

**Credit Opinion: Grupo Fleury S.A.**

Global Credit Research - 14 Nov 2012

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] **Grupo Fleury S.A.**

	9/30/2012(L)	12/31/2011	12/31/2010	12/31/2009	12/31/2008
Pretax Income (USD Million)	\$69.6	\$79.9	\$111.0	\$64.4	\$35.0
Revenue (USD Million)	\$774.3	\$674.7	\$495.5	\$390.2	\$375.0
RCF / Net Debt	40.5%	27.4%	-122.8%	-561.0%	20.1%
FCF / Debt	-5.8%	-8.5%	-8.7%	-12.7%	-4.1%
(EBITDA-CapEx) / Interest Exp	1.4x	1.4x	5.8x	4.2x	2.1x
Debt / EBITDA	2.8x	4.2x	1.4x	2.3x	2.7x

[1] All ratios are calculated using Moody's Standard Adjustments.

Note: For definitions of Moody's most common ratio terms please see the accompanying [User's Guide](#).

**Opinion**

**Rating Rationale**

Strong and well recognized brand

Good medium term prospects for the Brazilian health care industry

Highly fragmented industry

Disciplined and successful acquisitions

Overall good credit metrics, but limited cash generation

Relative small size when compared to global peers

## **Corporate Profile**

Founded in 1926, Fleury is a major provider of high quality diagnostic medicine (83% of gross revenues) and integrated medicine (17% of gross revenues) in Brazil. The Group has a diversified portfolio of brands that envisage different social classes in seven Brazilian states. For the last twelve months period ended in September 2012, Fleury Group posted revenues of BRL 1.5 billion (approximately USD 728 million at current exchange rates) and adjusted EBITDA was of BRL 367.8 million with margin of 25.3%.

## **SUMMARY RATING RATIONALE**

Fleury's Ba1 / Aa1.br ratings are supported by the company's strong and well recognized brand, positive medium-term prospects for the Brazilian health care industry and by its overall good financial metrics. The ratings also incorporate the fact that Fleury's 27 acquisitions made between 2002 and 2012 brought diversification in terms of branding & positioning, consumer's profile and geographic footprint. Key ratings constraints include the company's small size compared to global peers as well as its limited cash generation due to expansion activities.

## **DETAILED RATING CONSIDERATIONS**

### **STRONG AND WELL RECOGNIZED BRAND**

Fleury has one of the strongest brands in its business segment in Brazil, with wide recognition by patients and physicians. Patients' satisfaction with Fleury reached 85%, according to a survey performed in 2010. Unlike the US and other markets, the health care provider in Brazil is usually a choice of the patient and procedures are performed outside of hospitals and medical offices. Therefore, branding is a key factor in patient's healthcare selection.

### **GOOD MEDIUM TERM PROSPECTS FOR THE BRAZILIAN HEALTH CARE INDUSTRY**

The rating reflects favorable medium-term prospects for the Brazilian healthcare industry. Firstly, stability and economic growth have boosted the average income of Brazilian population, providing opportunity for a higher overall spending on private health services.

Secondly, health needs increase as people get older. Estimates are that the proportions of Brazilians aged 60 years or older should reach 30% by 2050 from 10% in 2010, meaningfully altering the demographics in the country.

Thirdly, private health plans in Brazil are still under-penetrated, especially when compared to international peers. For example, according to data provided by the US Census Bureau, by the Mexican Institute of Public Health and by the Brazilian Institute of Geography and Statics (IBGE), about 85% of the population in the US is covered by private health plans, followed by 60% in Mexico and 24% in Brazil.

Finally, as private health insurance plans are one of the main benefits offered by employers, the creation of formal employment opportunities should lead to a higher demand for private health care services. Unemployment rate reached 5.4% in September 2012, one of the country's lowest historical level since this data started to be compiled by IBGE (Brazilian Statistical Department).

### **HIGHLY FRAGMENTED INDUSTRY**

The private health care sector in Brazil is very fragmented and has no dominant player. There are currently more than five thousand health care services centers that serve private health plans in Brazil. We believe that in a fragmented industry the 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 consolidation is expected and should benefit the larger competitors, which are more likely to take advantage of M&A activity.

### **DISCIPLINED AND SUCCESSFUL ACQUISITIONS**

Acquisitions are a key growth strategy for Fleury. Although M&A activity can entail integration challenges and higher working capital and investment needs, we do recognize that Fleury has thus far managed its acquisitions successfully, as evidenced by the diversification of the group, without jeopardizing credit metrics. 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 envisages social classes A, B and C. Despite the acquisitions, the company's growth has been mainly organic-driven, with about 2/3 of the group's revenues increase coming from its existing store operations, except in 2012 due to the Labs D'Or deal.

We viewed Labs D'Or acquisition, announced in late 2011 for BRL 1.2 billion, being 50% in cash and 50% in shares, as a credit positive. The 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. The integration process has been running as originally planned by Fleury. Key steps have already been concluded, including cultural integration, processes standardization, negotiations with suppliers, ERP incorporation and unification of call center, among others. Going forward, the company still needs to implement some final IT resources in specific business areas, unify technical departments and develop a branding project in Rio de Janeiro.

In September, 2012 Fleury announced the acquisition of 51% of Grupo Papaiz, a dental diagnostics player with leadership position in the state of Sao Paulo and more than 30 years of track record in this market, by BRL 18.4 million. It is a small deal, given Fleury's size and cash position, but deemed as positive by Moody's, as it increased Fleury's role in the Brazilian healthcare industry. In the last twelve months period ended in June, 2012, Papaiz's net revenues reached 13.4 million, with EBITDA margin of 27.6%.

#### OVERALL GOOD CREDIT METRICS, BUT LIMITED CASH GENERATION

Fleury has overall good credit metrics, with comfortable liquidity and leverage ratios. As of September, 2012, cash and equivalents reached BRL 239 million and were enough to cover reported short term debt by 2.4x. Leverage measured by total adjusted Debt to EBITDA was of 2.8x in the same period. The company has also reported stable Adjusted EBITDA Margin over time, which reached 25.3% in the last twelve months period ended in September, 2012.

Nevertheless, we believe that cash flow generation is still limited, mainly due to investments needed to fund the company's expansion strategy. For the last twelve months period ended in September, 2012, Fleury had a negative free cash flow position of BRL 59 million, according to Moody's standard adjustments. In our view, Fleury should be able to turn free cash flow positive in the next few quarters, as investments related to recently acquired businesses should decline.

#### RELATIVE SMALL SIZE WHEN COMPARED TO GLOBAL PEERS

Although acquisitions have increased Fleury's size, the company remains relatively small in terms of size when compared to global peers, with annual net revenues of BRL 1.5 billion as of LTM September 2012 figures. 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.

#### Corporate Governance

Fleury is a public owned company listed in BM&F Bovespa. Currently, 31.2% of shares are free float and the company is part of the Novo Mercado, the highest standards of corporate governance in Brazil. Fleury's management is professional and the board has 10 members, three of them independent. Offsetting these positive aspects, Fleury currently still lacks a fiscal committee.

#### 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 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 performance proves sustainable. This will be the case if free cash flow to net debt consistently exceeds 10% and if (EBITDA-Capex) / Interest Expense is over four times. Finally, positive rating pressure depends on company's keeping 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 increase to 3.5x or higher Debt/EBITDA in a consistent basis or if liquidity deteriorates.

### Rating Factors

#### Grupo Fleury S.A

Business and Consumer Service [1][2]	LTM 09/30/2012		[3]Moody's 12-18 Months Forward View As of 11/11/2012	
	Measure	Score	Measure	Score
<b>Factor 1: Size and Profitability (30%)</b>				
a) Pretax Income (USD Million)	\$69.6	B	\$ 75 - \$ 120	Ba
b) Revenue (USD Million)	\$774.3	B	\$ 800 - \$1200	B
<b>Factor 2: Financial Strength (55%)</b>				
a) RCF / Net Debt	40.5%	A	40% - 55%	A
b) FCF / Debt	-5.8%	Ca	8% - 16%	Ba
c) (EBITDA - CapEx) / Interest Exp	1.4x	B	3.0x - 4.0x	Ba
d) Debt / EBITDA	2.8x	Baa	2.0x - 3.0x	Baa
<b>Factor 3: Financial Policy (15%)</b>				
d) Financial Policy	Baa	Baa	Baa	Baa
<b>Rating:</b>				
a) Indicated Rating from Grid	Ba3	Ba3	Ba1	Ba1
b) Actual Rating Assigned	Ba1	Ba1	Ba1	Ba1

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 9/30/2012(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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