MOODY'S
INVESTORS SERVICE

Credit Opinion: Fleury SA

Global Credit Research - 12 Feb 2015

Brazil

Ratings

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

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Key Indicators

[1]**Fleury SA**

	9/30/2014(L)	12/31/2013	12/31/2012	12/31/2011	12/31/2010
Revenue (USD Billion)	$0.7	$0.8	$0.8	$0.7	$0.5
EBITA Margin	17.1%	16.3%	17.3%	17.9%	27.1%
Debt / EBITDA	3.6x	3.7x	2.7x	4.1x	1.4x
EBITA / Interest	2.0x	2.3x	3.3x	5.3x	6.6x
RCF / Net Debt	12.6%	23.5%	39.0%	40.6%	-122.8%

[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

- Good medium term prospects for the Brazilian health care industry

- Highly fragmented industry provides room for M&A activity

- Disciplined and successful acquisitions

- Credit metrics currently weak for the rating category , but liquidity remains adequate

- 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 (84% of gross revenues), operations in Hospitals (13.3% of gross revenues) and others (2.7% of gross revenues) business segments. The group has a diversified portfolio of brands that envisages different social classes in seven Brazilian states. For the last twelve months ended in September 2014, Fleury posted revenues of BRL 1.6 billion (approximately USD 721 million converted by the average exchange rate) and adjusted EBITDA of BRL 458 million (or 27.8% EBITDA margin).

SUMMARY RATING RATIONALE

The Ba1 / Aa1.br ratings are supported by Fleury's strong and well recognized brand and the positive medium-term prospects for the Brazilian health care industry. The ratings also incorporate the improved diversification in terms of branding, consumer's profile and geographic footprint derived from the company's 27 acquisitions between 2002 and 2012. Ratings are constrained by the company's small size compared to global peers as well as its current pressured credit metrics and limited free cash flow generation due to portfolio restructuring activities.

DETAILED RATING CONSIDERATIONS

STRONG AND WELL RECOGNIZED BRANDS

Fleury operates under six brands (Fleury, Clínica Felippe Mattoso, Weinmann, a+, Diagnoson and Labs a+) in seven Brazilian states, providing premium and intermediary services for customers from classes A through C. The brands Fleury, Clínica Felippe Mattoso and Weinmann labs enjoy leading positions in the A and B social classes in São Paulo, Rio de Janeiro and Rio Grande do Sul states, respectively, which are among 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 high quality diagnostic services to beneficiaries of intermediary level health plans.

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 good market position in Brazil.

GOOD MEDIUM TERM PROSPECTS FOR THE BRAZILIAN HEALTH CARE INDUSTRY

Fleury's Ba1 ratings are supported by the favorable medium-term prospects for the Brazilian healthcare industry. Over the last several years, the increase in the population's average income level led to a gradual growth in private health spending. Moreover, health expenditures tend to be relatively resilient to economic cycles; according to Datafolha, health plans are the second consumption priority of Brazilians, lagging behind only housing. About 15 million net additions to health plans were done between 2005 and 2013, as a consequence of 13.5 million additional jobs created in the country during this period. For 2014 and 2015, additions to health plans should slowdown, given the current reduction in formal job creations and slowdown of the Brazilian economy. Between December 2013 and September 2014 there was a net addition of over 992k health plans beneficiaries.

Population aging supports our view of increasing demand for health care services in the mid to long-term. 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.

Finally, the private health plan segment is still under-penetrated in Brazil, especially when compared to international standards, which adds to our positive view on the sector. By September 2014, only 25% 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 majority (about 38%) of total health care plans beneficiaries in Brazil are located in São Paulo, 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 and Dasa (not rated) are in a more advantageous situation and have broader bargaining power when dealing with health insurance providers and hospitals.

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 to preserve its creditworthiness.

DISCIPLINED AND SUCCESSFUL ACQUISITIONS

Acquisitions were a key growth strategy for Fleury, but in 2015 and 2016 the company will be more focused on increasing profitability. Moreover, although M&A activity can entail integration challenges, higher working capital and investment needs, we do 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 seven Brazilian states and its portfolio of brands covers social classes A, B and C. Despite the acquisitions, the company's growth has been mainly organic-driven, with most of the group's revenues increase coming from its existing store 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 and 2014, Fleury did not announce any acquisition and focused on business integration and cost efficiencies to recover profitability. For 2015, the company's guidance point at an annual capex disbursement of BRL 175 - 225 million, which we believe is a sustained level going forward.

CREDIT METRICS CURRENTLY WEAK FOR THE RATING CATEGORY, BUT LIQUIDITY REMAINS ADEQUATE

In the last twelve months ended September 2014, Fleury's leverage was 3.6x, in the low-end of the `Ba' rating category. 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. These adjustments and strategic focus will improve Fleury's profitability going forward, but risks related to inflation may persist, as approximately 49% of Fleury's costs are related to labor. Still, we recognize Fleury's track record of efficiently passing-through costs increases.

We estimate that Fleury should be able to sustain operating margins at current levels going forward. For the LTM ending September 2014, Fleury's adjusted EBITDA margin reached 27.8%, up from 26.8% at the end of 2013. In the most recent quarter (3Q14), adjusted EBITDA margin reached 30%. Moreover, in the 3Q14, Fleury posted revenues/m2 of BRL 4.1, the highest level since 2011, with same store sales increasing 6.5% in 3Q14 versus 3Q13.

In October 2014, Fleury raised BRL 102 million 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%. Also, there is an additional BRL 53 million limit available on this line. Considering the impact of this loan and the initial amortization of the 1st series of debentures we estimate leverage to be at 3.5x at year-end 2014.

The company's liquidity continues to be adequate and debt maturities remain concentrated in the long-term. As of September 2014, cash position of BRL 519 million (including proceeds from the debenture issuance) was sufficient to cover reported short term debt by 6.8 times and corresponded to 53% of total reported debt.

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 1.6 billion as of LTM September 2014. 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 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 shareholder is Core Participações (unrated) through its indirect stake of 35% and direct stake of 6.3% in Fleury. During 2014, Core announced that it was negotiating a potential sale of its interests in Fleury, but none of the negotiations resulted in a definitive agreement. Fleury's management is professional and the board has seven members, being two independent. In Moody's opinion, the implementation of a permanent fiscal committee 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 and improving leverage ratios.

What Could Change the Rating - Up

Positive pressure on the rating could develop over time if the company is able to continue generating good and 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 company keeping leverage as measured by Debt/EBITDA below 3.0x (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 4.0x 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 "Ba3" rating, two notches below the current Ba1 ratings assigned. The grid reflects mainly the company's pressured credit metrics resulted from its growth strategy and its small size relative to global rated peers, while the assigned ratings incorporates qualitative factors such as Fleury's positioning in Brazil, adequate liquidity profile and gradual improvement in leverage going forward, as a consequence of improved EBITDA and gross debt reduction coming from the maturity of the company's first series debentures. Prospectively, Moody's 12-18 month forward view maps to a "Ba2" rating, with stability across all sub-factors, except for RCF/Net Debt and Debt/EBITDA, which are expected to improve.

Rating Factors

Fleury SA

Business and Consumer Service Industry Grid [1][2]	**Current LTM 9/30/2014**		[3]**Moody's 12-18 Month Forward ViewAs of 2/5/2015**	
Factor 1 : Scale (20%)	**Measure**	**Score**	**Measure**	**Score**
a) Revenue (USD Billion)	$0.7	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	17.1%	Ba	15% - 20%	Ba
Factor 4 : Leverage and Coverage (40%)				

a) Debt / EBITDA	3.6x	Ba	2.0x - 3.0x	Baa
b) EBITA / Interest	2.0x	B	1x - 3x	B
c) RCF / Net Debt	12.6%	B	15% - 25%	Ba
Factor 5 : Financial Policy (10%)				
a) Financial Policy	Ba	Ba	Ba	Ba
Rating:				
a) Indicated Rating from Grid		Ba3		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 9/30/2014(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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