

Q2 2020 Earnings Call

Company Participants

- Bruno Cals de Oliveira, Chief Financial Officer
- Guilherme Nahuz, Investor Relations Director
- Jorge Fontoura Pinheiro Koren de Lima, Chief Executive Officer

Other Participants

- Fred Mendes, Analyst
- Gustavo Miele, Analyst
- Mauricio Cepeda, Analyst
- Samuel Alves, Analyst

Presentation

Operator

Good afternoon and welcome to Hapvida's Second Quarter 2020 Earnings Conference Call. Today with us we have Jorge Pinheiro, CEO; Bruno Cals, CFO; and Guilherme Nahuz, Investor Relations Director. We would like to inform you that this event is being recorded and all participants will be in a listen-only mode during the company's presentation. After Hapvida's remarks, there will be a question-and-answer session for investors and analysts when further instructions will be given. (Operator Instructions) Today's live webcast may be accessed through the Internet address at www.hapvida.com.br/ir.

Before proceeding, let me mention that forward-looking statements made during this conference are based on the beliefs and assumptions of Hapvida's management and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of Hapvida and could cause results to differ materially from those expressed in such forward-looking statements.

Now I'll turn the conference over to Mr. Jorge, who will begin the presentation. Mr. Jorge, you may begin your conference.

Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Thank you. Good afternoon, everyone, and thank you for participating in our conference call. It is a great satisfaction to present to you the results of Hapvida of the second quarter of 2020.

During those extremely challenging pandemic and constantly reminded of the amazing and resilient company that we have built. I witness our employees, physicians and healthcare professionals working hard every day to save lives.

I'd like to thank their dedication and commitment to our members and the sacrifices they and their families have made during this healthcare crisis. Thank you very much. We have continued to present excellent numbers that makes us really proud. We have achieved financial and operating results that are spectacular and once again we have reached an unprecedented level for Hapvida in several spheres.

The net revenue in the second quarter of 2020 including Hapvida's acquisitions grew by 62.7% when compared to the 2Q '19 boosted both by the acquisitions and the increase in the number of members and readjustments implemented in the period.

Our EBITDA was BRL607.8 million, a 107% increase when compared to the second quarter of '19. The number of healthcare and dental members considering Hapvida and acquisitions grew by 53.3%.

Now if we consider Hapvida excluding acquisitions, we lost around 35,000 members especially in the corporate book as a consequence of the workforce adjustments that our corporate clients have had to make to go through this crisis caused by the pandemic, and also the active cancellation of some corporate contracts that had negative contribution margins to which we haven't been able to reach an agreement.

For us the month of May was the hardest hit in the quarter, but the month of June showed a strong recovery. It's important to mention that even in the regions that were affected by the pandemic first such as Manaus, Recife, Fortaleza, Belem and Sao Luis cities where 43% of our membership base is located have already come back to normal level operations.

Also as we said previously Hapvida usually benefits from moments like this and which companies and families have to make budget adjustments and they can count on a smart healthcare plan such as Hapvidas.

So our pipeline in these regions is already warming up with relevant quotes coming to the market and Hapvida is very well positioned to attract these new clients. We have already closed a few deals in those regions and also in the regions where the recently acquired companies are located. This represents a very positive prospect for Hapvida in the second half of the year.

With regards to claims, social distancing rules and the suspension determined by the regulator ANS promoted dramatic drop of demand for elective procedures in the quarter. So the cash flow MLR of Hapvida excluding acquisitions in the second quarter of '20 was

49.8% and an extraordinary reduction in MLR of 7.3 percentage points when compared to the second quarter of '19.

An important piece of information is that since the beginning of June, we started to address the backlog of elective surgeries that were contained because of the pandemic.

So I'm happy to say that up until now excluding the regions in which the elective surgeries are not yet advised. Over 90% of these procedures have been conducted and accommodated and have not caused impacts on our operations.

When it comes to elective examinations and appointments that started to recover since May already present about 90% of the monthly historical volume. We believe that this level will normalize until the end of the year. Our company is still growing and expanding its operations being now present in new regions of the country.

The second quarter of the year, we started organic operations in the City of Brasilia the capital city of the country with a portfolio of around 13,000 members operating for now with an accredited network.

We also continued to execute our inorganic expansion plan with the announcement of the acquisition of Grupo Sao Jose, one of the main healthcare players -- private healthcare players in Sao Jose dos Campos in the State of Sao Paulo. The private healthcare market is still very fragmented.

So this consolidation process should continue in the next years. We are certain that Hapvida is well prepared to seize and make the most of the opportunities that we will raise with a free cash flow of BRL3.4 billion. We believe that we have a competitive edge to take part in this process.

Currently, we have around 15 prospects in our pipeline in different M&A steps. Another important point is that we continue from and we are progressing well with the integration of the recently acquired Sao Francisco, America and RN Saude which together with Medical and (inaudible) Group will become one of the main regional platforms of growth for the company.

In August, we have started the second major integration phase implementing Hapvida systems in the acquired companies. We started with America and RN and after that we will implement the systems in the Sao Francisco Group. We are still working hard in our verticalization increase plans both in the North and Northeast regions as well as in the regions of the recently acquired companies and we are working in many different locations.

We have civil construction in operations and we are also working hard to deliver healthcare assets in the next 12 months. We have 10 hospitals that are either being designed right now or being built.

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One hospital located in Manaus, State of Amazonas. One in Maceio, State of Alagoas. Two in Recife, State of Pernambuco. One medical tower in Natal, Rio Grande do Norte State. One hospital in Dourados, Mato Grosso do Sul. One hospital in Uberlandia and three hospitals in the country side of the State of Sao Paulo in the cities of Barretos, Sao Carlos and Bauru reinforce in Hapvida's commitment to transparency and care to environmental, social, and governance issues.

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We have just published our first sustainability report. Our report follows the directives of the global report and initiative, which is the first and most widely used methodology for the production of reports around the world.

Now anyone can consult important information about our ESG performance in that document. Just a curious point in terms of diversity and gender equality. Hapvida has 62% of female employees in leadership positions in the company.

We are happy to say that we have a new Executive Vice President for people management and diversity who is also a woman. Her name is Maria Jose Campos. She has a best market experience and she is here to add to the strategy of the company and help us in our solid growth. She is also part of the Board of Hapvidas and the first female Vice President in the company.

When it comes to technology one of the novelties in the quarter is the launch of our new app Hap Med [ph]. It's one of the physician apps that Hapvida provides. Physicians can check in real time scheduled surgeries and have access to the medical record of every patient including seeing imaging tests and reports.

When it comes to innovation. We are still pioneers in the use of artificial intelligence in healthcare. And we have gained efficiency through Maida, our health tech. In recent months, we implemented three new features with the use of machine learning.

We are doing X-Ray imaging analysis and we have started to conduct dental procedures audit and also medical procedures audit with this app. Before we start talking about our results, I'd like to emphasize a few points that show our commitment and transparency in the way we deal with the pandemic. We are the only healthcare operator in Brazil that publishes since the beginning of the pandemic daily news letters about our combat operations to COVID-19 with data about the number of services, hospitalizations, death and recovered patients. Up until the date of this release over 12,700 patients had recovered from the disease. Since the beginning of the pandemic, we have provided over 70,000 appointments and medical guidance on telemedicine for COVID-19 to our members.

We also provided another 30,000 online appointments that were not COVID-19 related reducing the exposure to the virus. About 5% of the members use this type of service and had to go to one of our physical units.

We are very agile and we customized our telemedicine platform right after the beginning of the pandemic. We believe that this technology has come to stay. Telemedicine gives us

the possibility of making available more specialist physicians regardless of where they live in the country been comfortable both for physicians and patients.

But that's not all, we're also implementing some innovations with the use of telemedicine. For example, at our hospitals, we created a service for general physicians to make video calls with an intense service to help them decide how to refer this patients and if there is a need to send them to the ICU.

We also created a digital emergency room with the screening and everything else, but we also believe that some patients need in person appointments. Therefore, we are still investing smartly here with the goal of providing our members with high quality healthcare whenever and wherever they need it.

Telemedicine will be yet another tool used by Hapvida to increase the operating efficiency and to make sure that we always provide high quality care. We have exceeded BRL110 million spent in combat in COVID-19 up until now.

That includes the purchasing of ventilators and personal protective equipment during the pandemic. All of our units were fully supplied with personal protective equipment to protect customers, physicians, nurses and front-line personnel as well as support personnel with materials, drugs and everything we needed to treat our customers with outpatient and ICU beds available when needed.

Brazil is a country of continental dimensions. In some regions were more hardly hit by the pandemic. Some of them were hit in the beginning and they're now recovering like Manaus, Belem, Fortaleza and Recife and others that are still facing a difficult phase like Goiania, the country side of the State of Sao Paulo and others.

So our fight continues and we will not let our guards down. That's why we're still monitoring everyday the occupancy rate of our hospitals and offering great infrastructure to our members especially in the regions that are still seeing a growing curve in the number of cases.

Healthcare plans have always been really relevant in the country been listed among the top three objects of desire of the Brazilians. The pandemic made those become the top desire of the Brazilian population.

This should continue like that in the short and medium terms with the potential to increase the demand for healthcare plans. We expect to bring more people into the prevention and healthcare promotion programs, and that's where Hapvida has a great advantage that no other operator has with the possibility of being served and seeing the examination results at home.

Having said that I give the floor now to Bruno Cals, our CFO and Guilherme Nahuz our Investor Relations Director who will give you further details about the numbers of the quarter and then I'll come back for the Q&A session at the end. Thank you very much.

Bruno Cals de Oliveira {BIO 21030463 <GO>}

Thank you, Jorge. Good afternoon, everyone. Let's just start with the slides of the presentation. In slide two, you can see the main operating and financial highlights of the second quarter of 2020.

Consolidated data of Hapvida and recently acquired companies, Sao Francisco Group, America Group, and RN Saude. Our net revenue grew by 62.7% boosted mainly by the revenue coming from the acquisitions by 528 million from the Sao Francisco Group, 103 million from the America Group and 35 million from RN Saude.

This also impacted the average ticket of Hapvida ex-acquisition of 10.7% because of the price readjustments and new sales. They also contributed with a 135,000 lives to our dental portfolio. The net revenue growth of Hapvida ex-acquisitions was 10.4% even considering those adverse macroeconomic scenario and the readjustments and small and medium enterprises, healthcare plans and group plans.

There was a 53.3% growth in the number of members. As Jorge said, the MLR drop of Hapvida ex-SUS and ex-acquisitions was 6.1 percentage points. Now MLR of Hapvida ex-acquisitions was also significant 7.3 percentage points.

Our EBIT more than doubled in the period with a 106.9% growth and a margin that was 6.3 percentage points higher because of the reduction in the MLR and a good management of the consolidated expenses which made us reach expense levels of 8.7% with sales and 9.6% with administrative expenses.

Before I go onto the next slide, I'd like to emphasize that our net profit does not necessarily represent our cash generation. Well it's about BRL100 million per quarter or BRL400 million per year in amortization. This is a non-cash line that increases the administrative expenses and reduces the income taxes and social contribution to pay, leaving cash in the company for investments and M&A.

And slide three, you can see that starting in the second quarter 2019 we've added a 1,190 beds to our network. In the second quarter of this year alone we added over 300 beds to face COVID-19 and we also reserved another 1,000 beds in our own network.

During the pandemic, there was not a single case that could not be served because of the lack of capacity and in the regions where the epidemiological curves are going down, we have already freed part of the beds, but we also have some of the beds reserved in case there is a second wave of the pandemic.

Part of the equipment was sent to the regions in which the curves are still going up. Here we have a map to show you that we have 41 walk-in emergency units, 184 clinics, 174 labs and imaging clinics, which totals 438 units that are can be accessed by our members in all the five regions of the country.

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In the second quarter, we opened two medical clinics and closed 11 medical clinics or finished the works in 11 clinical -- medical clinics. We also opened one emergency room and three diagnostic units that will give us more operating efficiency.

It's also important to highlight that in recent months we opened several medical units in Goiania, the Cora Coralina walk-in emergency unit was opened with over 2,500 square meters of built area to offer adult and pediatric emergency service 24 hours a day, and Uberaba State of Minas Gerais, we opened a primary care clinic and another ward in hospital Mario Palmerio for medium and high complexity procedures. In Mossoro, we opened a lab within the premises of our brand new hospital.

ANS numbers for June haven't yet been available. So in the market share of the slide, we see the numbers of March 30, 2020. So at the time we had a total market share of 7.6%. Here you can also see the percentage by region. You can see that in the North and Northeast regions we have a largest market share of 29.9% and 25.1% respectively.

All the acquisitions together with the building of new assets contribute to our footprint expansion, reinforce our own network infrastructure and improve the member portfolio in several regions.

Since the end of '19 the company's exposures has become national. Our potential market has increased in a relevant way and we see great growth opportunities ahead of us. The implementation of new business models in the regions will connect the company to millions of customers will have access to an intelligent and affordable healthcare plan.

Now I'd like to give the floor to Guilherme Nahuz, our Investor Relations Director who will give you further details about our results.

Guilherme Nahuz {BIO 16728154 <GO>}

Thank you, Bruno. Thank you, Jorge. Good afternoon, everyone. I'll try and be brief so that we can move onto the Q&A session as soon as possible.

In slide number four, you can see the membership base of our healthcare portfolio, which shows an excellent growth of almost 45%. In the upper left corner acquisitions included, of course, and in the right hand side of the slide, you can see that individual healthcare plans grew by 38.4% and group plans grew by 46.9%, so we're growing a bit more in the corporate book.

Hapvida ex-acquisitions we have lost 18,000 lives in individual plans basically due to the pandemic. We've also changed the contract policies. We've been talking to the market about this for a while.

We are now stricter actually since last year and this has had impacts in all of the regions in the country. We want to make more qualified sales, reducing deadlines and increasing I mean reducing the churn.

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In group plans, we had an 18,000 lives net loss because of corporate contracts. So there were not many corporate contracts, but they are now reducing in size and that's mainly due to the workforce adjustments that our corporate customers have to make because of the pandemic as we said in the beginning.

We lost 13,000 lives in individual plans. As Eduardo said, we see a strong recovery of sales. Starting now people are now worried about their health because of the pandemic, this is highly positive. People are now seeking to protect their healthcare and their family healthcare with private healthcare plans.

May was you know hardly hit, but June and July are showing a stronger recovery. In June, we had a net increase in the retail book or individual healthcare book. In group plans, we lost 55,000 lives, but we need to say that in Hapvida ex-acquisitions we lost 31 of those 55 and of those 31,000 lives, 20,000 were active cancellations of three contracts as Eduardo mentioned. Three contracts that had negative contribution margins and that we haven't been able to reach an agreement. So we canceled those contracts.

In the acquired companies we lost 24,000 lives of those 55,000. And most of them coming from one single contract that was also giving us negative margins and it was located in Parana, which because of the size of the market.

It didn't make sense to us to verticalize of the companies located in the North and Northeast regions where our market share is very large have already gone back to normal activities.

So we've been seeing a lot of movement in the market, lots of request for proposals. So we are doing really well in this recovery with relevant corporate contracts being signed.

These contracts will be implemented in the coming months. ANS numbers will show that. Now, turn to slide number four, in the lower part, you can see the long-term view. 27% for group plans and almost 22% for individual healthcare plans.

In slide number five, you can see numbers of our dental portfolio. We had a strong growth of 66% including acquisitions. Group plans grew 120%. So very strong growth. And corporate dental plans, compared to the first quarter of 2020, we lost about 44,000 lives net.

For the same reason of the healthcare portfolio, but the drop was not as large here in the dental portfolio, which shows how resilient this portfolio is. The recovery is also happening in dental plans and the opportunities are ahead or still huge. The acquired companies have a low penetration of dental products.

So when we look at Hapvida plus acquired companies, we see a great opportunity. Now in slide number six. Average monthly ticket, Hapvida grew 10.7%, which is an intense growth considering the macro scenario and also considering that we have voluntarily

suspended readjustments of the small and medium enterprises and corporate groups for three months.

Average tickets compared to previous quarters and the dental portfolio has no stable margins. This is a fantastic product. So we have a huge potential there. From 12.2 to 11.9 and this translates into a higher product participation. In slide seven, you can see the net revenues. Bruno and Jorge already said that we had an amazing growth of revenue 62.7% increase.

This growth was boosted by the increase in the number of members and the growth in average ticket as you can see there, but also organically we grew by two digits, which is also an excellent growth, considering the macro scenarios, the price adjustments and life reductions, which proves that the revenue of our company is quite resilient and has been able to resist even in challenging months like the ones we just faced.

In the next slide, on the right hand side, you can see the medical costs and MLR. We have consolidated medical loss ratios here. The second quarter of 2020 had the lowest level of MLR in the history of our company. Cash flow MLR as Jorge and Bruno said was below 50%, for the first time 49.8%. So Hapvida ex-acquisitions in that case, so an exception, no performance, we already talked about the impact on the quarter and the drop in the number of procedures. So not repeat that.

I just want to say that our medical and operational teams worked spectacularly during this very challenging times led by Anderson Nascimento and others which were amazing during the pandemic.

In the upper right side of the slide, you can see that we were able to increase the verticalization volume. You can see there, the numbers of hospitalizations, medical appointments, exams in general. We internalize 82% of the claims, so a growth of 1.8 percentage points in the quarter.

No constructions were suspended during the pandemic. This area was led by Andre Melo who led all the construction even though they had to face many challenges during the pandemic.

Now, MLR, elective claims were reduced because of the regulators, social distancing recommendations. So we also had a medical expense reduction and because we reduced the number of procedures in our accredited network we also had an IBNR reversion. In the next slide, you can see SUS reimbursement. We received one ABI. ABI number 81 in the month of May, the market actually received it.

On the left hand side, you can see the reimbursement flow. At the end, you can see that ANS analyzes the operators return and they were not able to keep up the pace they had before the pandemic and that's why we had an extraordinary reduction in the reimbursement volume.

Only 17 million in claims and 12.6 million in interest, monetary restatement, fines which impact our financial expenses. Once ANS goes back to the same pace they had before the pandemic, we expect these numbers to grow once again.

Now in slide number 10, you can see that the levels are stable. You can see SG&A, administrative expenses in the quarter has shown a small improvement and the impact of the operational leverage, bonus payout, new hires were positive and traveling expenses were reduced because of the pandemic.

When it comes to selling expenses, we also saw a drop in the quarter because of the smaller sales volume. So the expenses with commissions were reduced and also we had a reduction in the advertisement expenses. If we include the acquisitions, this number drops even further because of the selling expenses, which are smaller as a percentage of the revenue in the acquired companies.

Now in slide number 11, we talked a lot about EBITDA already. I just want to reinforce Bruno's message. We had depreciation and amortization making pressure, but this will continue in the coming years. So EBITDA and EBITDA margins are the one that will become the representation, a good representation of our performance and not only net margin.

We did not have to declare interest over own capital. So now in the last slide, slide 12, free cash flow and CapEx. The company is still generating a lot of cash. So there is a positive impact here of the -- amazing cash flow generation in the quarter and in the semester.

And the only negative impact in the quarter was the slight increase in our working capital as a consequence of higher stock levels or higher inventory levels in the company.

As we try to maintain all of our units very well supplied because of the pandemic with personal protective equipment, devices and drugs. Our CapEx for investments were impacted by additions of the new units that Bruno and Jorge already talked about and you can see in the slide once again.

So now I close our presentation and open for questions now. Thank you very much.

Questions And Answers

Operator

We will now start our Q&A session for investors and analysts only. (Operator Instructions) Mauricio Cepeda from Credit Suisse has the first question.

Q - Mauricio Cepeda {BIO 21783651 <GO>}

Good morning, Jorge, Bruno (inaudible). Thank you for answering our questions. My question is more about the future perspectives. We know that we're going through hard

times. But on the other hand, you are at a good position to attract new corporate contracts. So can you tell us a bit more about that. What do you feel in the field? Do you think that there are already companies that are looking for you and asking you for proposals?

A - Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Thank you very much for your question, Mauricio. I'm quite excited about the second quarter because we have a good concentration of lives in places that are already coming out of the pandemic.

So the economy is going back to pre-pandemic levels in those regions. We are already seeing a recovery of retail healthcare plan sales there which is already very close to our historic levels.

Now corporate clients haven't yet started to re-hire employees. This will probably happen in the second half of the year. On the other hand, our company always benefits from difficult economic times and we already have contracts signed of large corporate clients that have terminated their contracts with other operators and our contracts will now start to be implemented in the North and Northeast regions and other regions where the acquired companies work.

So I see a sound and consistent recovery of organic growth. I'm really excited. Yes, I believe that the worst has passed and I'd like to remind you that since our company is the first in the country to have their -- its own network in all five regions.

We are very happy. In the Midwest, we are seeing great growth. Many investments in the region with new hospitals being built there. We are now present in Brasilia and all the cities in the Midwest are being now benefited from us.

And I think that this region is going to help us with the organic and inorganic growth, also the regions of Sao Paulo in the Southeast will continue to help us grow. So I am quite excited about the recovery of the economy, the worst is behind us in my point of view. Of course this country is still very fragmented, but we are present in all regions and we can have a great consolidation because of that.

Q - Mauricio Cepeda {BIO 21783651 <GO>}

Thank you, Jorge. That was very clear.

A - Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Yes, thank you.

Operator

Our next question is by Samuel Alves, BTG Pactual.

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Q - Samuel Alves {BIO 18720076 <GO>}

Good afternoon, Jorge, Bruno, Guilherme and everyone else. I have two questions about topics that you have already mentioned, but I'd like further details. First, which regions are leading the commercial recovery. Are there any highlights or the growth is well distributed throughout all regions of the country. Now my second question, can you tell us a bit more about the integration of RN, America and San Francisco. The deadlines and all that. Thank you.

A - Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Hi, Samuel. Thank you very much for your question. Generally speaking retail is leading this recovery. For example in the month of June and beginning of August, Hapvida's regions of the North and Northeast are now very close to our historic levels.

But when it comes to corporate clients, I mean, these clients are not yet rehiring employees, but we already see that the country is going back to pre-pandemic levels. North and Northeast regions are already hitting up and the retail growth, so individual healthcare plans.

We also made implemented containment measures. As Guilherme said, we postponed readjustments for small and medium enterprises for individual (Technical Difficulty) as well.

So these readjustments will probably made in the third or fourth quarter. Now in recent months. We said that we would integrate the Sao Francisco Group in four years, America in 30 months and we are going to do it even faster than what we promised.

The most complex steps of the integration have already been given. Our integration philosophy is quite generous. Whenever we implement a system, all of the intelligence, business intelligence requires the asset to be prepared to receive our systems. Our MLR is of around -- in those acquired companies is of around 70%, but we believe that we can take those MLR closer to that of Hapvida depending of course on the characteristics of the asset.

So, yes, we will finish the integration before we said in the third quarter we're going to start integrating the systems in the Americas and we will actually integrate all of our assets before the deadlines we gave you

A - Bruno Cals de Oliveira {BIO 21030463 <GO>}

This is Bruno speaking. I just want to give you further details about what Jorge was saying. We are implementing -- we're going to implement systems in America and RN Saude this year and next year we are going to implement the system at counterfeits.

For risk mitigation, the hospital systems will be implemented in one unit per month. To contain risks of doing this in many upper -- many units at the same time. This is a risk mitigation measure, but this is our plan, that will be executed in the coming months.

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AI, also what we've been doing when it comes to integration cannot be characterized a systems integration, it's actually the implementation of our own systems. We rarely keep the systems of any of the acquired companies because all of our tools are required to be implemented with this new management philosophy.

So it goes way beyond an integration. We do a complete implementation to keep the high quality of the healthcare services we provide and also a great cost control.

Q - Samuel Alves {BIO 18720076 <GO>}

Okay, thank you very much. That is very clear.

Operator

Our next question is by Gustavo Miele, Itau BBA.

Q - Gustavo Miele {BIO 21077665 <GO>}

Good afternoon, Jorge, Bruno, Guilherme. Thank you for your presentation. My question is very brief. With regards to PDB. We were worried about how this line will be shown to you and also worried about the pandemic, but you have mentioned sound numbers. Of course this line has a macroeconomic exogenous effect, but has the company implemented any measures that made it easier for you to control PDB or was there any beneficial effect of the acquired companies when it comes to that. So can you tell us a bit more of the PDB dynamic?

A - Bruno Cals de Oliveira {BIO 21030463 <GO>}

Hi, Gustavo. This is Bruno speaking. We've been talking a lot about that the market. This was actually one of the pleasant surprises we've had in this challenging moments.

We reduced the default rates of our customers which shows how they prioritize the payment of the healthcare plans for obvious reasons of course they don't want to lose their healthcare plans especially in uncommon moments like this.

So PDB has been stable and sound, as you said, which is different from other industries, but this shows the resilience of our countries especially in times like the ones we're going through right now.

So we expect this to continue like that in the future. The second quarter of '20 compared to the first quarter of '20 had higher commercial expenses because of contract cancellations. Commissions are acquired depending on the medium-term of the contract and once the contract is canceled we have to pay everything that is left.

But we expect the PDB levels to continue at, I mean, high. Our customers have been showing that they are not intended to be in default. We are also working hard with our clients to show everything we've been doing in the company not only to our clients, but to society in general we have videos, we are interacting on social networks.

We have been given market notices during the second quarter to show them that we're there for them. So we postponed TMS I mean the readjustment of small and medium enterprise plans. For some customers, we temporarily replaced complete healthcare plans for hospital expenses only plans.

So they could pay prices that were 30% lower during these times these difficult times. So with those macro scenarios of resilience and private healthcare plans, we were able to achieve sound levels of PDB as you said.

Q - Gustavo Miele {BIO 21077665 <GO>}

Excellent, Bruno. Thank you very much.

Operator

Our next question is by Fred Mendes from Bradesco.

Q - Fred Mendes {BIO 17221617 <GO>}

Good afternoon, everyone. Thank you for this call. I have two questions. The first one. I'm not sure you can talk about this, but do you have any idea of the percentage of the growth sales. Are they growing? Are they stable? Can you just tell me a bit more about growth sales. That's my first question.

A - Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Fred, I'm sorry. Your audio was cutting out and I can't understand your question. Can you please repeat it.

Q - Fred Mendes {BIO 17221617 <GO>}

Sure. No problem. I think I got an incoming call and that's why my sound cut off. So my first question is about growth sales. You told us that two of the contracts were canceled actively by you. What about growth sales? Are they improving and, of course, you talked about workforce adjustments. So can you tell us about the lives? What about MLR in acquired companies because acquired companies that are not as verticalized would have more possibilities to reduce MLR, but it was actually the opposite, the reduction of MLR was much higher at Hapvida. So can you tell me why? Thank you.

A - Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Hi, Fred. Okay, now it's clear. Thank you for your question. About sales, retail sales is already very close to pre-pandemic levels. So that's already recovering.

Now new customers coming into corporate plans, which would reflect that our corporate clients are rehiring employees. While these numbers have not yet recover to pre-pandemic levels.

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We believe this is going to happen in the second half of the year, but we are excited, starting in June, July we saw negotiations taking place, some contracts have been signed and I'm talking about large contracts in several regions and generally speaking, we believe that the second half of the year will show us a recovery of the company's organic growth.

Now about your second question. About MLR reduction in the second quarter for the acquired companies. While the acquired companies had a loss ratio around 69%, 70% up to 85% you know in the set of acquired companies and that were not in our reports last year.

Now the second and third quarters for those companies had the highest loss ratio levels. The second quarter MLR was 59%. So if you compare the second quarter '20 of these companies to the second quarter '19 there was a significant reduction in their MLRs.

In addition to that, Fred, I just want to add something. Comparing the second quarter of 2020 to the first quarter of 2020 Hapvida ex-acquisitions drop was higher because Hapvida's ex-acquisitions in the first quarter was impacted by sales reimbursement three percentage points of the revenue.

So if you exclude that you would have a similar drop in percentage points comparing Hapvida's ex-acquisitions and acquired companies. So compared to the first quarter of 2020 this is what we saw.

Q - Fred Mendes {BIO 17221617 <GO>}

Okay, thank you. Thank you very much, Jorge and Bruno. That's very clear.

Operator

(Operator Instructions) If there are no further questions, I'd like to give the floor to Mr. Jorge for closing remarks. Mr. Jorge you can proceed.

A - Jorge Fontoura Pinheiro Koren de Lima {BIO 15412259 <GO>}

Well, I'd like to thank you very much for your presence and I'd like to tell you that our company has been committed to saving lives and helping people for over 40 years.

In the first half of 2020 we faced a huge challenge, but we've been able to fully deliver on our mission, which is to save lives. I'd like to give a special thanks, a heartfelt thanks to all of our team who worked really hard and fought really hard in order to help people and provide them with high quality service.

So we have fulfilled our mission of helping people in the best possible way. I would also like to thank our other partners, our shareholders who are working with our team giving us strength to continue investing and growing and innovating to fulfill this wonderful mission.

And finally, I'd like to thank our users who deserve all of our efforts and dedication. We believe that the worst is behind us, but we know that we still have great challenge ahead of us and we continue from and committed to all of them. So thank you very much and see you next time.

Operator

Thank you. This concludes Hapvida's earnings conference call. Please disconnect your lines and have a good day.

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