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Credit Opinion: Fleury SA

Global Credit Research - 05 Feb 2016

Brazil

Ratings

Category	Moody's Rating
Outlook	Stable
Corporate Family Rating -Dom Curr	Ba1
Senior Unsecured -Dom Curr	Ba1
NSR Corporate Family Rating	Aa1.br
NSR Senior Unsecured	Aa1.br

Contacts

Analyst	Phone
Erick Rodrigues/Sao Paulo	55.11.3043.7300
Dean Diaz/New York City	1.212.553.1653
Marianna Waltz, CFA/Sao Paulo	55.11.3043.7300

Key Indicators

[1]**Fleury SA**

	9/30/2015(L)	12/31/2014	12/31/2013	12/31/2012
Revenue (USD Billion)	**$0.6**	**$0.7**	**$0.8**	**$0.8**
EBITA Margin	**17.5%**	**16.6%**	**14.8%**	**16.6%**
Debt / EBITDA	**2.8x**	**3.2x**	**3.3x**	**2.1x**
EBITA / Interest	**2.1x**	**2.0x**	**2.1x**	**3.4x**
RCF / Net Debt	**43.4%**	**18.3%**	**33.6%**	**56.8%**

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. Source: Moody's Financial Metrics

Note: For definitions of Moody's most common ratio terms please see the accompanying User's Guide.

Opinion

Rating Rationale

- Strong and well recognized brands in the local market

- Brazilian recession to pressure operations, but health care industry long term fundamentals remain favorable

- Highly fragmented industry provides room for M&A activity

- Disciplined and successful acquisitions

- Adequate credit metrics and liquidity

- Relative small size when compared to global peers

Corporate Profile

Founded in 1926, Fleury is a major provider of high quality diagnostic medicine in Brazil through its Patient Service Centers (83% of gross revenues), operations in Hospitals (14% of gross revenues) and others (3% of gross revenues) business segments. The group has a diversified portfolio of brands that envisages different social classes in six Brazilian states and Distrito Federal. For the last twelve months ended in September 2015, Fleury posted revenues of BRL 1.8 billion (approximately USD 624 million converted by the average exchange rate) and adjusted EBITDA of BRL 528 million (28.6% adjusted EBITDA margin).

SUMMARY RATING RATIONALE

The Ba1/Aa1.br ratings are supported by Fleury's strong and well recognized brand, its market positioning in Brazil, focused on the more resilient higher income level population, and the positive long-term prospects for the Brazilian health care industry, despite the expected deterioration in operating environment as a consequence of the Brazilian recession. The ratings incorporate the improved diversification in terms of branding, consumer's profile and geographic footprint derived from Fleury's 27 acquisitions between 2002 and 2012 and the company's adequate credit metrics and liquidity profile. The ratings are constrained by the company's small size compared to global peers as well as the fragmented nature of the industry, which provides room for M&A.

DETAILED RATING CONSIDERATIONS

STRONG AND WELL RECOGNIZED BRANDS

Fleury operates under six brands (Fleury, Clínica Felippe Mattoso, Weinmann, a+, Diagnoson a+ and Labs a+) in six Brazilian states and in Distrito Federal, providing premium and intermediary services for customers ranging from classes A through B. The brands Fleury, Clínica Felippe Mattoso and Weinmann labs enjoy leading positions in the A social class in São Paulo, Rio de Janeiro and Rio Grande do Sul states, some of the most economically robust regions of the country. The Fleury brand is widely recognized by patients and physicians. The national brand "a+" was launched in 2011 as a result of the consolidation process of brands previously acquired. Currently, "a+" operations are present in the six main economic centers in Brazil offering diagnostic services to beneficiaries of intermediary level health plans.

The Fleury brand, which accounted for 50.2% of the company's revenues in the LTM ending September 2015, benefits from the resilience of the consumption patterns of the higher income level population, which confers defensive characteristics to Fleury's business model. This is particularly important in the current challenging economic environment in Brazil, where economic recession is quickly driving unemployment rates higher and reducing the total number of health plan beneficiaries.

Unlike in the US and other markets, the choice of a health care provider in Brazil is usually determined by the patient and procedures are performed outside of hospitals and medical consultations. In Moody's view, Fleury's successful branding strategy provides a competitive advantage to the company during the patient's decision making process. The company's wide coverage and integrated solution for physicians also contribute to its strong market position in Brazil.

BRAZILIAN RECESSION TO PRESSURE OPERATIONS, BUT HEALTH CARE INDUSTRY LONG TERM FUNDAMENTALS REMAIN FAVORABLE

The long-term prospects for the Brazilian healthcare industry remain favorable, but contrast with the challenges related to a rising unemployment rate and a decline in total health plan beneficiaries, which impacts especially the lower income job levels. Until September 2015, the number of health plan beneficiaries decreased by 436 thousand as a result of an acute macroeconomic contraction in Brazil and it was the first drop observed since 2004. In the same period almost 730 thousand formal job positions closed in the country, and in the whole year of 2015, 1.5 million jobs were closed. Over the last several years, the increase in the population's average income level led to a gradual growth in private health spending and, according to Datafolha, health plans are the third consumption priority of Brazilians, lagging behind only education and housing. About 15 million net additions to health plans were done between 2005 and 2013, as a consequence of the 13.5 million jobs created in the same period. Although health expenditures tend to be relatively resilient to economic cycles the crises will pressure the sector operations as we expect further contraction of the jobs market. We see Fleury's brands as more resilient given the high level of service and brand recognition, focused mainly on higher income level customers, which should temper the impact of the economic slowdown in the company's operating performance.

In the long-term the population aging will support an increased demand for health care services in Brazil.

According to the Brazilian Institute of Geography and Statistics - IBGE, the proportion of Brazilians aged 60 years or older should reach 30% by 2050 (or 19.2 million inhabitants) from 13% in 2013. Also, the private health plan segment is still under-penetrated in the country, especially when compared to international standards. By September 2015, only 26% of the Brazilian population had a health plan contracted, while in developed economies the penetration rate reached 37% in the same period, according to ANS - National Health Agency. It is noteworthy that the individual penetration rate is higher than Brazil's average in more developed states such as São Paulo (45%) and Rio de Janeiro (37%), where Fleury has a particularly strong presence.

HIGHLY FRAGMENTED INDUSTRY PROVIDES ROOM FOR M&A ACTIVITIES

The private health care sector in Brazil is very fragmented and has no dominant player. There are currently more than five thousand health care service centers that serve private health plans in the country. We believe that, in a fragmented industry, larger players like Fleury are in a more advantageous situation and have broader bargaining power when dealing with health insurance providers and hospitals. Negotiations with health insurance providers are usually made once a year, and consist of the price adjustment to be implemented by the health care service providers.

Also, under this scenario, further industry consolidation is expected, especially involving larger and capitalized players such as Fleury. However, the assigned ratings incorporates our expectations that Fleury will conduct any future acquisition in a prudent manner in order to preserve its creditworthiness.

DISCIPLINED AND SUCCESSFUL ACQUISITIONS

Acquisitions were a key growth strategy for Fleury in the recent past and we believe the company will continue to pursue opportunistic acquisitions to further consolidate its position in the Brazilian market. Although M&A activity can entail integration challenges, higher working capital and investment needs, we recognize that Fleury has so far managed well its acquisitions. Originally, the Fleury group targeted the A social class in the state of Sao Paulo. Through acquisitions, it managed to diversify its revenues, both in terms of customer base and geographic footprint. Currently, Fleury is present in six Brazilian states and Distrito Federal and its portfolio of brands covers social classes A and B. Despite the acquisitions, the company's growth has been mainly organic-driven, with most of the group's revenues increase coming from its existing operations - with the exception of the Labs D'Or deal, a BRL 1.2 billion acquisition announced in 2011.

The Labs D'Or acquisition (i) increased Fleury's presence in the state of Rio de Janeiro; (ii) brought business opportunities through the alliance with Rede D'Or and Sao Luiz Hospitals; (iii) diversified the company's product portfolio mix, with an increase in imaging diagnosis and hospital services; and (iv) turned Fleury into a bigger player, with higher market strength and broader bargaining power.

During 2013, 2014 and 2015 Fleury did not announce any acquisition and focused on business integration and cost efficiencies to recover profitability.

ADEQUATE CREDIT METRICS AND LIQUIDITY

In the last twelve months ended September 2015, Fleury's adjusted leverage of 2.8x compared favorably to similarly rated companies. During 2013 and 2014 the company faced some headwinds and margins were negatively impacted by: (i) operational adjustments and integration costs in Rio de Janeiro; (ii) the early stage of new a+ brand labs, which have not yet reached maturity; (iii) the company's strategy to adequate its service offering by focusing on more profitable clients and on cost synergies; and, lastly, (iv) inflationary cost pressures. Following those pressures, the adjustments and strategic focus improved Fleury's profitability already in 2015, but now the risks come from the environment Fleury is inserted in and margins will be challenged by a contracting market, rising inflation (as approximately 51% of Fleury's costs are related to labor), and currency depreciation (which will increase dollar denominated costs, about 10% of total). Still, we recognize Fleury's track record of efficiently passing-through some of the costs increases.

Even with the increased cost pressure we estimate Fleury will be able to sustain operating margins fairly close to current levels in the next 12 months. We estimate top line will still benefit from volume and price increases and Fleury will continue to benefit from steering actions taken in 2013 and 2014. Going forward, the company will benefit from its position within the A and B social classes in Brazil for whom health care spending is more resilient. For the LTM ending September 2015, Fleury's adjusted EBITDA margin reached 28.6%, up from a low of 26% at the end of 2013, reflecting the operational adjustments made by the company in the last two years. In the most recent quarter (3Q15), adjusted EBITDA margin reached 30.3% and Fleury posted revenues/m2 of BRL 4.3, the highest level since 2011, with same store sales increasing 6.9% in 3Q15 versus 3Q14.

In October 2014, Fleury raised a BRL 102 million loan with FINEP (public company linked to the Ministry of Science and Technology) to fund projects that will improve productivity and level of service, thus supporting the expansion of existing premium brands. The loan has a 8-year term, grace period of 2 years and annual interest payment of 4%. In addition to the FINEP line, Fleury's indebtedness comprises two debentures totaling BRL 926 million at the end of September 2015. The debentures are already been amortized, and the next relevant installment (of BRL 150 million plus accrued interests) is due in the 4Q16. Pro forma to the next payment and the one made in 4Q15, Fleury's adjusted leverage would decline to 2.4x, providing the company more room under financial metrics.

The company's liquidity continues to be adequate and debt maturities remain concentrated in the long-term. As of September 2015, cash position of BRL 617 million was sufficient to cover reported short term debt by 7.7 times and corresponded to 59% of total reported debt. At the current margin level, Fleury's cash flow from operations should be sufficient to cover non-discretionary capex and its dividend pay-out orientation, considering the 1H15 distribution of 35% of net income. Accordingly, we expect Fleury to generate positive free cash flow, which should be used together with a portion of its cash balance to meet upcoming debt maturities.

RELATIVE SMALL SIZE WHEN COMPARED TO GLOBAL PEERS

Although acquisitions have increased Fleury's size, the company remains relatively small when compared to global peers, with annual net revenues of BRL 1.8 billion as of LTM September 2015. In Moody's view, larger companies are often better able to realize economies of scale, to benefit from broader access to potential customers and to have more access to capital markets, if needed. Nevertheless, Fleury's ratings incorporates its position as one of the largest providers of diagnostic medicine in Brazil.

Corporate Governance

Fleury is a public owned company listed in the São Paulo Stock Exchange, BM&F Bovespa. Currently, 39.9% of its shares are in free float and the company is part of Bovespa's Novo Mercado, the level with the highest standards of corporate governance in Brazil. The largest shareholders are the partner doctors via their indirect stake, through Integritas, of 12.0% and direct stake of 16.3%, linked to the shareholders agreement. In September 2015, the partner doctors sold 13% of Fleury's total shares to Advent International (unrated) private equity firm, through the sale of Core Participações ("Core", unrated) shares. The transaction resulted in the election of a new Board of Directors, which is now composed of 10 members, of which 3 are nominated by the partner doctors, 2 by Advent, 2 by Bradseg (Fleury's second largest shareholder with 16.4% of total shares) and the remaining 3 as independent members. There were no changes to Fleury's senior management as a result of the transaction. In Moody's opinion, the implementation of a permanent fiscal committee and formal financial policies regarding leverage target and minimum liquidity would be positive for Fleury's corporate governance practices.

Rating Outlook

The stable outlook reflects our view that Fleury will be able to maintain its operating margins and consistent organic growth. Also, Moody's expects the company to prudently manage Capex and to be disciplined with acquisitions, while maintaining comfortable liquidity.

What Could Change the Rating - Up

Positive pressure on the rating could develop over time if the company is able to continue generating consistent organic growth, while pursuing its expansion strategy, and profitability proves sustainable. This will be the case if EBITA Margin exceeds 25% and if EBITA / Interest Expense is over 6x. Finally, positive rating pressure depends on the company maintaining leverage as measured by Debt/EBITDA below 2.5x (all figures considering Moody`s standard adjustments).

What Could Change the Rating - Down

The ratings could be lowered if the company fails to deliver organic growth or to maintain EBITDA margins near its current level. The ratings could also come under pressure if leverage ratio remains above 3.5x on a consistent basis or if liquidity deteriorates.

Other Considerations

MAPPING TO THE RATING METHODOLOGY

Fleury's grid-indicated rating under Moody's Business and Consumer Service Industry Rating Methodology maps

to a "Ba2" rating, one notch below the current Ba1 ratings assigned. The grid reflects mainly the company's small size relative to global rated peers, while the assigned ratings incorporates qualitative factors such as Fleury's positioning in the Brazilian market, adequate liquidity profile and expected continued improvement in leverage, as a consequence of improved EBITDA and gross debt reduction coming from the maturity of the company's debentures. Prospectively, Moody's 12-18 month forward view also maps to a "Ba2" rating.

Rating Factors

Fleury SA

Business and Consumer Service Industry Grid [1][2]	**Current LTM 9/30/2015**		[3]**Moody's 12-18 Month Forward ViewAs of 1/27/2016**	
Factor 1 : Scale (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$0.6	B	$0.5 - $1.5	B
Factor 2 : Business Profile (20%)				
a) Demand Characteristics	Baa	Baa	Baa	Baa
b) Competitive Profile	Ba	Ba	Ba	Ba
Factor 3 : Profitability (10%)				
a) EBITA Margin	17.5%	Ba	15% - 20%	Ba
Factor 4 : Leverage and Coverage (40%)				
a) Debt / EBITDA	2.8x	Baa	2x - 3x	Baa
b) EBITA / Interest	2.1x	B	1x - 3x	B
c) RCF / Net Debt	43.4%	A	25% - 40%	Baa
Factor 5 : Financial Policy (10%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Rating:				
a) Indicated Rating from Grid		Ba2		Ba2
b) Actual Rating Assigned				Ba1

[1] All ratios are based on 'Adjusted' financial data and incorporate Moody's Global Standard Adjustments for Non-Financial Corporations. [2] As of 9/30/2015(L); Source: Moody's Financial Metrics [3] This represents Moody's forward view; not the view of the issuer; and unless noted in the text, does not incorporate significant acquisitions and divestitures

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