

## Q3 2019 Earnings Call

### Company Participants

- Bruno Cals de Oliveira, Chief Financial Officer
- Guilherme Nahuz, Director of Investor Relations

### Other Participants

- Bruno Jordano, Analyst
- Vinicius Figueiredo, Analyst

### Presentation

#### Operator

Good morning. Welcome everyone to Hapvida Third Quarter 2019 Results Conference Call. Today with us we have Bruno Cals, CFO and Mr. Guilherme Nahuz, Investors Relation 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 remark, there will be a question-and-answer session for investors and analysts only 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](http://www.hapvida.com.br/ir). Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Hapvida 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. Bruno, who will begin the presentation. Mr. Bruno, you may begin your conference.

#### **Bruno Cals de Oliveira** {BIO 18472117 <GO>}

Good morning, everyone and thank you for being here today. We're very happy to present to the market and to our shareholders our earnings release of the third quarter of 2019. This has been another very intense period for us. Last months, we dedicated to expanding our operations and planning at the integration of our recent acquisitions, especially the San Francisco Group based in Ribeirao Preto city in the state of Sao Paulo.

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We have finished the processes with the regulating organ and the close was done on November 1. We're very happy with the conclusion of this acquisition and very happy about our future opportunities.

To all of the employees of the San Francisco Group, who are taking part in this -- well in this conference, I'd like to welcome you. We also finished the acquisition of Padre Cicero in the region of Cariri in the South of Ceara and this has been our 28th hospital. In the third quarter, we also added two diagnostic units and one HAPV [ph] clinic with new infrastructure and easier access to service, reinforcing our commitment to the quality of the services provided to our members. We have one of the lowest complaint rates with only 3.23 complaint rate against 4.28 on average considering the 78 large-sized healthcare operators in the country.

So let's go to Slide 3 of our presentation. I would like to emphasize that our Company has cap to net revenue growth of 13.1% in the quarter. This growth was supported by the number of dental members that increased outperforming the rest of the industry. And we have about 4.8% growth in the number of healthcare members and 4.9% increase in the number of dental members. Our member loss ratio dropped compared to the previous quarter. And we also had improvements in our EBITDA with a 23.7% growth and a total of 268 -- I'm sorry -- BRL235 million in the quarter.

Our margin this quarter was 17.9%, our EBITDA margin. Now let's talk about the macroeconomic scenario. In the North, North East and South, the regions where we were more exposed in the third quarter, we had a slow pace of recovery. But with the acquisition of the San Francisco Group, our exposure will have a different dynamics because we're now more present in the country side of the state of Sao Paulo. After the acquisition of RN Metropolitan and the America Group that are still waiting for the National Healthcare Agency approval. We are going to have nationwide operator and that's why the dynamics is going to change. The macro scenario in the country showing signs of recovery because of the better economic perspectives with GDP growth prospects for 2019 and 2030. In September, 2019, our country had once again a positive balance in the number of jobs created. These numbers then give us positive prospect with positive perspectives for the healthcare industry as well.

Now, I'd like to give the floor to Guilherme Nahuz, who is going to give you further details about the financial results.

### **Guilherme Nahuz** {BIO 21255437 <GO>}

Thank you, Bruno. Good morning, everyone. I'll try and be brief in my comments, so that we can go straight to our Q&A session. In Slide 4 of our presentation, you have further details about what Bruno said in the beginning of the call. This slide shows you the constant investment of our Company in our own service network. We closed the quarter with 28 hospitals. The 28th hospital was the Padre Cicero General Hospital as mentioned before. And so we have a total of a 1,842 hospital beds available to our members. We also have 19 walk-in emergency units, 83 clinics and 90 diagnostic units. So you can see the growth. In total, we have 210 unit.

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We've had an increase in the number of beds basically because of the new operations of the Santa Catarina hospital in the city of Joinville in April this year and 17 beds from the General Hospital Padre Cicero. We've also had growth because of an increased capacity and increased number of beds in our existing hospitals. So compared to second quarter of 2019, we had a net reduction of 31 beds because we closed the period and the season of viruses, we had lower demand for ICU beds and some units as well and some hospitalization beds were transformed into pediatric beds in one of our units. Our own network is measured with a tool that was developed by Hapvida. This tool takes into account several variables such as expected growth, average productivity and usage profile of each region. We also have our own infrastructure in at 12 states with our physical presence in those 12 states, but now with the San Francisco Group and with the America and acquisitions, we're going to have our own service network operating in 18 states in the country.

In Slide number 5, you can see the evolution of the member base. On the left hand side, you can see the growth of our health members and on the right hand side, dental members. So you see that the growth was 4.8% in number of health members and 4.9% in the number of dental members. The supplementary healthcare industry is still going through a slow movement when it comes to the increase in number of members. Compared to the third quarter 2018, the whole industry had a drop in the number of members. While Hapvida had an increase in the number of members. So you can see that we are still outperforming the market.

So you see that we increased 4.9% in the number of dental beneficiaries, which is great. Bahia and Pernambuco presented organic growth, the state of Amazonas also had growth. And Santa Catarina, which was not one where we had members in the third quarter of 2018. Inorganic growth was present in Piaui and Ceara because of the acquisitions at the end of last year. Compared to the second quarter of 2019, our healthcare member portfolio had a small drop of around 20,000 lives. We still have a high cancellation rate. There hasn't been any increase or decrease in this number, but it's still high and we've been impacted by as stricter hiring policy in certain regions. Our goal is to decrease the churn rate and increase contract retention rates and this has been showing positive results. In Slide number 6, you can see the evolution of our average monthly ticket, healthcare on the left-hand side and dental on the right-hand side. We've had great growth in the average healthcare ticket, an increase of 9.3%, 3.2% in the individual healthcare plan and in the collective healthcare plan a bit more achieving this average of 9.3% and in dental ticket, we've had a growth, an average growth of 1.7%.

In Slide 7, you can see our net revenue growth. So the growth trend has been capped with a growth of 13.1% in the quarter and 14.4% year-to-date. That's due to the increased number of members and also the increase in the average ticket amount, which has been influenced by price increases that were implemented in the portfolios that was something needed to balance to achieve this economic balance in our contracts.

In Slide number 8, you can see our medical loss ratio and medical costs. This quarter, you can see the ex-SUS loss ratio. This is the rate that can better represent the performance of Hapvida's operations and the range [ph] was 61.4%, an improvement of 0.8%. That is a relevant improvement for us because it's happening during a time in which we started

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operating new healthcare units, including in Joinville as I said, so that means almost BRL9 million more in medical loss ratios there compared to the last quarter. Of course, we also had some positive in administrative expenses and we also hired new employees in the third quarter of '19 compared to the third quarter of '18 so BRL7.5 million impact. The vertical model's beauty is that the investment in expanding our own network is quickly converted into cost control to the Company. So even though we had all of these impacts, we were able to reduce the medical loss ratio. The volume of our hospitalization in our own hospitals went from 92.4% in the third quarter of 2018 to 95.2% in the third quarter of 2019. So a 3 percentage point gain in the volume of hospitalizations in our own network.

So the total medical loss ratio is the last line of the table here that includes SUS reimbursement and provisions for IBNR 73.3% or 63.3%, so 0.7 percentage point increase compared to last year. But we had significant increase in SUS reimbursement provisions as well. In the quarter, we had BRL24.6 million against BRL6 million in the third quarter of last year. So a difference of almost BRL20 million comparing to third quarter of 2018 to the third quarter of 2019.

Now, something that do not impact the total medical loss ratio was an improvement in the processing of the medical expenses of our accredited network due to improvements in our operating systems with the implementation of the SAP. This implementation happened in the second quarter in our own network and in the third quarter in our accredited network. As a result, we were able to acknowledge BRL30 million in additional loss ratio but this effect was offset by the reduction of the IBNR that had a net reduction of almost BRL30 million. So we think that the medical loss ratio should not be taken into account on its own. We should also take into account IBNR, when we look at those numbers.

On the next slide, you can see our selling and administrative expenses. On the left hand side, you can see the selling expenses chart, we've had a rate of 9.7% in this quarter with impacts of the approval deadlines, so we had a positive impact of BRL1.5 million in the quarter and year-to-date. We've also had a decrease in the selling expenses, also because of the Commission's approval deadline changes.

We've had a positive impact of BRL15 million last year that did not come about this year. On the chart, on the right hand side, you can see the administrative expenses. The total administrative expenses of the Company divided by net operating expenses. So year-to-date, our rate was of 10.7% with a reduction of 1.3 percentage points compared to the third quarter of 2018, that is a significant improvement for us.

We've had impacts of collective salary increase accounting for about BRL5 million and year-to-date improvements were also impacted by that, by the same factors. The numbers are all mentioned in the earnings release that you can see later. Now in Slide number 10, you can see our EBITDA numbers and our EBITDA margin numbers. We're very happy with BRL235 million in EBITDA in the third quarter of 2019, a 1.6 percentage point gain compared to the third quarter of 2018. So a significant increase, and year-to-date, it is BRL780 million of EBITDA, 14.5% increase compared to the same period of 2018.

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In Slide 11, you can see our net income and net margin. The results are very satisfactory. We are happy about this results of almost BRL216 million in net income in this period, BRL662 million [ph] year-to-date with a 13.5% increase in our net income and 16.7% increase in our net margin.

Our net margins are quite robust. We've had gains even with relevant negative impact such as the SUS reimbursement. We have already commented. We've had a net income increase that is very favorable side effect. We've had some positive impact as well on our net income, both in the third quarter of 2019 and in the third quarter of 2018 as you can see. And Slide 12, our last slide, you can see our free cash flow generation and CapEx. Free cash flow can be seen on the left-hand side and CapEx on the right hand side of the slide.

We've had BRL62.4 million of CapEx in the third quarter of 2019 due to the investments in our own service network as we said in Slide 4 of this presentation. So in the third quarter of 2019, we generated BRL32 million of free cash flow. There is a small reduction compared to the third quarter of 2018 and this is basically due to the larger CapEx. We also had a few acquisitions in this period with the Pedro Cicero General Hospital and Infoway acquisition and a negative variation of working capital. And this impact in accounts receivable on September 30.

But anyway, we are very happy about our third quarter results and thus I conclude my comments. We are now available for the questions of our shareholders. Thank you.

## Questions And Answers

### Operator

We shall now begin our Q&A session for investors and analysts only. (Operator Instructions) First question by Vinicius Figueiredo from Itau.

#### Q - Vinicius Figueiredo {BIO 20592660 <GO>}

Good morning, everyone. Thank you for answering my question. I'm going to talk about the net increases. We saw a drop in collective and individual plan. For individual plans, you have a stricter policy for the sales of products, which had an impact. What about the collective plans? What impacted the numbers, cancellation of contracts or sales or some specific performance of one or another region?

Now about medical loss ratio, we saw positive IBNR numbers, which was impacted by the implementation of SAP and enhancement of your processes. Will we continue to see gains of this type in the future? Will those implementation have impacts on the loss ratios this quarter and in the quarters to come? Also, do you see any movement by the regulator to affect SUS reimbursements? Thank you very much.

#### A - Bruno Cals de Oliveira {BIO 18472117 <GO>}

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Good morning, Vinicius. This is Bruno speaking. So about the individual plan, indeed, in some of the regions, we improved our sales processes, which had an impact in the cancellations rate. But from now on, we believe our churn of the portfolio will be lower, and as a consequence, we're going to have more efficiency in our sales processes. But generally speaking, we've been feeling great stability compared to what we saw in the past in the economy of the North and the Northeast regions. We see many jobs being created and the economy is working better and especially in the Southeast region of the country in the state of Sao Paulo. And this actually gives us hope for good numbers in the future with the acquisition of the San Francisco Group and starting in November, our results will also take into account the growth of the San Francisco Group. This growth is actually quite robust. San Francisco is growing 7% a year this year compared to last year. If we take into account all the acquisitions, this growth will actually increase to around 10% or 11%. So we have great expectations about the investments we've been making in the regions and the launch of new product, so that we can continue with our very good growth performance also in the Southeast region of the country and in the Midwest region in the near future as well.

So this is very much related to the economic environment, which is still unfavorable in the North and Northeast regions compared to the Southeast region of the country. Now about IBNR. This is an effect that we see only on this quarter. From now on, we're going to have regular IBN variation and this was only a specific enhancement that we saw due to the implementation of the SAP system. So from now on, we expect these numbers to go back to normal. To the traditional variation of the loss ratio and also traditional IBNR variation.

So now about SUS. That's something we don't have much control over. That will depend on the accounts processes -- processing by ANS. In some quarters, we get 2 million, others 5 million or 13 or 24. So indeed there is a lot of variation and we have no predictability from about what is about to come.

**Q - Vinicius Figueiredo** {BIO 20592660 <GO>}

Okay, that's very clear. Thank you very much Bruno.

**Operator**

Next question by Bruno Jordano from Bank of America.

**Q - Bruno Jordano**

Good morning, Bruno and Guilherme. I have a question about the medical loss ratio. If we were to exclude the expansion of Hapvida, what would be the medical loss ratio in this quarter. And if we look at the isolated medical loss ratios for collective plans and individual plans, what has been the evolution in the last 12 months. Thank you.

**A - Bruno Cals de Oliveira** {BIO 18472117 <GO>}

Hi, Jordano. Good morning and thank you for your question. So about the medical loss ratio. In our earnings release, we disclosed all of the impact. And you'll be able to

compare this to the third quarter of 2018. So as I said, you have to take into account a SUS reimbursement, which is above the normal levels and the IBN variation. Also we had expenses of personnel of around BRL7 million which actually was moved from expenses to costs. So the loss ratio would be closer to 60% with attractive gains compared to the third quarter of 2018.

Now about the individual plans and collective plan behavior. We've had no significant variations compared to last year. This is pretty much in line with the total medical loss ratio. So there is no individual factor in the individual segment or corporate segment. They've been evolving pretty much hand in hand with what we saw in previous quarters.

### **Q - Bruno Jordano**

Okay. Now about the first point, the numbers that you release are the enhancements in some expansion operations. Right. But last year, you already had costs related to these expansion. So I wanted to understand, your running rate of the medical loss ratio. Not taken into account these expansions. But we can discuss this offline later if you prefer.

### **A - Bruno Cals de Oliveira {BIO 18472117 <GO>}**

Sure. But please, do the math, considering SUS and the personnel expenses reclassification. And then if you need, we can give you further detail. So that you understand the influence of the new units, especially the Joinville unit.

### **Q - Bruno Jordano**

Okay, great, thank you very much.

### **Operator**

(Operator Instructions) Thank you. This concludes the question-and-answer section. At this time, I would like to turn the floor back to Mr. Bruno for any closing remarks.

### **A - Bruno Cals de Oliveira {BIO 18472117 <GO>}**

Thank you everyone for participating in this conference call. We're sure, we're prepared to make the most of the opportunities that are arising with the conclusion of our acquisition. And we know that we have built a solid robust business that can advance quicker and quicker. For those of you who live in Brazil, enjoy the holidays tomorrow and we'll talk to you soon. Thank you very much.

### **Operator**

Thank you. This concludes today's presentation. You may disconnect your line at this time and have a nice day.

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