system change in São Paulo has been studied and detailed. There will be a phased deployment over the first half of 2024 started with care delivery units and completing the cycle with the healthcare operator.

And finally we have completed a number of corporate takeovers as you have seen, hospitals, holdings and everything is progressing according to plan.

Before handing the floor over to Mauricio, who will go into a little more detail about our results with you, I want to conclude by saying that we are continuing to write a balanced and diligent 2023 disciplined and recomposing tickets, strengthening our units and operational objectives and seeking to recover our margins.

I am grateful for the contribution of our staff, doctors, dentists, brokers, suppliers and for the trust and action of the Board of Directors, shareholders and above all, our clients, the key reason for all of our efforts.

We restate our commitment to serving the Brazilian people, taking care of their health at high quality and at affordable prices. Mauricio, please go ahead.

Mauricio Teixeira

Thank you, Jorge, and thanks everyone for joining us. Well, today is Doctor Jorge's birthday. So happy birthday, Jorge. And we also want to celebrate the execution of the plan that we shared with you in the beginning of the year and our results starting on slide five, you can see the results of this strategy that we communicated with you of readjustments to recompose our margins in our portfolio.

In healthcare plans, you can see our revenue growth of 10.3% year over year, which is a reflex of the increase of 11.8% in average ticket prices due to product mix changes and also a 1.3% drop in our member base year over year.

For dental, we see a growth of 3.2% year over year and a ticket growth of 2%, which led to revenue increase of 5.2%. In terms of hospital services which includes other services this drop is related to the sale of São Francisco Resgate last quarter so if we exclude their revenue, then our hospital services revenue remains stable.

On slide six, you can see the movements and health care plans. We lost 90,000 members this quarter, reducing the loss space we had in earlier quarters, which is a reflex of sales of lives, but with a negative turnover of 33,000 lives, which is a consequence of our exposure in a segment that is reducing the number of employees and a weaker churn, which is a reflex of the portfolio readjustments we have made since the beginning of the year, so there was a 90,000 decrease in the number of members, but this is all aligned with our margin recomposition.

And now on the next slide, you can see our cash MLR, which was of 71.9% this quarter. It's worth emphasizing that we had a quarter over quarter drop that is above the expected seasonality from the 2nd to the third quarter, we usually have a an even greater loss and there is also a drop year over year.

This is the best cash MLR since the merger between Hapvida and Intermedica, and since we started to operate as a combined company and we were able to reach those because of the increased verticalization that you can see on the right hand side consistent increase in verticalization for appointments, tests and admissions and better synergies between the two operators.

On slide eight, you can see our admin expenses ratio. We can see a gradual reduction of G&A related to revenue. Of course the readjustments help, but we see a nominal drop in Q3 compared to Q2 so we reached a level below 9% which is consistent with our trajectory to dilute G&A plan for the biennial of 23/24 which is the year of transition and integration, but there are still many other initiatives to be started that depend on systems improvement, process improvement and incorporations that we're doing as announced after that, more benefits are yet to come.

Now to talk about our sales expenses you can see that the level is stable compared to the beginning of the year and stable when compared to the same quarter last year. There has been a growth compared to 2Q23 due to commissions, because commissions are deferred when the contracts are signed, so there is no result effects during the sales this is deferred, but when the contract is terminated then we take care of the non-amortized value and since we optimized our portfolio, we lowered the number of commissions by R$28.8 million in our results and our strategy is to concentrate the marketing and advertisement initiatives in the second-half of the year we had a higher level of marketing and advertisement as compared to last quarter and in Q4, this level is going to increase because we are investing in the repositioning of our brand, not only in locations where we are renowned, but also in new locations where we are making acquisitions so that the customers can get to know our products so we're going to continue invest in the marketing and advertisement in Q4.

All of that leads to our Adjusted EBITDA, as you can see on slide 10, which grew as compared to Q3 last year by 47%. Strong growth compared to Promed Adjusted EBITDA we went from R$500 million to R$742 million due to increasing net revenue decrease in cash MLR and dilution of SG&A so we were able to achieve this level of two digit in Adjusted EBITDA going back to pre-pandemic and pre-merger levels.

This is a trajectory that we have been planning in order to reach growth quarter after quarter. This also helps with our cash flow. As you can see on slide 11.

Here you can see strong cash generation going from R$700 million in EBITDA and removing working capital we have a level of R$493 million in cash generation, so 6 to 6% conversion which is very close to our historical levels of cash generation.

So considering income taxes and all of the efficiencies and the acquisitions that will continue with the restructure in here and a more controlled CapEx because our philosophy this year is to preserve cash and reduce debt. And the chart at the bottom you can see how our net debt is behaving. In addition to this operational cash flow of R$345 million, we had a settlement of R$24 million.

The sales of São Francisco Resgate which made us R$108 million and we are yet to receive another R$42 million which will help in deleveraging. The compensation of the Promed sales of R$151 million so these values are more than necessary for us to pay our debt interest rates and our net debt dropped to R$4,954 billion, which represents 1.58 times net debt over EBITDA in the beginning of the year, we got to 2.3 times, but we were able to reduce those by at least one time throughout the year there were some inorganic movements, but also organic cash generation that help us helped us settle part of our debt and with the reduction of basic interest rates and margin recomposition and the continued growth in the coming quarters, we'll see an acceleration of the decrease in our net debt, which will make us even more comfortable in this position.

This also reflects and the regulatory requirements that you can see on slide 12 in recent quarters, we told you that the technical provisions, which is what we have to deposit in cash to give guarantor assets to ANS is stable at R$3.150 billion, our total cash had a small drop because of the amortization of approximately R$1 billion that we paid in nominal and interest rates in Q1.

So R$1 billion in debt was paid that reduced the liability and also the cash even though free cash after all that is at the level of R$4.100 billion, which is very comfortable for the companies everyday operations and regulatory capital which we track from up close, comparing our risk based capital with adjusted equity. Had an excess of over R$1 billion and all of the group's operators, even though smaller ones showed a regulatory capital surplus which is great all of the groups operators have a high regulatory capital with over R$1 billion in excess with all of the businesses combined.

All of the operators are increasing their P&L which led to this result.

And now we are going to open for questions. We would like to thank you all for your trust and we can now answer your questions. Thank you very much.

Q&A:

Operator

We're now going to start the Q&A session. When your name is called, you get a pop up on your screen to enable your mic.

Please enable your mic and then ask your question. When you get the pop up and please ask all your questions at once, starting with our first question by Gustavo Miele, sell side analyst at Goldman Sachs.

Gustavo, we're going to enable your mic so that you can ask your question. Please go ahead.

Gustavo Miele (Goldman Sachs)

Good morning, Jorge, Mauricio and Nahuz. Thank you for your presentation. I have 3 brief questions.

The first one is when we look at the net adds breakdown this quarter, we see a gross sales that is a bit more significant than we saw last quarter and you emphasized this do and the presentation, what is the readjustment like for new sales? Can you give us more color about the impact of these readjustments on the consolidated ticket for the company this quarter? That's my first question.

Now my second question. Have you seen any variation in Q3 about appointments and tests related to the flu and other winter season illnesses we've been seeing here that we have had in a typical winter throughout the country, which led to positive impacts for some players and a negative impact for others. So have you seen a drop in these items because of a warmer winter that this lead to changes in frequency compared to other Q threes that the company placed?

And now about working capital, we saw a cash consumption of R$250 million this quarter and provision for bad debt had slight deterioration on the same comparison basis so is there like a macro factor maybe related to the hospital operation business like you said in other opportunities, can you give us more details about the working capital?

Thank you. Flu, readjustments on new sales and working capital, these are my three questions. Thank you very much.

Jorge Pinheiro

Thank you for your question. I will start and then I'll turn the floor over to Mauricio to answer the other two questions.

I'll talk about the seasonal aspects first. After so many months, even years with our characteristics seasonal curve of illnesses been impacted due to the COVID pandemic we start to see a return to historical patterns now.

You know that Q2 and Q3 are more affected by viral diseases, viral infections and that happened in Q2 and Q3 at least in our exposure, which is national.

The disease is the start in the north of the country affected by the rainy season there and then with the cold weather, this moves along Center and South of the country and we noticed that this year we're going back to the historical seasonal curves, which is good because it gives us greater predictability if it continues like that.

Now I'd like to turn the floor over to Mauricio to talk about readjustments and working capital.

Mauricio Teixeira

Hi Gustavo, thank you for your question.

About new sales, the price tables are also readjusted at similar levels to the readjustments that we are applying to our portfolio because that would be a problem to sell at lower prices than the current prices of our portfolio.

We had a stronger readjustment in the beginning of the year and we're now having the second wave so the readjustment of the price tables are at around 15% and of course, we don't want to create any distortions so we look at each of the cities and the levels of our readjustment there, but the mix of gross sales is lower than the mix that we have previously.

We're losing lives with higher tickets and PPO products that sometimes is more expensive than HMO and selling in locations with lower price tickets. However, the like for like prices of products are also being adjusted.

Now about working capital and provision for bad debt. This is a stable as you saw in our numbers and there is no major risk or attention point right now this has stabilized we saw growth in late last year, but now the PDD has stabilized and what is still impacting working capital is you know the receivables part accounts receivable or still being impacted by the sales of services when we look at the hospital network, there is a greater delay to convert receivables into cash the same is happening with all operators in the market there are denials, there are disputes and therefore the conversion takes longer to take place and that impacts working capital.

However, our business has a natural working capital consumption like brokerage, commission is paid and the results are deferred until this is amortized or the contract is cancelled, so the working capital remains stable so there are two factors that will always be there, commission and accounts receivable which is more concentrated on the sales of hospital services to other operators.

Gustavo Miele (Goldman Sachs)

That was very clear. Thank you Mauricio and Jorge and have a great day.

Operator

Our next question is by Leandro Bastos, sell side analyst from Citi.

Leandro, we're going to open your mic so that you can ask your question. Go ahead.

Leandro Bastos (Citibank)

Thank you. Good morning, everyone. I have two questions.

The first one about readjustments. Do you have any expectations about the readjustment level for next year and in your different verticals?

And 2nd about the nursing salary floor. Can you tell us about the negotiation with the nursing class in general, thank you very much.

Jorge Pinheiro:

Hi, Leandro, thank you for your question. Well, about readjustment it's important to note that the cycle of your readjustments that started in May 23 will be completed in April 24, we expect similar levels for individual, SME and affinity, large companies and all of that, this should remain at similar levels than we saw in Q3.

Until April next year that's the pace that we expect. Now for the second-half of 24 we have not defined this yet we still need to assess some other aspects you know related to inflation we're going to close the year to see the cost assessment. We have until February to define the readjustment level so that should be done only in the beginning of 2024. There's still time for us to do that.

And now regarding the nursing salary floor, this is running in court in STF and TST the higher courts, but we want to emphasize the importance of these professionals in our operations, my mother, Anna, was a nurse and she was one of the main people behind the definition of our mission but we are waiting for the STF and the TST rullings they are working hard on this and we don't have any visibility about possible impacts. If they will happen or when they happen, we're still waiting for the court rullings.

Leandro Bastos (Citibank)

Ok, Jorge, thank you. Have a great day.

Operator

Our next question is by Vinicius Figueredo. Sell side analyst at Itau BBA.

Vinicius, we're going to enable your mic so you can ask your question. Go ahead.

Vinícius Figueiredo (Itaú BBA)

Good morning, everyone. Thank you for taking my question. I actually have two questions.

1st we want to understand the acceleration in the loss of lives. You continue with the same churn because you close some contracts that were at a loss but gross sales are now progressing again as this due to the acquisitions you were able to migrate the systems, is there any specific region where you're more competitive?

And now another topic about the NDI accredited network reviews, especially in São Paulo and Rio. So have you been reviewing these providers? Have you done a lot in the second-half of the year or this is going to be accelerated after the systems are deployed next year?

Jorge Pinheiro

Thank you, Vinicius, for your great questions. So first about the growth, yes we had a loss of lives that was below expected due to a resumption of sales. Sales are doing well, our production is attacking in sales. Q3 is doing well.

Now about the losses of lives, Mauricio explained this well. The main reasons are the portfolio review, the readjustment policy and also the clients themselves.

Most of our large clients now have a smaller base of lives, but we think that after you know the resumption after the end of the pandemic, these clients will employ more people and this is great because this would be an increase in the number of lives that would not require payment of commissions because these are clients that are already in our member base so we see a promising growth after we finish the cycle of portfolio review, which will end in April next year. This is an annual journey like you are all aware of so we are being diligent in this review, but the good news is that the sales production is doing well.

And once the cycle is completed, we should expect this to happen again and having a healthy portfolio and sustainable organic growth which should start after this annual cycle is completed and about the accredited network we did everything we had to and there are no major challenges to be exceeded in São Paulo, Rio, Minas, Rio Grande do Sul, only some minor adjustments, nothing significant except for the natural verticalization movements.

For example, we have just opened a hospital in São José do Rio Preto, this is a hospital in the better real estate in the city, state-of-the-art technology that will have adult pediatric, obstetric services, ICU, high complexity surgeries, it's natural that our members will be referred to our own network which is specialized and customized to serve our patients. These are the movements we expect without major changes to our accredited network.

Vinícius Figueiredo (Itaú BBA)

Great. That was very clear. Thank you, Jorge and Mauricio and the whole team and congratulations on your result.

Operator

The next question as by Samuel Alves, sell side analyst at BTG Pactual.

Samuel, we're going to open your mic so you can ask your question. Go ahead.

Samuel Alves (BTG Pactual)

Good morning, doctor Jorge, Mauricio and team. I have two questions.

The 1st is about MLR. During the Q2 earnings conference call, you commented that you expected the company to run with a duplicate cost structure because of your strategy to increase verticalization and reduction of PPO plans, but the company could get overdue claims from this accredited network this this effect happen and we could expect then to have and even greater reduction in additional MLR in Q4 and 1Q24?

And now about financial results, that MTM effect of R$60 million in derivatives that had helped the financial results in Q2 is it the same instrument that got in the way of your financial results in Q3 at a similar magnitude? And do you think that at the end of Q3, like you said in the release, this is going to have any accounting effect in Q4? Thank you.

Jorge Pinheiro

Hi, Samuel, thank you for your question I will answer the first enter the floor over to Mauricio for the 2nd. About MLR yes, there was an impact, which is natural in the verticalization move whenever you have a temporary duplicate duplication of costs, you pay your credit network and your own network so yes, that happened and what also happened in Q3 is that all of the measures that we have taken, you know going from we adjustments based on our needs, portfolio review and other cost measures not only verticalization but other actions that we start to take in the beginning of the year are now having effects and after integration we have operational standardization and unification of suppliers so the whole set of measures helped us to get these gains a bit earlier then expected and the MLR was lower than expected, so breaking that natural trend of having levels similar in Q3 and Q2.

From now on, we're going to work with a lot of discipline in our plans like we've been doing in all fronts. This journey of margin recovery is, you know a medium or long term journey and then we expect to go back to historical MLR levels in the future, but of course with the recent acquisitions have their own pace of asset correction, you know their own pace of verticalization systems deployment, standardization and so on and so forth so it's a long plan.

We'll still have the whole year of 2024 which will be full of verticalization, integration, standardization of processes, suppliers and so on and so forth so we continue in this firm and disciplined journey to recover margins.

Now, I would like to ask Mauricio to answer your second question please, Mauricio.

Mauricio Teixeira

Thank you for your question, Samuel, about the Swap and the impact on the financial results, the answer is yes. The same instrument that led to benefits in Q2 led to these expenses in Q3.

Though interest rates dropped in Q2 and we had a positive pricing change, but then these curves went up in Q3 and we had this negative result, but R$60 million is R$50 from the derivative that comes from IPCA + to CDI percentage which was IPCA + 5% and something now to CDI percentage and R$10 million is the Swap record with the repurchasing of shares that we did with our assets and since our shares recovered in Q3, we had a positive impact of R$10 million.

We had a penalty of R$40 million in the interest derivatives and a negative of R$7 million of the negative Swap so what was the cash effect here?

Well in the disposal of the IPCA + to CDI percentage, we had a gain in MTM cash. So the R$10 million positive which was residual was invested by the Swap counterpart so we opened a new Swap which will bring benefits and the new Swap due to market conditions had a drop in the Swap cost so rather than 113% went to 107% and we also increased the duration, we Swap IPCA + for CDI percentage so rather than paying the CRI with only, the interest of COPOM we are now paying nominal interests, that anticipated the cash of the instrument, we had a CRI of seven years or 10 years and we were able to anticipate the flow by going from actual interest to nominal interest payment.

We did dozens of Swaps so we had R$500 million in the top two instruments and that decreases the need for cash in the short term and that concentrates the payment for the nominal later on, with a longer duration, a positive cash effect of R$10 million, then we monetize the MTM.

This can be seen in the instrument variation and we reduce the effective cost from 113% to 107%. That's why we thought this oscillation from Q2 to Q3. But these variations were not cash effect it was only the R$10 million positive and with a longer duration instrument from now on, that was the rationale of the Swaps.

Samuel Alves

Ok, thank you, Mauricio, Jorge and congratulations for the improvements that you shared.

Operator

Our next question is by Ricardo Boiati, sell side analyst from Banco Safra. Ricardo, we're going to enable your mic. Please ask your question.

Ricardo Boiati (Safra)

Good morning everyone. I have two quick questions.

1st about MLR. You have had qualitative changes in the main components of MLR. Can you give us a bit more color about the participation of the readjustment? Was it In charge of half of this improvement in MLR, or 2/3 of the improvement, any quantitative input would help us understand the quarter dynamic.

And now my second question is a bit more strategic. What is the companies's appetite like for new acquisitions? And a possible timing of new acquisition assuming that the company intends to be more active in M&A will you wait for the completion of the integrations of NDI here in São Paulo and what would be the profile operators or service providers to accelerate verticalization, go into new markets?

I would love to hear a bit more about that. Thank you.

Jorge Pinheiro:

Boiati, thank you for your questions.

About your first question, it's hard to measure, Boiati, the participation of all of these factors that we talked about. Not only readjustments but also portfolio review, not only of the current portfolio, but also the sales portfolio, integration, verticalization, standardization and best practices, reinforcement and preventive medicine actions, definition of better protocols so there is a whole range of initiatives and our action plans have long list of measures not only focusing on costs and sales, but also G&A and also in our corporate structure, we have many gains already captured and a lot yet to be captured, so there are hundreds of lines that we with a lot of discipline track here internally, so it's very hard to measure the share or the participation of all of these measures to the final results that we shared with regards to acquisition, it's natural and obvious that our main effort and main focus is on integration and standardization of this whole set of acquisitions that we made, not only the operations with NDI, but everything that NDI had acquired and our latest acquisition made by Hapvida in São José do Rio Preto, the HB Saúde, which has yet to be integrated, this is the main focus of the company, which will enable us to capture more results, but of course we have an active M&A team that is constantly assessing market opportunities with a critical view to check for the best possibility. In the short term, we're going to focus on integration to capture everything we can and then at the end of this journey, we'll have one single standardized company with the same indicators that is stronger and more resilient and of course in the medium term, we will go back to our natural journey of acquisitions.

We like to make acquisitions, we know how to do acquisitions, we have the right team and the right processes to do that so at the right time we'll go back to that.

Ricardo Boiati

That is very clear, Jorge. Thank you very much and happy birthday.

Operator

Our next question is by Estella Strano, sell side analyst at JP Morgan. We're going to open your mic. Please ask your question. Go ahead, Stella. You have the floor.

Estela Strano (JP Morgan)

Hi, everyone. Good morning. Thank you for taking my question.

Still talking about MLR, I would like to hear a bit more what you see in terms of MLR gap between the two regionals of the company and what is your verticalization target for the consolidated operation?

In a second question about the Q4 dynamic, given that we already had a two percentage point improvement in sequential MLR, what can we expect in terms of improvement for Q4? Considering that the seasonality is a bit favorable here, thank you very much.

Jorge Pinheiro

Hi, Stella. Thank you for your questions. So about MLR it would be interesting to break this down into three main blocks.

The first are mature operations of Hapvida that we call internally regional one. Here, due to the high level of verticalization and low level of exposure to an accredited network and since these are mature operations, also in terms of systems standardization long lasting agreements running at full speed we have a higher pace here to return to historical margin levels and of course this is aligned to some initiatives and the readjustments this will bring regional one nack to historical levels, in the medium term.

I don't want to give you any specific deadlines, but let's just say that this will happen in the medium term, but we also have regional 2 there we have mature NDI operations, but with a higher exposure to accredited network and we don't have the same level of controls with our own assets and in addition to that, we still don't have systems deployed which include other opportunities such as standardization of suppliers, indicators, cost reduction and so on and so forth, so this journey, as we said for regional 2 with the system deployment should be completed by half 2024, so the margin recovery base in region 2 is lower, but it's going on the right track in all of the regions where we operate we have had gains in our MLR at different levels depending on the maturity of the operations, operational standardization, so each one of them at a different pace, but all on the right track and the third block is for the. most recent acquisitions, each one of those acquisitions has their own history of asset correction in the South, CCG still needs the more verticalization or hospital we'll be getting new services in the coming month and we are preparing the architecture, engineering and regulatory in order to be able to provide those new services, so even in operations like CCG with all systems deployed, there's still a plan to be followed and the same applies to other assets like HB and São José do Rio Preto, we opened a new hospital, but we still need to deploy systems, have a standardization process, so each asset acquired is on the right track.

With consistent reduction of MLR and each at their own base, so I think that we are on the right track, but of course we need to respect the model and the exposure level of each one of our regionals.

Now with regards to Q4 MLR will still have two important months, November and December to assess this we expect these months to behave like they do historically because they have a lower impact of seasonal illnesses and the holidays should also lead to a lower demand level, so naturally Q4 shows the trend to have a lower MLR. In terms of intensity, we'll still need to define this because we still have two important months to go, but most important here is to know that this whole action plan that we have detailed and that we have been implementing strictly is leading to effect on all fronts and in the medium and long term we will get there. Thank you.

Operator

Our next question is by Caio Moscardini, sell side analyst at Santander. Caio, we will enable your mic, please ask your question.

Caio Moscardini (Santander)

Good morning everyone, I would like to hear about the grace period that you have for new lives that are coming in. What is the average grace period for new lives and also when we look at the company churn, can you identify where these lives are going? Are they going to regional players or other national player that is being more aggressive? Thank you very much.

Jorge Pinheiro

Hi, Caio. Thank you for your questions about the grace period this is basically defined by law, the grace periods are of up to two years and there is no change here in our sales rate and we have no products that have had any changes to the grace period which is something that we don't want to do.

We wouldn't be smart to change grace periods or make acquisitions of grace periods because one thing that the law says is that especially in retail channels you have to comply with the grace period to prevent a user to start. using high complexity procedures that are highly costly, just the next day after they have made the purchase so the more retail, the greater the grace period, the more corporate the sales, the less or the shorter the grace period.

That's the market. Pattern that we see now about your second question about churn, we see one or another player with a greater commercial behavior, but our main concern is to have in house a product that has a great balance between quality and cost.

We have a cost structure that enable us to price correctly and in a sustainable way to reach the margins we expect, we don't see any other major player or medium size layer with. a cost structure that enable them to be adventurous, so to speak when we see players like that, we see a cost structure and then selling for non-compatible prices, we know what happens right there is always one or another player trying to do that, but our commitment is to grow with sustainability having the best cost and quality structure in order to continue highly competitive.

Caio Moscardini (Santander)

Great. Thank you very much.

Operator

Our next question is by Gustavo, sell side analyst at Bank of America, Gustavo. We're going to open your mic so you can ask your question. Go ahead.

Gustavo Tiseo (Bofa)

Good morning, everyone. Thank you for taking my questions. I have two questions.

Going back to the last question Caio asked about the competition, last month ANS published reports saying that Unimed were a bit shy maybe they will start having, I mean, are they weaker in the competition? Do you think that's going to open up more space for you from now on and PPO? PPO has had an accelerated drop, you have 490,000 lives, do you have any targets for PPO that can be reasonable in the long term? Thank you.

Jorge Pinheiro

Hi, Gustavo specifically about the operator that you mentioned, but also trying to be more general, what we see is that the whole market needs readjustments, what we hear in association meetings and by talking to our peers is that everyone needs those readjustments because of everything that the industry has gone through, you know, COVID pandemic, negative readjustments, inflation, new therapy that led to a generalized caused pressure that's not something related to one operator only, but something that applies to the whole market.

All operators need greater readjustments to go back to their historical margin levels. Now about the PPO product, we did review our sales portfolio, we suspended sales of some of them and started to include other products in the PPO grid and we tend to grow in lines where there is greater profitability, so those lines that had lower result had their sales suspended, but we still have a broad range of products.
That is needed for this to be competitive with a range of products that can serve all levels of a company and we can do that because of the great diversity of products that we have here, especially in regional 2.

Gustavo Tiseo (Bofa)

Great. Thank you very much.

Operator

The Q&A session is now completed. The third quarter 2023 earnings conference call of Hapvida is now finished, the IR team remains at your disposal, so we thank you for your participation.