

# MOODY'S

## INVESTORS SERVICE

### Credit Opinion: Fleury SA

Global Credit Research - 09 Jan 2014

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.

	9/30/2013(L)	12/31/2012	12/31/2011	12/31/2010	12/31/2009
Pretax Income (USD Million)	\$69.3	\$80.1	\$79.9	\$111.0	\$64.4
Revenue (USD Million)	\$783.7	\$771.9	\$674.7	\$495.5	\$390.2
RCF / Net Debt	36.7%	42.7%	40.6%	-122.8%	-561.0%
FCF / Debt	-3.5%	-4.4%	-6.7%	-8.7%	-12.7%
(EBITDA-CapEx) / Interest Exp	2.6x	2.5x	1.8x	5.8x	4.2x
Debt / EBITDA	3.7x	2.7x	4.1x	1.4x	2.3x

[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 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
- Short term pressure on leverage ratios and overall credit metrics

- 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). 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 2013, Fleury posted revenues of BRL 1.6 billion (approximately USD 784 million converted by the average exchange rate) and adjusted EBITDA of BRL 419 million (or 25.5% EBITDA margin).

## **SUMMARY RATING RATIONALE**

The Ba1 / Aa1.br ratings are supported by Fleury's strong and well recognized brand, the positive medium-term prospects for the Brazilian health care industry and by the company's overall good financial metrics. 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. Key rating constraints include 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 expansion activities.

## **DETAILED RATING CONSIDERATIONS**

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

Fleury operates under six brands (Fleury, Clínica Felipe Mattoso, Weinmann, a+, Diagnoson and Labs) in seven Brazilian states, providing premium and intermediary services for customers from classes A through C. The brands Fleury, Clínica Felipe 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. The Fleury brand is one of the strongest in its business segment in Brazil, with wide recognition by patients and physicians. In 2012, Fleury was pointed as the best and most reliable diagnosis center by a survey made by IBOPE (Brazilian Institute of Public Opinion and Statistics).

The national brand "a+" was launched in 2011 as a result of the consolidation of brands previously acquired by the company. Currently, "a+" operations are present in the six main economic centers offering high quality diagnostic services to the clients, which are mainly composed by beneficiaries of intermediary health plans.

Unlike 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 health plan 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. The potential for additional formal job creation in Brazil over the next years could also imply net additions to health plans. For the 12.4 million formal jobs created from 2005 to 2012, there were 14.9 million net additions to health plans.

Population aging also supports our view of increasing demand for health care services. 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 10% in 2010.

Finally, the private health plan segment in is still under-penetrated in Brazil, especially when compared to international peers, which adds to our positive view on the sector. By 2012, only 25% of the Brazilian population had a health plan contracted, while in developed economies the penetration rate reached 42% in the same period, according to ANS - National Health Agency.

### **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.

#### 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 so far managed its acquisitions successfully, 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 covers 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, with the exception of 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 by Fleury has taken longer than initially estimated with still a few steps left to be concluded in 2014. But the key steps such as cultural integration, processes standardization, negotiations with suppliers, ERP incorporation and unification of call center, among others, have been concluded. The company also adjusted its portfolio in Rio de Janeiro aiming at achieving higher profitability. The entire benefit of such actions will be captured throughout 2014.

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.

#### SHORT TERM PRESSURE ON LEVERAGE RATIOS AND OVERALL CREDIT METRICS

In January 2013, Fleury issued BRL 500 million debentures, which pressured leverage and overall credit metrics during recent quarters. Moody's estimated that leverage ratio, as measured by adjusted gross debt/EBITDA, would end 2013 at about 3.0x. However, given Fleury's strategy to adequate its service offering and other cost pressures during 2013, leverage should remain higher than anticipated in the short to medium term. In the last twelve months ended September 2013, Fleury's leverage was 3.7x, up from 2.7x at the end of 2012.

During 2013, Fleury's margins were negatively impacted by: (i) operational adjustments and integration costs in Rio de Janeiro; (ii) the early stage of the 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. Although we believe that most of these actions will increase profitability from 2014 onwards, risks related to inflation may persist, as currently about 37.4% of Fleury's costs are related to labor.

The company's liquidity continues to be adequate and debt maturities remain concentrated in the long-term. Current cash position of BRL 583 million (including proceeds from the debenture issuance) at the end of September 2013 was sufficient to cover reported short term debt by 22.4 times and corresponded to 59% of total reported debt.

Moreover, Fleury has shown a good track record of integrating acquisitions and delivering planned results. In the 3Q13, Fleury posted revenues/m<sup>2</sup> of BRL 4.100, the highest level since 2011, with same store sales increasing 11.1% in 3Q13 versus 3Q12. Following the acquisition of Lab's D'Or in late 2011 and the expected pressure in performance during the period of integration, the group was able to normalize its credit metrics by the end of 2012. In our view, it was a well-managed process, especially given the relatively large size of the acquisition.

#### 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 2013. 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.

## Corporate Governance

Fleury is a public owned company listed in BM&F Bovespa. Currently, 40.2% 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. Fleury's management is professional and the board has nine members, being three 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 free cash flow to debt consistently exceeds 8% 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 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.

## Rating Factors

### Grupo Fleury S.A.

Business and Consumer Service [1][2]	LTM 09/30/13		[3]Moody's 12- 18 month Forward View - As of 12/16/2013	
<b>Factor 1: Size and Profitability (30%)</b>				
a) Pretax Income (USD Million)	\$69.26	B	\$75 - \$250	Ba
b) Revenue (USD Million)	\$783.66	B	\$500- \$1.500	B
<b>Factor 2: Financial Strength (55%)</b>				
a) RCF / Net Debt	36.70%	Baa	25% - 40%	Baa
b) FCF / Debt	-3.46%	Caa	0% - 8%	B
c) (EBITDA - CapEx) / Interest Exp	2.60x	Ba	2.5x - 4.0x	Ba
d) Debt / EBITDA	3.66x	Ba	3.0x - 4.0x	Ba
<b>Factor 3: Financial Policy (15%)</b>				
d) Financial Policy	Baa	Baa	Baa	Baa
<b>Rating:</b>				
a) Indicated Rating from Grid	Ba3	Ba3	Ba2	Ba2
b) Actual Rating Assigned	Ba1	Ba1		

[1] All ratios are calculated using Moody's Standard Adjustments. [2] As of 9/30/2013(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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