Conference Call Transcript
Hapvida
4Q23 Results

Operator

Hello everyone, thank you for waiting. Welcome to Hapvida's fourth quarter 2023 earnings conference call. Joining us today are Mr. Jorge Pinheiro, CEO, Mr. Luccas Augusto Adib, CFO and Mr. Guillerme Nahuz, IRO. Should you need simultaneous translation, this is available on the platform. Should you need it, just click on the interpretation button on the bottom toolbar and choose English. We would like to inform you that this conference 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. 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 questions 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 would like to turn the floor over to Jorge Pinheiro, CEO, who will start the presentation. Mr. Pinheiro, you have the floor.

Jorge Pinheiro – CEO

Thank you. Hello, good afternoon everyone and thank you once again for joining us to this conference call to release the results of financial year 2023 with greater focus on the fourth quarter of 2023.

First of all, I would like to publicly welcome our new CFO, Luccas Adib, who has been with us for almost five years now and has made many contributions to the financial area leading important projects and is now taking on this new challenge for which I am sure he's fully qualified.

Luccas, myself and the IR team Gleycianne, Rafael Sobral and Candido Neto, we are all here to share with you some details about the results of the quarter and the full year.

2023 was a very challenging year, but also won in which we learned a lot and had great achievements. We consolidated important initiatives to pave the way for improving our margins and in a firm and disciplined way, we maintain our recovery trajectory quarter after quarter. We have consistently and reliably executed our strategic plan, which we shared with you at the beginning of last year, always with the full confidence we have in our innovative business model, which has proven to be superior.

Let's get started. On slide two of the presentation, you can see an overview of the year and the quarter. Our net revenue in 2023 grew by just over 10% getting to R$27.4 billion, this is the result of coherent and responsible pricing in new sales and readjustments in existing contracts. We went through a period of extensive review of our portfolios, which resulted in a temporary reduction of around 3% in our healthcare membership. It's important to note that our gross sales performance was very close to historical levels, attracting 1.7 million new health care members over the course of 2023. In dental plans, our membership continued to grow with the addition of 71,000 lives. As a result, we ended the year with 8.9 million and 6.9 million members in healthcare and dental plans respectively.

Our average ticket grew by 11% year over year. This was another fundamental front in 2023 the continued implementation of our pace of readjustments in existing contracts, which was necessary for their respective financial balance, aiming for more profitable and sustainable levels for our portfolio as a whole. We're setting a good pace of average readjustments. And the cycle, which began in May last year and will end now in April.

One of the main highlights of the year and the quarter was the evolution of our cash MLR. We saw a significant improvement in the rate up 3.6 percentage points in 4Q23 against 4Q22 and 1.5 percentage points against the full year of 2023. The MLR, which for the first time broke the barrier of 70%, was 69.3% the best for a quarter since the business merger, an important milestone for the company, it's important to note that are pre pandemic proforma historical average for the second-half of the year had an MLR that was 80 basis points lower than that of the first half of the year. In 2023, the second-half of the year was 250 basis points lower than the first. That is our MLR actually moved to a whole new level over the course of 2023. A more favorable macro scenario, a coherent and rational pricing and readjustment policy, a consistent increase in verticalization and the continuous capture of synergies have made it possible quarter after quarter to maintain our trajectory of returning to our historical MLR levels were not there yet, but we're much closer now than we were at the beginning of 2023.

With the proper management of sales and admin expenses, which also had important dilutions both in the quarter and in the year we reached an Adjusted EBITDA of R$2.9 billion in 2023 and R$950 million in 4Q23. These are impressive increases 47.6% against 2022 and 85.7% against the 4Q22. Our adjusted net profit also showed significant growth up a bit more than 38% year on year and over 345% in the quarter compared to 4Q22.

Turning now to capital structure, there was also a very important evolution there in 2023. Throughout the year, we took advantage of market windows to raise some funds. There were two debenture issues which together totaled R$ 1.75 billion with the rating of both reaching the maximum investment grade AAA confirming how solid the company in April last year, we successfully concluded. Our third follow on for a total of R$1.1 billion with the Pinheiro families, R$360 million anchor also in line with my family's long term commitment, we acquired 10 of the company's hospitals for R$1.2 billion in a sale and lease back operation. All of these operations were aimed at rationalizing our capital structure and optimizing our debt profile. This, together with improved operating results and solid cash generation has led our leverage level to improve from 2.4 to five times at the end of 2022 to 1.38 times now in 4Q23, which is a very healthy level in one of the lowest in the supplementary healthcare sector in Brazil.

Finally, still on slide two, let's focus on CapEx. The improvement and increasing in our own Healthcare Network remains one of our main commitments to our clients, investments totaled R$441 million including 50,000 square meters either built or renovated throughout the year. We ended 2023 with a total of 796 care units including hospitals, emergency rooms, clinics and diagnostic units throughout the country, constituting an unparalleled structure in our own healthcare units. The amount dropped compared to 2022, in line with our goal of cash preservation and deleveraging.

Talking about CapEx in 2024, overall our goal is to complete the implementation of systems in Sao Paulo to renew and upgrade our asset base and to continue our verticalization journey including some major projects. Our investment plan for the year includes 4 new hospitals that will expand our capacity and allow us to absorb the growth in membership, which is something we expect to see happening throughout 2024. Our pipeline includes a highly complex General Hospital in Recife state of Pernambuco, which should be opened at the end of this year. For the beginning of next year and will be a reference in the city, two other significant investments are part of the process of expanding our own network in Sao Paulo we're going to reactivate one of our hospitals, Analia Franco, in Villa Formosa neighborhood, which is due to open in the second-half of the year and will have around 90 bats. We should also start construction of a large and beautiful hospital in a strategic region within the Sao Paulo expanded downtown area, which should be designed for more than 200 beds. Both facilities will enable us to verticalized an important share of the region's. Insurance claims. Finally, we have another project that will see us massively expand. Our own network in the greater Rio de Janeiro area a region where we see an enormous potential for growth and where we still have little presence. The Greenfield projects in Sao Paulo and Rio de Janeiro are preliminary and are currently in the prospecting phase for land, buildings and assets, with openings expected for 2026. In short, we have a broad front of investments that will give us a privileged platform for local competition. It's important to mention that our investments including these hospitals I've mentioned will be fully funded by our operating cash flow. My whole family and I are comfortable with the companies gradual and organic deleveraging process.

Moving on to slide three, we would like to highlight our permanent focus on quality of care. We are showing our IDSS, which is the official index of the National Supplementary Healthcare Agency that measures the quality of care of al healthcare operators in the country, you can see that of the five largest operators in terms of number of members, Hapvida and NDI outperformed the average of the other three operators that make up the top five. We understand that hospital quality is a very important factor, but one that is little publicized here in Brazil. As the company is verticalized and integrated, it internally monitors dozens of healthcare indicators and here on this slide, we have chosen a few for you to follow. With comparisons with their respective benchmarks when they exist, for example emergency room waiting times. Not only is this not measured by the emergency departments of the hospitals on the market, but there isn't even a commitment on their part to see the patient within a certain time frame, while here at Hapvida and NDI in all of our 87 hospitals, we have a commitment and internal targets to serve our clients in no more than 15 minutes. Our internal target is to try to have at least 75% of patients seen within this time frame. And here with complete transparency you can see our performance month by month over the past year. Another important indicator is SMR, which stands for a standardized mortality rate, an indicator and intensive care units used all around the world. Here the lower the index, the better the performance. You can see that we are consistently better than a AMIB’s average. AMIB is the Brazilian Association of intensive care media. In fact, it's quite common for our indicators to perform better than their respective benchmarks. Finally, you can also see here an indicator that we're very proud of, which is that of natural childbirth. The higher the number, the better. You can see that we also consistently outperformed and ANAHP’s average, which represents the largest and most renowned hospitals in the country.

Moving on to slide four, I want to share with you a bit more about the progress in our integration processes. In 2023, we implemented the companies proprietary systems in 82 care units including our assets at Central Clinico Gaucho in Rio Grande do Sul, Clinipam in Parana and Santa Catarina, some hospital assets in Rio de Janeiro and at the end of the year at the NDI operation in Minas Gerais. For 2024. We also have important challenge, but we are confident that we'll be able to deliver since successive deployments throughout 2023 have allowed the company to evolve in its systems. Turnaround processes using its learnings to continuously improve. Based on this acquired knowledge, we have decided to change our planning to smooth out the integration of Sao Paulo's our largest location in terms of number of units and membership. We changed the initial plan where we would make the turn around on a single date to a phased integration process bringing forward some stages such as the implementation in some care units with gains in the standardization of protocols and procedures. Control of customer journey and full visibility of all of our care indicators. The final stage of this turnaround of the operator is expected to happen in October. Our first wave, which took place now on March 1st, covered 23 units, including five hospitals and was very successful. At the end of this journey, which should be completed by the end of the year we'll have a fully integrated company with apps, features and controls that are paramount for our management.

Before handing the floor over to Luccas, who will give you for the details about our results, I would like to conclude by stressing that we are prepared for 2024 of continuing the work that we started last year. In other words, we're going to work to strengthen our operations and continually recover our margins. We will remain firm in our purpose, always preserving the company's sustainability in the very long term. Once again, we would like to thank our staff, doctors, dentists, brokers, suppliers as well as the Board of Directors, shareholders and above all our clients, for their trust in us. Luccas, you have the floor.

Luccas Adib – CFO

Thank you, Jorge. Good morning, everyone. Thank you for your participation it's a great pleasure to be with you on my first Hapvida's earnings conference call.

I'll get started on Slide 5 talking about net revenue. Let's focus on the chart here on the top left you can see that consolidated net revenue grew by 10.1% from 2022 to 2023. This is the result of our successful price readjustments strategy aligned with our goal of portfolio sustainability and margin recovery.

As positive drivers of net revenue, in addition to the readjustments 've just mentioned, we acquired HB in January 23, which added R$334 million in revenue for the year. On the negative side, we had a shrinking membership, a consequence of higher readjustments and stricter underwriting, in addition, but less significant overall, there was a drop in revenue from the sales of medical services, which I will detail later on.

Moving on to the top right hand corner, our health plan revenue was up 8% against 4Q22, reflecting the sequential increase in the average ticket which was up 10.8% year on year, the 8% is less than the ticket increase due to the shrinkage of the portfolio which fell by 2.5% year on year and also saw changes in product mix in view of the profile of entries and exits and the adoption or increase of copayments.

In dental here at the bottom of the slide, you can see that we had an increase in the average ticket of 7.6% year on year and close to 1% growth in the average number of members in the quarter.

Concluding the slide are other revenues in 2022 were made-up of revenues from sales of hospital services and other activities such as San Francisco Resgate, Maida Health and our Occupational Health business. This line fell in 2023 as we decided to sell the company's non-core businesses, which happened at different times of the year. These three businesses that were sold contributed around R$60 to 65 million in revenue per quarter. In 2024 will no longer have this revenue, which would be around R$250 million for the year, leaving only the operation of selling medical and hospital services to other operators.

Looking at this revenue quarter against quarter, in addition to the seasonal slowdown in the quarter, we were also more selective and will continue to be so in credit risk while prioritizing. Our hospital capacity for use by our members, this trend should remain with us throughout 2024.

Focusing a little bit more on changes in membership and average ticket now on slide number six. We lost 61,000 lives net, which is a smaller net loss than we have seen in previous quarters. We have been explaining the reason why we've had net losses of lives over the last few quarters, but it's worth remembering and summarizing the reasons one more time. First, the company and the industry have been going through a period of needing stronger adjustments. Second, some changes in the accredited provider network and in some products, despite being necessary to rebalance our contracts, cause additional friction. Third, there was a rationalization an optimization of the company's strategic causing us to lose some relevant collective contracts. 4th, we experienced a more aggressive competitive environment than historically, notably in the second half of 2023 and in the South and Southeast regions, with some competitors behaving in an anomalous way, fifth and last, several of the company's operations stemming from acquisitions, notably in the NDI vertical were integrated over the course of the year with full replacement of their systems and implementation of Hapvida without protocols. The sum of these factors naturally generates some level of cancellations, and this is what we saw in the period as a result in the quarter there were cancellations of 431,000 lives almost entirely offset by our gross sales, which continue to be strong add 428,000 member store base. Turnover, which reflects the net movement that is highers miners terminations within existing collective contracts is still in the negative with the loss of 58,000 lives and natural consequence of our exposure to certain sectors.

As for the average ticket at the bottom of the slide, we saw an increase of 10.8% from 4Q22 to 4Q23 as I mentioned which is the result of the 11.5% recomposition of tickets offset by -.8% due to the product mix, which is the result of our commercial focus on selling more verticalized products with lower tickets at the same time as cancellations that are concentrated in contracts with higher tickets but with greater exposure to the accredited provider network with higher MLR.

All of the movements above are part of the company's strategy and that plan to recover our historical margins which continues firm into 2024 and is being carried out with great rigor and discipline. I think that if in 2023 the watchword was resilience in 2024, it will be disciplined.

On Slide 7 we'll see how this connects with our main operational performance indicator, which is MLR. As you can see on the chart on the right, I apologize, we're now talking about slide seven.

We had a cash MLR of 69.3% in the quarter, which is a drop compared to the the quarter and the second quarter and a greater drop than what seasonality would indicate for this period. If we look at the pre-pandemic history from 2017 to 2019 from the 2nd to the fourth quarter and MLR would usually show a drop of 330 BPS on average in 2023 as you can see, we improved by 460 BPS against the historical 330 from Q2 to 4Q.

That means that we were able to deliver improvements beyond historical seasonality. In other words, an actual reduction in MLR which is the result of the combination dozens of initiatives that the company started in 2023, such as readjustments, increases in verticalization, integration, implementation of systems and protocols in addition to the ongoing process of capturing synergies and best practices after the merger.

As you can see here in the chart on the right, we have seen a consistent increase in the verticalization of inpatient admissions appointments and tests representing an additional challenge since utilization volumes remain at a high level and have not decreased.

On the next slide, you can see cash admin expenses, which exclude the effects of SOP, depreciation and amortization.

We can see the gradual dilution of admin expenses in relation to revenue. It's true that the stronger readjustment helps with this indicator, but we also see a nominal drop over the course of the year. More than diluting the impact of inflation. We reached the level of 8.7% in 4Q23 due to the dilution, but also some one-off events that should not be repeated, such as a reduction in the personnel line resulting from the reversal of R$40 million and variable compensation that included employees who have left the company and the partial achievement of annual targets.

In 3rd party services there was a reduction of R$25 million in line with the other quarters of the year. Just as a reminder, in Q323 this item was pressured by R$19 million and expenses with the acquisitions from previous periods, systems deployments and developments and integration consultancies, expenses that should not be repeated.

We should still see some erratic and volatile behavior over the next few quarters, which is absolutely normal and to be expected since there are expenses related to integrations with system changes and deployments that involve support staff, travel and temporary legacy systems and new systems. Therefore, it's clear that we'll have room for improvement with initiatives that we must undertake as these integrations take place stabilized throughout 24, we should see this movement in relation to the integrations already carried out in 23 in the South, Rio de Janeiro and Minas Gerais and in 2024 for the integration of Sao Paulo. We're not going to disrupt anything that could generate turbulence in these movements which are being carried out very carefully and responsibly, as mentioned at the beginning.

On slide nine, we see a slight increase quarter on quarter but a small decrease year over year in selling expenses as shown in the previous slide, we reallocated R$9.6 million from personnel to sales of which R%7 million was made retroactively. We also had a slight increase in PDD mainly due to the provisioning of a client that we canceled in the middle of the year. Then we reduce the expectation of receipt with the increase in aging.

On slide 10, you can see our Adjusted EBITDA which was R$950 million in the quarter. As Jorge mentioned in the opening, this is the highest EBITDA for the combined company since the merger. It's a strong growth of 60% quarter on quarter, jumping from R$600 million in 4Q22 to R$950 million now, the growth is even greater when disregard some extraordinary effects from the previous year, such as the reimbursement and price adjustments of the acquired premium of R$87 million. This growth is reflected in the increasing revenue as we mentioned and the reduction in cash MLR and the dilution of admin expenses.

EBITDA margin for the year is up from 8% in 2022 to close to 11%, a substantial increase that is consistent with the ongoing trajectory of margin recovery.

Now moving on to slides 11 and 12 we have prepared two additional slides to help you understand the main cash movements in 23.

First, on slide 11, looking at the table on the bottom left hand corner, we can see a R$2 billion increase in the company's cash flow in 2023 which comes from the following: R$1.2 billion of free cash flow generation, another R$1.2 billion from financial activities and the consumption of R$405 million and M&A activities.

The free cash flow for 2023 resulting from the companies activities happened because of the following reasons and here I will breakdown the components that were previously grouped within the working capital item: Consumption of R$456 million with leases from rental contracts which were increased after the sale lease back operation; R$230 million and ANS regulatory deposits to cover the recess charges; R$115 million in tax credits on quarterly advances and tax withholdings such as income tax on financial investments and interest on equity, these credits are recorded as assets and will be used in the 2024 financial year; R$215 million in IR&S, although the current tax for 23 was R$191 million due to a slight gap between calculations and actual dismemberments; R$440 million in CapEx significant reduction compared to previous years, consistent with the strategy of preserving cash and reducing leverage while maintaining the quality and integrity of our own network. This is consistent with our strategy, as I said earlier, to preserve cash and reduced leverage, maintaining the quality of our own network even at a time of deleveraging and restricted allocation we managed to increase verticalization as you noticed, opening 3 hospitals, clinical centers and dozens of units for ASD care, as you can see, we converted just over 63% of EBITDA into operating cash of more than R$1.8 billion returning to historical levels on an annualized basis.

As for the M&A activities on slide 12, you can see that we had the payment of R$567 million for the acquisition of HB Saúde in January and receipts of R$151 million from the reimbursement of Promed experiences in 3Q23 and a R$108 million from the sale of San Francisco Resgate in August, there was a lot of movement in financial activities this year as we raised around R$1 billion in April in our third and fastest follow one aiming to strengthen our cash position and reduce leverage as well as R$1.2 billion in the sale and lease back operation in May, we also raised R$2 billion mostly in the ventures to extend the 2023 maturities which between interest and principal totalled R$3.7 billion. Finally, we had R$700 million and financial revenue generated on the company's cash position, a yield of around 12%, very close to 100% of the CDI for the period maintaining a conservative investment policy and disciplined risk management with a comprehensive surplus of collateral assets.

On slide 13, you can see the company's solid cash management quarter after. The fourth quarter 2023 cash flow is in line with what we saw in previous slides with the addition here of the payment of the 13th salary, which normally puts a bit of pressure in the conversion of EBITDA into cash in fourth quarters as well as the effects of the December turnover of accounts receivable with some payments is slipping into January, but nothing unusual here. Without these effects, EBITDA to cash conversion, which would have been close to 67% throughout the year, we made some divestment moves from some businesses that were not core to the company which I mentioned which helped us to deleverage and to focus on our core activities. As a result, the company has maintained its disciplined, gradual and responsible pace of deleveraging quarter after quarter, reducing our net debt over EBITDA from 2.4 to five times at the end of 2022 to 1.38 times, now in the contractual covenant of our issues.

Moving on to slide 14, the last slide of this presentation before we open for questions. We highlight the strengthening of our operation, which is reflected in significant and consistent improvements throughout the year in terms of regulatory requirements. We have been sharing with you over the last few quarters that the technical provision, which is what we have to deposit in cash equivalents for the purpose of ants collateral assets is stable at around R$3.1 billion. Our total cash in 4Q23 increased by R$1 billion due to the latest issue of the ventures that we settled in December 23 and the cash generation of R$308 million barrels, which was offset by the payment of R$674 million an interest and principal in the company's debt so if we exclude the effect of the last issue which was used to amortize the previous one that was due to mature in 1Q24, we ended 2023 with free cash after collateral assets of almost R$4 billion which is quite solid for our operation. Now let's talk about regulatory capital which we moan it closely. Here we compare our risk-based capital with adjusted shareholders equity in line with ANS normative resolution 526. We ended the year with a surplus of more than R$1 billion. All of the group's operators, including the smaller ones are capitalized and have adequate regulatory capital generating. And increase in their respective shareholders equity.

Finally, we have released our IFRS 4 audited financial statements are in the process of finalizing our IFRS 17 statements. We expect to release them in the coming weeks, but it's important to mention that for market comparability purpose, we'll continue to publish our release #4 together with the 17 financial statements to have the greatest transparency of our financial statements until the full integration is done, just like we did previously with IFRS 16, that's it.

Thank you for your patience. I hope this deep dive has been useful and now we're going to open for questions. Jorge, myself and Guilherme Nahuz will be here to answer your questions. Thank you again.

Operator

We're now going to start the Q&A session for investors and analysts. When your name is announced, a prompt to unmute your mic will pop up on your screen. You should then unmute your mic and ask your question. Please keep your questions to a maximum of two and ask all your questions at once, starting with Vinicius Figueredo, sell side analyst at Itau BBA. Vinicius, please unmute. Go ahead. You have the floor.

Vinicius Figueiredo (Itaú BBA)

Good afternoon, everyone. Thank you for taking my question. I would like to talk about two topics. The first one is profitability. You showed us several KPIs like cash generation, solvency, which are both at a good level, but I'd like you to give us an update about your priorities. Recovery of profitability and MLR closer to pre pandemic levels, are these still priorities for the company? Or you think that the levels that you have already achieved would make the company become a bit more aggressive, competitively speaking, to grow more from now on? And now the second question is about the branches in Rio, Minas Gerais and in the South that add 2 percentage points to cash MLR in the year. Can you comment on how these two percentage points evolved throughout the year, quarter after quarter? And do you think this was one of the main reasons why you were able to improve your MLR throughout the year or is do you think that with systems integration these two percentage points could converge here for the medium and long run?

Jorge Pinheiro – CEO

Hi Vinicius. Thank you for your questions. You mentioned quite a few issues, so if I forget anything just let me know. So first about MLR although we have seen a very consistent trajectory of expanding margins by reducing MLR, mainly we still see a lot of room for improvement and this room for improvement comes from different fronts, the readjustments. Journey, you know the cycle that started may last year and will end now in April and we'll start now a new cycle of readjustments starting in May this year, which is going to be, you know, smaller than last year, but still double digit and this is going to help us reduce MLR as well.

On the other hand, we have a strong pace of verticalization and many synergies to be captured. We have already started the integration processes here in Sao Paulo 20 something units have already been implemented and we see many standardizations and other protocols being implemented, so we should see yet another year of MLR improvement closing the cycle in April 25. In terms of competitiveness, the Company is preparing a new sales portfolio that should be launched still in the first half of the year and this portfolio will be much more focused on units in places where we have units with idle capacity in our own network. We have over 2,000 beds that are idle in our own network, so we are now about to launch these products that will bring efficiency because this will dilute fixed cost by using up our capacity in our own network. This is going to be, you know, with aggressive, competitively speaking and as for the acquired companies? In all of the situations we've been able to have operational improvement but each one of them respects their own integration base. In some situations, we need more verticalization in others the systems deployment was done recently. So there are still adjustments to be made and gains to be captured. So each integration has its own pace of synergy capture, but the good news is that we have had gains in all of them.

Vinicius Figueiredo (Itaú BBA)

Great. That was very clear, Jorge. Thank you. Thank you, Luccas, and thank you all very much.

Operator:

Our next question is by Fred Mendes, sell side analyst at Bank of America. Fred, please unmute your mike and ask your question.

Fred Mendes (BoFa)

Good afternoon, everyone. Thank you for your presentation. I have two questions as well. If we can go back to Vini's question about MLR, can you give us more information about the member cost? Because year over year this cost was close to 0. So with the price going up, MLR will evolve. It seems quite clear but you're getting close to a cruise ship speed now when it comes to costs, right? Or when, as Jorge has said, there is still a lot of work to be done when it comes to costs, I understand what Jorge talked about, better use of assets, but I'd like you to talk a bit more about cost. Now when it comes to taxes on gross revenue, it was from 5 to 4.7% and this quarter it was 4.3% much better. Is that efficiency coming from the integrations or was that something specific about this quarter. Just want to understand this a bit better. Thank you.

Jorge Pinheiro – CEO

Hi Fred. Thank you for your questions. I will answer your first question about costs. Yes, there's still a lot to be done. As I said earlier, we have a strong verticalization agenda to cover this year. When it comes to our own units, we're focusing on autism service in regional 2 we have exceeded 80% verticalization and in regional 2 we are at 40% and growing but we want to get to the same level of verticalization as regional 1 with the integration companies here in Sao Paulo. Every 30 to 45 days we have new rounds of systems deployment and this leads us to capturing more synergy. And we have other fronts in prevention programs protocol implementation best practices. There are many, many initiatives. Indeed, it's beautiful to see the number of initiatives that the company has in many different fronts, which have a positive impact on MLR and improvement in the quality of care. And this helps us keep good control on cost per life, but this is also impacted by the sales mix and also copayment, franchisee more verticalized, more corporate, or more individual. There are many factors there impacting the cost mix as well as the revenue. And Luccas will answer your other question.

Luccas Adib - CFO

Yes, Fred, you're right. Indeed, we saw an optimization of indirect text, especially in the Hapvida vertical with the movement that we carried out last year to incorporate the only care units and the Hapvida's the operator verticals so that happened because of an optimization in our structure and this led to indirect taxes, which impacted the numbers that you mentioned. So yes, this is fruit of hard work that we carried out here at the company.

Fred Mendes (BoFa)

Ok, great. That was very clear. Thank you very much and congratulations Luccas on your new position.

Operator

Our next question is by Leandro Bastos, sell side analyst at Citi. Leandro, please unmute your mic and ask your question. You have the floor.

Leandro Bastos (Citi)

Hi everyone, thank you for taking my questions. I have two questions as well. Can you talk about frequency? Here in the beginning of the year, we've seen many cases of dengue fever, so can you talk about frequency or anything that is impacting costs now in the beginning of 24 and now my second question, you talked about a toughest competitive environment in the South and Southeast here last year, can you give us an update about the competitive landscape now in 2024? Thank you.

Jorge Pinheiro – CEO

Hi Leandro, thank you for your questions about frequency, yes at the end of the first quarter, we see a typical and seasonal increase in frequency. You are used to hearing our reports about the rain season in Brazil that affect the North and Northeast in the beginning of the year and then the Midwest of the country, and then with the cold season we have the center in the South being impacted with seasonal viral infections. So yes, we saw an increase in frequency. This should not impact the first quarter, but this it's important to mention that this is within the historical volume respecting the typical seasonal curves that happen in Brazil. Dengue fever has been affecting some cities more than others and in other cities we see other typical viral infections of the season. The good news is that we are fully prepared in some units, like in Minas Gerais or Belo Horizonte, there has been hardly hit by dengue fever we set up units dedicated to this and with telemedicine we provide 500,000 appointments a month through our proprietary platform that was developed internally and that is fully integrated with all of our systems. So we're fully prepared to serve this higher volume, which is very typical of this season in Brazil. Now about the competitive environment indeed, last year we saw one or another player being a bit more aggressive, but today we see all of them being very rational require in readjustments that are needed to recompose their margins. This is what we see in the market today, so we don't see anyone else being artificially aggressive right now, all of the players are now more focused on readjustments. The good news, on the other hand for us is that historically our level has always required about 30% less readjustments than our competitors in the market in general. So throughout the year, we should benefit from this.

Leandro Bastos (Citi)

That was very clear. Thank you, Jorge.

Operator

Our next question is by Samuel Alves, sell side analyst at BTG Pactual. You have the floor. Go ahead.

Samuel Alves (BTG)

Good afternoon Jorge, Luccas, Nahuz. I have two questions here on my side. The 1st is about MLR. Jorge was saying that the first quarter has been seeing this seasonal pattern, now, can you explain a bit more about the seasonality with all of the acquired companies comparing the first quarter to the fourth quarter of the year and is the MLR level within historical levels? Comparing quarter to quarter. And now my second question about the numbers of the fourth quarter. We saw a reversion of tax provision in your tax risk line. Can you just explain? Why there's provision reversal reversion happened? That's all. And I would like to congratulate Luccas on his new position as well.

Jorge Pinheiro – CEO

Hi, Samuel, thank you for your questions about MLR for the first quarter, it's well in line with the historical behavior well in line indeed nothing here showing major reductions as compared to historical levels or increases. In the beginning of the year, January, MLR is always lower because of the holidays. But then in February and March, the volumes tend to grow in certain cities but this is within historical pattern. Nothing that is changing the pre pandemic seasonal behavior. 4Q and 1Q with lower volumes and 2Q and 3Q with higher volumes usually impacted by the seasonal occurrences. Now I turn the floor over to Luccas to answer your second question.

Luccas Adib – CFO

Hi Samuel. Thank you. Some tax processes left the provision and impacted assets and liabilities. At the close of the year, we see a more intense movement in these processes. We can give you further details about that later, but this is the basic concept for the movement.

Samuel Alves (BTG Pactual)

Ok, thank you, Doctor Jorge and Luccas, and have a great afternoon. Thank you.

Operator

Our next question is by Ricardo Boiati sales side analyst at Banco Safra. Ricardo, please unmute your mic and ask your question. You have the floor.

Ricardo Boiati (Safra)

Hi, Doctor, Jorge Luccas, Guilherme and all the IR team. My first question is about the readjustments that you expect for the next cycle, which is still at double digits as Jorge mentioned. Can you give us further details about what you expect in terms of readjustments for the corporate plans, individual plans, affinity? That would help us understand the dynamic for the coming cycle. So that's my first question. And my second question is the following n the integration process of and NDI in Sao Paulo. I want to understand the reason why you have phased out this integration. This is a conservative approach which is welcome in this operation, which is extremely important for the company, but was this motivated by previous experiences in the integrations that you have already carried out, or are you being more conservative here to try and mitigate the possibility of any disruption in the service provided here. Thank you very much and congratulations and good luck, Luccas on your new position.

Jorge Pinheiro – CEO

Hi, Ricardo, great questions. Thank you. So first let's talk about readjustment. We see different dynamics happening at the company. Regional one, North, Northeast and the Midwest have lower readjustment rates than they had last year and they are on track to achieve historical levels of profitability. Regional 2 requires a bit more readjustment even knowing that this readjustment is going to be lower than last year's. Of course, that will depend on the channel and the situation this could vary one to two percentage points. We're still working on the average combined readjustment for the whole company. Now about your question on integration. Last year we did a lot of integration activities starting with Rio de Janeiro in hospitals and then CCG we close the year with operations and Minas Gerais so our team is fine-tuned the best one happened in Minas Gerais with all operating indicators that we wanted to achieve. This was very, very successful. Of course, there are always many lessons learned, integration is always challenging, but considering our operational indicators, we characterize those integrations as very successful and the experience we had last year made us customized integration process in Sao Paulo rather than having one single date to deploy in dozens of units, which would require a lot of effort focused on one single date, we decided to phase out the process so we divided our own units into different phases and saved the operator for last so that we could have a more concentrated effort in that regional. The idea was to smooth out the process as much as possible. So that it is not as challenging. So we are very confident about this phased customized process for Sao Paulo. Our teams are prepared and we have all it takes to complete the integration process very successfully.

Ricardo Boiati (Safra)

Great. Thank you so much.

Operator:

Our next question is by Mauricio Cepeda, sell side analyst at Morgan Stanley. Mauricio, please unmute your mic and ask your question.

Mauricio Cepeda (Morgan Stanley)

Hi doctor Jorge, Luccas, Nahuz thank you for taking my question. Let's go back to MLR by member, but from a perspective of variability, we saw some variability in recent quarters specifically on this indicator, and of course there is seasonality and product mix factors that impact us, but in 2Q It seemed like the reduction trajectory has been taking place since 2Q. So do you think that we see this variability through all time because you still have some exposure to your accredited provider network since part of this? MLR is not under direct management, this impacts the variability? And now can you give us an update about what's going on in the commercial environment? What is the profile of the operators from which you've been gaining contracts? Cause I see that your gross addition is quite strong, so what is the profile of the operator that has been losing to you? And when you lose, what is the profile of the operator that you lose to? Thank you very much. Of course, you don't have to mention any names.

Jorge Pinheiro – CEO

Hi, Cepeda thank you for your questions. So about cost per life, this is quite simple, all of the initiatives and many of which we've mentioned here like verticalization which is quite strong and autism and in the coming months, we should have more outpatient units and more diagnostic units as well as ER's considering our level of integration of systems, protocols, area unification, all of that brings a lot of efficiency as we verticalize, we are able to reduce costs and this is a clear example of an initiative that reduces per capita cost, but it's always important to note that this varies according to the mix, for example, in recent months, we've been growing sales in corporate channels with a lower average ticket. And lower average cost naturally, but in recent months, we see that the retail channels are warming up and they have a higher average cost, but they haven't yet gone back to historical sales levels. We believe that with the recovery of the economy and the new product mix that we will be launching by the end the of the semester we should see a greater weight from the retail channel that have a higher average ticket, but also higher average cost and this mix is very important to determine average cost, as I said earlier, finally about competition I cannot give you any names. We closed major contracts in 4Q and 1Q, some of them already implemented and some still been implemented and they came from different competitors. We signed major contracts as I said, a contract of over 50,000 lives, another one of 10,000 lives, another one of 12,000 lives, most of them being implemented now in 1Q, and they came from different competitors. Now, today we don't see any operator behaving irrationally from the commercial perspective. This is a different situation from what we saw last year when one or another player was being more aggressive, commercially speaking today, no one is being crazy to offer prices that are not sustainable.

Mauricio Cepeda (Morgan Stanley)

Ok, great. Thank you, Doctor Jorge.

Operator

This completes the Q&A session. This is the end of Hapvida’s fourth quarter 2023 earnings conference call. The IR team remains at your disposal should you have any other questions. Thank you for joining and have a great afternoon.