Conference Call Transcript

Hapvida

2Q24 Results

Operator

Hello everyone and thank you for waiting. Welcome to Hapvida's second quarter 2024 earnings conference call. Joining us, Mr. Jorge Pinheiro, CEO, Luccas Augusto Adib, CFO and Guilherme Nahuz, IRO.

We would like to inform you that we have simultaneous translation available on this platform. To access it, please click on the Button's interpretation and choose the English language. This event is being recorded and will be made available on the company's IR website with the complete earnings release materials.

You can download the slide deck by clicking on the icon in the chat and please refer to 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. 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 would like to turn the floor over to Jorge Pinheiro, CEO, who will start the presentation. You have the floor, Sir.

Jorge Pinheiro – CEO

Hello everyone. Thank you so much for joining us for our second quarter 2024 earnings conference call.

We're gathered here in Sao Paulo, Luccas, Guilherme, myself and the IR team, Bello, Gleyci, Francianne to share some details with you.

Let's get started on slide two of the presentation. Here you can see an overview of some of the financial highlights that we'll explore later in further detail. I'd like to comment on a few of them. As you all know, the second quarter is marked by a historical seasonality with higher frequencies and greater volume of care services provided. This quarter was no different. Our frequency of per capita use in appointments, tests, admissions and surgeries increased and even surpassed that of the previous year. But even with higher volumes, we managed to control our MLR and this is the strength of our verticalized and more than that, integrated model.

Our commitment and discipline to each one of the verticalization strategies implemented over the last few years, combined with other initiatives such as the prevention program, standardization of best practices and strong investments in technology have been showing results.

Speaking of verticalization, a few weeks ago, we announced a financing structure using the build to suit model for two new hospitals to be built in Rio de Janeiro and Sao Paulo. This structure frees up the company's capital to accelerate other investments we have in our verticalization plan which includes for example, bringing imaging equipment as well as radiotherapy services and infusion centers in house providing more comfort, quality and warmth to our members. In our own network, we continue to expand the number of therapy rooms, clinics and diagnostic units. We are also going to expand and upgrade several hospital units throughout the state of Sao Paulo and Rio de Janeiro, in the North, Northeast and Center West regions of the country, plus increasing the capacity of hospital beds as more mature places like Manaus, Belem and Fortaleza continue to grow in number of members. In Manaus for example, we have just signed the lease for one of the city's largest hospitals, Nilton Lins, which will add around 250 beds to our own network in the city.

In short, the verticalization strategy remains strong and should intensify in the coming years. Looking back, our own network has already become more representative in the composition of our total cost, not only because of the verticalization process I mentioned, but also as a result of the process of oxygenating the member portfolio, which with new sales, is adding more and more clients to verticalized plans.

We also successfully concluded the cycle of portfolio review and readjustments that were needed for the economic balance of our contracts, which began in late last year and was completed in April this year. We continue strong in this new cycle with appropriate adjustments and the responsible and sustainable underwriting policy. This has helped us to make important progress quarter after quarter. Here at the center of the slide, you can see our cash MLR, which is our most important operating indicator, showing an important improvement of 3.4 p.p. against the second quarter of 2023. Since we've had some changes in the season of viral diseases and a major dengue fever epidemic this year concentrated in the second quarter, we have to look at the first half of the year as a whole. On the right-hand side, you can see that the improvements in the MLR in the first half of the year is even more marked with a 3.9 p.p. reduction, EBITDA of R$958 million in the quarter is almost 60% per year, then in the same quarter last year, but it's also higher than that of the fourth quarter of 2023, which is typically the best quarter of the year. Finally, it's also important to mention here that our gradual and organic deleveraging process continues with our indicator reaching one-time net debt over EBITDA, a very healthy and comfortable level.

Moving on to slide #3. Here I'd like to share a bit more about the progress we have made in the integration process. Two waves of integration were carried out in the second quarter, one in April and another one in June, covering around 66 care units including hospitals, emergency rooms and diagnostic units. Therefore we now have all of our hospitals, emergency rooms and diagnostic units integrated and we are now in the final phase of this

Sao Paulo integration with just one last phase left planned for October, which is the turnaround of the healthcare operators system.

The integration waves of the care units have been carried out efficiently and effectively with no impact on customer perception in terms of quality of care and consequently having no impact on cancellations, on the contrary, quarter after quarter we are seeing our cancellation rates decrease. The second quarter was actually the first quarter since the beginning of last year in which gross sales exceeded cancellations. We are optimistic with the growth that is ahead of us.

With the end of this integration journey, we will have a 100% systemically integrated company with significant gains in control of the customer journey and full visibility of all of our care quality indicators, which are paramount to our management. As an example, you can see here the evolution of one of these indicators, which is service in up to 15 minutes for urgent and emergency appointments at our beautiful Lifecenter hospital located in the city of Belo Horizonte, state of Minas Gerais. This percentage was at 32% before the integration and you can see now that the figures are better now at 88%. In other words, all of our members who needed to get care at the Lifecenter during this period, 88% of them were seen by a doctor in up to 15 minutes from the moment they checked in. That's a very strong figure and throughout our network we can see a solid improvement in this indicator.

Still talking about quality of care, another important indicator that we have been publicizing is the percentage of natural births in our network. As a reminder, natural childbirth is recommended by the World Health Organization (The Who), because it has a number of advantages and benefits both for babies and mothers with 50 maternity hospitals in our own network and an average of 5,000 deliveries a month, we have performed around 30% of normal deliveries, a performance that is consistently higher than that of a ANAHP’s average, which represents the largest and most renowned hospitals in the country, when we look only at the cities where we have already implemented prenatal care programs called Nascer Bem e Gestar Bem, this rate gets close to 40%.

Another important front on which we have made rapid progress is in the use of AI artificial intelligence in many care fronts. For example, we're now rolling out an innovative tool developed in house by training an AI with a vast set of clinical data. The tool is able to capture clinical terms and conditions in texts during a written during care and recommend possible diagnosis to the doctor using ICD 10, the International Code of Diseases AI, has contributed to the quality and efficiency of care by supporting doctors in identifying correct diagnosis, minimizing possible errors, and helping to ensure the right treatment is provided.

Finally, I would like to mention advances in our research, development and education area. The shortage of medical professionals in various regions of the country, and the need to introduce final year students and institutional medical activity model prompt the creation of a structured educational development program, our internship, medical residency programs either on our own or in partnership with educational institutions, organized and managed by Hapvida Notre Dame Intermedica and many hospital units in our own network throughout

Brazil guarantees future medical professionals access to high quality, practical training and reinforces our commitment to excellence in medical training.

Before turning the floor over to Luccas, who will go into further details about our results, I want to conclude by reinforcing that we remain focused and very disciplined, facing challenges and taking advantage of opportunities, working hard to continue these strategies we kicked off last year. We continue to invest in the strengthening our operations and seeking a healthy balance in our margins. We appreciate the contribution of our employees, doctors, dentists, brokers, suppliers and the trust of the Board of Directors, shareholders and above all, the trust of our clients.

Luccas, you have the floor now.

Luccas Adib – CFO

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

Let's get started on Slide 4 about net revenue with the chart at the top left, you can see that consolidated net revenue grew by 4.5% in 2Q24 against 2Q23 and by just over 4% in the first half of 2024 compared to the same period of 2023. Moving on to the chart at the top right, our healthcare plan revenue is up 5% against the second quarter of 23 and up 5.4% compared to the first half of 23, driven by a nine percent increase in the average ticket that more than offset a slight drop in the number of members and dental at the bottom of the slide, you can see that we have had a revenue growth of 4.4% and 4.2% in the period on the same basis of comparison, boosted by the increase in average ticket.

In the line of revenue from sales of medical services and other activities, we saw a reduction of 27% in the second quarter of 24 and 34% the first half of the year. The main factor that boosted the reduction in this line as a whole came from the sales of San Francisco Resgate and Maida, bringing our revenue from other activities to 0. Specifically in the sales of medical hospital services, we have been more selective with the aim of reducing exposure to credit risk and prioritizing our hospital capacity to serve our members in increasingly verticalized products, that is, those that prioritize our own network of care like we mentioned in previous calls, it's important to know that this line grew by almost 14% compared to the first quarter of 24, reflecting the typical seasonal effects of higher utilization.

Moving on to slide 5, let's see more details about changes in members and average ticket. We lost around 13,000 lives net a similar level to the previous quarter. This reflects a gradual slowdown in the levels of cancellations from previous quarters. Our gross sales remains very strong, performing above 490,000 new lives in the quarter. These are high quality contracts with more verticalized products and a healthy pricing in line with our portfolio sustainability paradigm. On the other hand, cancellations of 460,000 lives in the quarter are still dynamic. The result of not only the readjustments that were necessary for the economic balance of the contracts, but also of the processes of optimization, verticalization and regulation of the accredited service network.

As Jorge mentioned, it's worth noting that this quarter, for the first time, gross sales exceeded cancellations. Showing that we are on the right track to resume our organic growth, we are more optimistic about growth looking forward, but without this costing us any flexibility in our pricing discipline and portfolio profitability.

At the bottom of the slide, we can see the improvement of average ticket up 9% between the second quarter of 23 and 24, in the first column net price, we had an increase of almost 9.1%, which reflects our tariff discipline and price adjustment efforts already net of the effects of increased verticalization and coparticipation in existing contracts. Compared to the first quarter of 24, the ticket grew by 2.5% due to the concentration of anniversaries of contracts with HMO's, as well as a better performance of mass market products which have a higher average ticket than corporate products. In the second column, we have -0.5% which we call mix or miscellaneous which represents the net difference in the average tickets of incoming contracts, gross sales and outgoing contracts, cancellations. This change is the result of our commercial focus and greater demand for more verticalized lower ticket products while cancellations are concentrated in contracts with higher tickets but with greater exposure to the accredited network as we mentioned in previous earnings conference calls. More recently, we've seen a certain migration of lives and insurers with higher tickets coming to our product right in the middle of the pyramid with PPO and HMO components.

All of the movements mentioned above are part of the company's strategy and the plan to recover our historical margins, which is being carried down with rigor and discipline.

On slide 6, we can see our cash MLR of 70.5% in the quarter, a significant improvement of 3.4 p.p against the second quarter of 2023. As compared to the previous quarter, this indicator is up by 2.5 points, reflecting the seasonal growth that was expected and higher utilization that is inherent to our segment. This includes emergency appointments, tests and admissions related to the virus diseases that are typical of this period in addition to the fact that we had we had fewer holiday in this quarter. This year, exceptionally we saw significant increase in dengue fever cases in some regions.

Looking at the first half of 2024, we saw an improvement of 3.9 p.p. compared to the first half of 23 positively overcoming the implicit seasonality of these periods in line with our goal of always trying to overcome seasonality this journey of gradual and responsible margin recovery.

This also reflects the various strategies we have implemented including successful price adjustment cycles and increased sales of more verticalized products. The company has worked hard to increase verticalization, standardized protocols, optimized the provider network and implement cost control and management measures.

These effects are clear in our verticalization rates as you can see in the chart on the right in the second quarter of 24 for plants that prioritize their own network, which we call HMO, verticalization was almost 82% in appointments and 79% in admissions, with 79% of admissions in total for example, the average of 83% in regional 1 and 75% in regional 2, we still have an opportunity to increase these indicators and we understand that greater verticalization and consequently less exposure to the accredited network is a factor that ends up reflecting in fair prices for everyone.

On slide 7, cash admin expenses which disregards the effects of long-term incentive plans, depreciation, amortization and non-recurring items we can see that the percentage of expenses in relation to revenue has remained stable in recent quarters and slightly better than the second quarter of 23.

The second quarter so an increase of just over R$14 million which was mainly due to the increase of R$37 million in contingencies for acquired companies and incremental contingencies for outcomes that were unfavorable to the company as well as R$8.7 million in location and operation, which are expenses with concession areas, travel and accommodation in the readjustment of technology infrastructure in the context of system implementation and turnarounds.

On the positive side, there were two effects that are worth mentioning:

- R$33 million in 3rd party services including R$49 million in capitalization of investments in technology and R$6.5 million and reclassification of expenses to costs, both referring to previous periods. The first quarter of 24 was negatively impacted by R$14 million and IT expenses related to the implementation and system integration process affecting comparability.
- We also had R$14.5 million in other incomes in which the company was able to renegotiate and settle in advance the retained installments of two acquisitions in those negotiations, we always evaluate the potential contingencies versus the balanced payable in a conservative manner.

And having said that I continue to reinforce this we should see an erratic behavior in the coming quarters for G&A, which is normal and expected since the expenses related to integrations with turnarounds and system implementations that involve support staff, travel, accommodation, temporary coexistence of legacy systems with new systems can cause this line to behave more upwards or downwards. We are confident that there is room for improvement through initiatives that we will undertake as these integrations stabilize. These are initiatives that cut across G&A lines and we expect to reap the rewards of those from 2025 onwards.

Moving on to sellings expenses on slide eight, we see stability year over year in comparison for the quarter and for the first half of the year. Looking at the first quarter of 24, we see a reduction of just over R$55 million in the second quarter, mainly due to the positive impact of R$66 million on the provision for bad debt line. On this amount R$15 million relates to extraordinary receipts for SME and individual clients the result of a major new campaign which we are undertaking, which reduced the company's delinquency levels and consequently provisions in the quarter. In addition R$20 million came from bank reconciliations of receivables from previous periods. In the first quarter of 24, R$32 million were also provisioned on a one-off basis, an amount that was not repeated in the second quarter which affects the comparability with the second quarter.

These amounts were partially offset by an increase of R$11 million in the advertising and publicity line due to the institutional campaigns carried out between March and May focused on strategic locations for growth and retention.

On the next slide, our Adjusted EBITDA was R$958 million this quarter, almost R$2 billion in the first half of the year, significant increases of almost 60% compared to both the first, three and six months of the year of 2023, margins are also close to the historical pro forma levels of the combined company.

Our adjusted net income rose 121% in the second quarter of 24 against the second quarter of 23 and more than 290% in the first six months of 24 compared to the first six months of 23 because of the factors I already mentioned.

On slide 10, you can see that in the second quarter of 24, cash increased by a net R$490 million of which R$307 million came from free cash flow, R$1 billion from the raising of the 7th issue of the debentures and R$200 million from income on financial investments, which were partially offset by payments of R$396 million with retained M&A installments and R$518 million with interest on our debts.

In free cash flow, we started from R$958 million of Adjusted EBITDA and R$120 million to from rents and consumptions and working capital. This consumption of working capital is seasonal and varies from quarter to quarter. The main points that affected working capital this quarter were the disbursement of R$50 million in IRPF and INSS related to the payment of the 2023 variable compensation that occurred in the first quarter of 24 and the increase in revenues from customers receivable of just over R$50 million in our medical hospital services sales business. And the remainder in judicial deposits that where the company has proactively increased this practice to minimize the potential impacts of fines and interest during the course of the proceedings. If we adjust the operating generation, but just one of the elements mentioned above, the IRPF and INSS our generation would be above 60% in line with the company's historical conversion parameters.

IRCS for the quarter was R$47 million, although current tax was R$84.5 million. There is a shift between calculation and actual disbursement.

CapEx was R$185 million with the resumption of a stronger pace and verticalization and significant developments in IT. Our historical pro forma CapEx before the pandemic was around 2.5 to 3% of gross revenue considering our recent as recently announced BTS transaction with Riza we have freed up R$300 million in CapEx for 2024, which opens up interesting options to accelerate other projects that were in the allocation pipeline all within a prioritization regime that takes into account the sufficiency of care in some locations in addition to verticalization with a view to more accurate cost and quality control in others. Our CapEx projection for 2024 in this sense should remain around R$700 million.

On slide 11, M&A activities consumed around R$400 million with payments of retained installments detailed here for each one of the assets. There was also R$90 million corresponding to the initial installment of the agreement with the seller of Notre Dame Intermédica, an arbitration dispute that we inherited after the business combination so we still have monthly installments up until December 25 totaling R$356 million.

In the financial activities section we generated almost R$680 million. We raised the net amount of R$1 billion in the context of the company's 7th issue of debentures held in May 24 optimizing our cost of capital, there was also R$200 million in income from financial investments, reflecting responsible and optimized management of our cash above the CDI rate for the period and last but not least R$518 million in interest and principal on the maturities for the period.

This is what we want to continue doing for our financial management conversion and robust cash generation. There are important to increase our level of verticalization and qualification of our own network in a strategic location supporting our commercial strategy and maintaining our gradual pace of deleveraging quarter after quarter reprofiling our debt as necessary to maintain strong cash levels, this quarter, we reached 1.03 times EBITDA in the calculation of our contractual financial covenant as mention in the beginning we've reached this EBITDA and we'll continue to reduce it.

Moving on to the last slide, before we open up for questions, we have the regulatory requirements as a reminder these are only applied to individual operators.

So on the left you can see that free cash increased by R$660 million of which R$590 million was from the increase in the cash position and the inclusion of almost R$150 million in real estate as collateral allowed by ANS regulation, freeing up more tight cash.

On the negative side, there is an increase of R$75 million and required technical provisions and the breakdown of this increase is the reduction in adjustments to the balance of the reimbursement to SUS in accordance with regulation and the increase in medical bills received at the end of the quarter affecting PESL.

In regulatory capital on the right-hand side, we saw substantial increase that was a R$1 billion net increase in capital of the operators and further R$675 million from surplus in operating results.

It's worth mentioning here the reverse incorporation of BCBF, one of the company's subsidiaries which after all its effects had a net increase of R$142 million with this merger we eliminate some inefficiencies and we kick start the pass of the many mergers will carry over the next few years, especially in the NDI vertical.

Anticipating a potential question, this incorporation of BCBF affects the CBR which is risk-based capital, because this methodology does not only take into account underwriting risk, which obviously this did not apply to be BCBF because it's an intermediate holding company, but also involves additional risks such as credit, cash, among others, in the system of actuarial calculation of risk based capital.

Thank you once again. I hope this presentation has been useful for you to understand our financial numbers and we are all here available for you should you have any questions. Jorge, Guilherme and myself can answer any questions you might have. Thank you very much.

Q&A

Operator

We'll now start the question and answer session for investors and analysts. When your name is called, they prompt to unmute, your mic will pop on your screen. Please unmute your mic and ask your question.

We ask you to please ask all your questions at once and limit your questions to two per analyst. Our first question is by Vinicius Figueiredo, sell side analyst from Itaú. Vinicius, go ahead, please ask your question.

Vinícius Figueiredo (Itaú BBA)

Good morning, everyone. Thank you for taking my question. I'd like to start by praising your earnings release, it's now very clear and self-explanatory and this has helped us in our analysis, so congratulations to the whole team.

Now I'd like to explore two topics. First, I would like to understand a bit of your MLR performance in Q2. You came from a quarter in which you had many rollouts of systems in hospitals, as you said with, you know, probably more adherence to protocols and greater cost efficiency, now in the second quarter, have you seen any gains related to that or do you expect the effects to be seen only in the second half of the year? Can you tell us about how this has helped in your MLR numbers throughout the quarter? Like month after month?

And now a more specific question. When we look at the cash generation of the company, something I would like to explore is the line of deposits and judicial blocks. There has been an increase in this line especially when we look at civil lawsuits, is that an externality? Have you seen more lawsuits or is this because of a more conservative posture at the company in this specific quarter, do you expect this to happen again in the second half of 2024? Thank you.

Jorge Pinheiro – CEO

Hi Vinicius, thank you for your questions. I will start by talking about MLR and then I'll turn the floor over to Luccas.

So, speaking specifically about the benefits of the system deployment in our own network we have done this deployment in full here in Sao Paulo, but before that it's important to mention that the MLR that we have achieved for the first half of the year, which is 69, if we deduct 1% which was the effect we had because of the inclusion of new therapies in ANS's list, especially autism therapies I mean we would be at the pre pandemic levels.

Spite of that, there is a lot yet to be done in terms of verticalization, a lot to be implemented in prevention projects which are running at full steam with new projects and the use of artificial intelligence to define best practices and centralization of units. So there's a lot to be done in MLR and we have a very robust plan in that area.

So yes, we have already seen some significant gains as we deploy these systems in our own network, but the full fact will only be seen when we implement these systems in HMO's, because there is full integration between what is done in HMO's in the operator in our own network. So yes, we have already captured a few gains, but it's only after implementing the systems in October, that will see the full effect with that full integration with the operator. An example of that is prevention programs. Once we do that, we can capture gains in the operators because the outpatient systems are in operators so we can close the care loop of all of our programs. So yes, there's a lot to be done and a lot of opportunities of gains from more verticalized and integrated systems. Now Luccas will answer the other question.

Luccas Adib – CFO

Vinicius, thank you for your questions and we need to thank you for your question and for giving us the opportunity to give further details about this topic. We've been trained to break down our cash numbers so that things become very clear to you.

Specifically about this column, we have two main factors there. The 1st is related to RESUS. This was a change in the legal strategy of the company in order to stop multi-interests and discuss in court certain topics, so part of this comes from there and the other part, which is more representative in the whole, is related to civil lawsuits, judicial deposits and civil lawsuits. So here you can see lawsuits in which the company thinks they have a right and we make the deposit proactively and we also have judicial blocks come in from these RESUS, yes, there is increased judicialization in this industry. People go to court to have access to health, and this can lead to the judicial block of certain amounts, and sometimes they are converted into judicial deposits and then we will discuss those demands in court. So these are the two main vectors. The first broken down into two fronts. Representing almost the whole amount of judicial deposits that affected our working capital for the quarter.

Vinícius Figueiredo (Itaú BBA)

That was very clear. Thank you for your answers, Jorge and Luccas. Just one clarification here. I understand the nature of this increase in judicial blocks and cases that are taken to court but about the recurrence of those from now on, is this a new level that you expect from now on?

Luccas Adib – CFO

Well, it's hard to say, Vinicius. We don't expect to see this recurring in the future. This has escalated from the first quarter to the second quarter and we don't expect this to happen again, but it's hard to say this for sure. We'll have to see the coming months, of course, we have many internal conversations, and we review our methodologies, but I can't say how this line will behave in the coming quarters unfortunately.

Vinícius Figueiredo (Itaú BBA)

Ok, great. Thank you very much. Have a great day.

Operator:

Our next 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, Jorge, Luccas, Guilherme and other attendees. I also have two questions. The first one is related to slide #3 about a location that I believe is very important in your growth plan, Minas Gerais. You said that the integration process has been completed there and that you are now operating with a better structured network and a more controlled complaint level. Now can you give us an update about your guidance to grow in this state in the next two years? Lifecenter, Vera Cruz or Otaviano Neves, do you think that the current occupancy level of those assets is enough to support a growth of lives in that location? And what about the competitive environment in that location? You have a significant competitor there with over 50% market share and the rest of the market share is quite spread. So do you aim to attack that spread market share or are you aiming at this competitor that has a more relevant share? Can you tell us about your growth plans in the state of Minas Gerais, please? That's my first question.

Now the second question is more about the results. About the ticket 9.1% year over year, what is the trend? Slowed down in regional 1, you have more mature contracts in terms of margins in the North and Northeast. So just want to understand how much the contracts you have in those regions have already been readjusted and are now at a more compliant level or not. I just want to understand how much this 9% ticket can be seen as a good reference for the rest of the year. Thank you very much.

Jorge Pinheiro – CEO

Hi, Gustavo. Thank you for your questions.

About Minas Gerais, this is a very strategic location for us. We entered the state in a broad and complex way. We have made acquisitions of the Promed group that included three operators and one affiliate and then NDI made another acquisition there of an operator that had its own network. We had made other acquisitions in Divinopolis, Hapvida had made another acquisition of RN in the state and then we had another acquisition by NDI in the city of Patos and so on and so forth. So up until recently we had a number of operators with their own networks that were broad but still very fragmented. So our strategy was to organize this portfolio, we suspended sales and revisited portfolios in many of the cities where we did not have our own network, some of those operations were selling previously in many cities that were not our scope, our focus and we installed ER's is Santa Efigência case, we complemented acquisitions with Otaviano, a reference unit in the city of Belo Horizonte where we did not have a maternity hospital yet and then at the end of the year we finish the complete integration now below BH is one single body managed by one single system and with a new portfolio that focuses. Mainly on sales for the greater Belo Horizonte area where we have our own network with great growth capability, but not only in the greater metropolitan area, but also in other regions where we have our own network like Divinopolis, Poços de Caldas, Triangulo Mineiro, Alfenas, Varginha. So, our portfolio is much more focused where we have our own network, but in corporate plans, we can sell for the whole state of Minas Gerais because we do have accredited network all over the state. So that's a very promising state for us. We have gone through this very complex and difficult phase of integrating with products that were already in the market and now we see great opportunities for growth in the whole state of Minas Gerais, particularly in locations where we have our own network.

With regards to average ticket, we have just implemented a cycle of readjustments completed in April in our existing portfolio, at the level of around 13%, this was done quite successfully and way beyond these measures taken we had many other activities such as the possibilities of implementing coparticipation or offering more verticalized products coming from products with broader networks to our own networks. So, in many situations, we swapped readjustments for network review and that benefited our own network and this whole plan was implemented successfully. We're now starting a new readjustment cycle, which should be 2points below last years, but still above 2 digits. And this cycle started now in May 2024 with a greater need for regional 2 and a lower need for regional 1, but the consolidated numbers are expected to be above 2 digits with an inflation rate below 4%, those readjustments going to be needed and enough for us to continue diluting costs and expenses throughout this new journey that started now in May and there is no concentration of anniversaries that will hit regional 1 more than regional 2. Because that was your question, right? But I talked about readjustments in a broader way. And as you saw, we are less exposed to the accredited network, so with the lower inflation rate and the readjustments we'll be able to continue diluting costs and expenses.

Gustavo Miele (Goldman Sachs)

That is very, very clear. Thank you very much, Doctor Jorge. Have a great day.

Operator:

Our next question is by Mauricio Cepeda, Sell side analyst at Morgan Stanley. Will open your mic so that you can ask your question. Mauricio, go ahead.

Mauricio Cepeda (Morgan Stanley)

Doctor Jorge, Luccas, Nahuz. Thank you for this opportunity. I have two questions. The 1st is about growth avenues, it's clear that you have rebalanced your tickets. You are now at a good position of the claims for member are better controlled now. So my question is what can be done now to increase the number of members? I see that small and medium businesses plans in your portfolio have not been growing as much as the rest of the market, do you see this as a possibility for you? And in the greater Belo Horizonte area and in regions where you have enough verticalization, wouldn't that be a good case for growth now that you have a better MLR ratio?

And my second question is about the build to suit. Can this be a new avenue to accelerate verticalization throughout the country even more? Thank you very much.

Jorge Pinheiro – CEO

Hi Cepeda, thank you for your questions. Yes, we have completed this phase as we have made clear to all of our investors and to the market as a whole of reviewing portfolios and that review was completed last April. From April onwards our commercial area has been very responsible, but also very excited because the corporate channels are doing really well month after month we have seen a very good performance in our corporate channels.

On the retail channel, we have not achieved our goal yet. Retail is at around 89 to 90% of our target, but it's growing and we expect this to gain momentum. So July was better than June, which was better than May, which was better than April and that's, you know, for retail. So it's an upward trend and we're hopeful if the retail channel has a similar performance to the corporate channel, considering that the cancellations are going down. We have reached historical levels of cancellations at the company now and with a good control if the upward trend in the retail channel continues, we see a great chance of having a stronger growth.

Still talking about retail, we have just launched a new portfolio. Products focused on the retail channel, so individual and small businesses these are more district products or neighborhood products, so we offer hospitals in the region and they're based on family physicians and since the price of these new products is more attractive and we have a low level of complaint with great acceptance, we believe that this can boost the retail channel helping us to achieve our targets and this could create a virtuous cycle of growth. But we'll see how this unfolds in the coming months.

Now Luccas is going to talk about the build to suit, but I can already tell you that the company is getting ready after we were able to have better discipline at the company and have robust cash generation quarter after quarter and having consistent deleveraging quarter after quarter because of that cash generation, we have started to dedicate more resources to expand our own network.

So we now have projects in Recife, we're going to open a major hospital, so in the beginning of next year, there we have just announced the lease of a large hospital in Manaus and the build to suit model will help us expand our own network in Sao Paulo and Rio de Janeiro with two hospitals. There will be another hospital opened by January here in Sao Paulo and we have projects to open hospitals in the Center West region and expand their own units and the ABC region of the state of Sao Paulo, we also have the opening of ER units in Sao Paulo. So very robust plan to expand our own network. This will make us more competitive because having our own units, we can be more aggressive, commercially speaking and bring better margins. So, Luccas will now comment a little bit more on the BTS.

Luccas Adib - CFO

Cepeda, you fully understand what our purpose is here. We like to win all games and do many things at the same time. So, with this BTS strategy we have many strengths. The 1st is to accelerate our verticalization capacity creating an avenue here and this BTS is not supposed to be one-off. We want this to be medium to long term so that we can have this verticalization capacity whenever we need and at the same time, we have space to continue with our deleveraging process, so we deleverage the company, we accelerate our CapEx projects and the third point that is also very important here that takes into account our optimization structure within the group is that our holding has revenue per equivalence and our operating units, which will recognize the right of use in those BTS's where we have the operating centers. So, there is intrinsic utilization in this operation considering this difference between the reference revenue per equivalence and operating revenue. So, that's another strength in this BTS structure, but the idea is that this becomes a journey and not a one-off project we want to be able to have some BTS’s in order to advance in our strategy of advancing our own network to support our commercial strategy.

Mauricio Cepeda (Morgan Stanley)

Thank you very much. Thank you for all of these details, Jorge and Luccas.

Operator:

Our next question is by Samuel Alves, sell side analyst of BTG Pactual. Open your mic so that you can ask your question. Samuel, go ahead.

Samuel Alves (BTG Pactual)

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

Just I just want to make sure I understand it right. The first quarter you had an IBNR reversion and the provision for bad debt as well, which boosted your results. Do you see these reversions as a result of the integrations and system deployments that you have made, increasing verticalization, improving collection mechanisms and so on and so forth? To understand if these lines will be recurring or not.

Now my second question is: you have been talking a lot about your growth potential. So, can you give us a geographical heat map and what locations do you have the best opportunities, Rio de Janeiro, Sao Paulo, or Minas Gerais? Can you rank your main growth targets, please? Thank you very much.

Jorge Pinheiro - CEO

Hi, Samuel. Thank you for your question. I'll start with your last question. In places like Fortaleza, where the company has over 50% market share and is still growing, and with investments reserved, of course the greatest volume of investments. That the company will do not only through our own proceeds, but also through operations such as the BTS one that we have announced will happen in Sao Paulo and Rio, in the Southeast region in general, this is where we believe we can have the greatest growth even though we continue to make investments in expanding our network, I haven't mentioned, but in Belém, for example, we're going to open a hospital that was closed it's going to be reopened. We have contract signed with a major industry there starting in January next year. So even in locations where we have a large volume of lives, we believe that we can continue to expand and we're going to make investments across the country. But summarizing, the southeast, Sao Paulo, Rio and Minas are the regions where we can see the greatest growth opportunities and that's where we're going to expand our network the most. Luccas?

Luccas Adib – CFO

Hi, Samuel, thank you for your question. So, talking about recurrence, well, it's a bit hard to talk about recurrence in these two lines IBNR and PDD. IBNR as we continue our verticalization strategy and optimization we have new lives coming in, more exposed to our own network and with the optimization of our own costs. These are all factors that impact IBNR. So, if we try to deduct by IBNR to see what the EBITDA would be, I don't think this makes sense because I think this is fruit of activities that we have been implementing here and not an exogenous situation that has favored a certain line of our balance sheet. This is all fruit of this great work that has been done and as part of this journey, we can see of course reversions as part of this technical and actuarial provision of almost R$1 billion, so yes, we can see some volatility when it comes to IBNR reversion and when it comes to PDD, provision for doubtful debt, I read all the reports that you published overnight. Congratulations. It's amazing to see how fast you process all of this, but I saw some calculations being made saying “oh, let's remove this PDD because it can be one-off”. PDD was favored by a possibly one-off situation, but this is also fruit of actions we have taken internally to improve our receivables. We have an internal campaign being led by our treasure financial person, Rodrigo, to improve our delinquency level, so although this looks like a one-off thing, we are working really hard on this and we're not going to stop now we'll continue working really hard on this in order to improve our delinquency profile at the company. So, this is how I see when it comes to the reversion of IBNR and PDD this order.

Samuel Alves (BTG Pactual)

Thank you, Luccas and Jorge. Have a great day.

Operator

This concludes our Q&A session. Thank you very much for joining us for the second quarter 2024 earnings conference call. The IR team remains at your disposal if you should have any questions. Thank you all for joining and have an excellent day.