Q3 2012 Earnings Call

Company Participants

- Joao Patah, Head
- Omar Hauche, CEO
- Unidentified Speaker, Company Representative

Other Participants

- Andrea Teixeira, Analyst
- Josh Milberg, Analyst
- Luciano Campos, Analyst
- Manuela Thez, Analyst
- Pedro Montenegro, Analyst
- Rafael Frade, Analyst

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury's 2012 Third Quarter Conference Call. Mr. Omar Hauache, CEO and Mr. Joao Patah, Head of IR, will present the results. (Operator Instructions)

Those following the presentation via the webcast may post their questions in advance on our website. They will be answered during the Q&A session as long as we have enough time. Before proceeding, let me mention that forward statements are based on the beliefs and assumption of the Grupo Fleury management and on information currently available to the Company. They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur.

Investors and analysts should understand the conditions related to macro-economic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Omar Hauche, CEO of Grupo Fleury. Mr. Hauche, you may begin your presentation.

Omar Hauche

Okay, thank you. Good morning, everyone and welcome to our Third Quarter 2012 earnings call. And please let's move on to slide three. Let me start by giving you some highlights of the Third Quarter 2012 results and some perspectives based on our growth strategy. The Third Quarter 2012 results will be detailed by Joao Patah later on. But let me share with you comments.

You will see that we keep on growing on our vision. Organic growth in spite of some deceleration association with Brazil's economic slowdown, we feel stronger than the market's growth. In fact, patient service centers' organic growth was even superior than last year's growth. Costs are strictly under control and our current cost structure is prepared for further growth in the next coming quarters.

Maturation of the new square footage and services mainly launched in December of 2011 has earned the way. And we will probably expect good results of this maturation in 2013. The same works for labs integration, which so far runs well and initial good results are already being seen, such as increased productivity for labs patients service centers.

Our profitability remains stable when compared to last year's profitability even if we consider the marketing campaign expenses that are concentrated in the second half of 2012. Operating cash hit very good figures this quarter. But net income improved a lot in financial expenses and higher default income tax are not included.

As for our branding strategy, the national brand a+[ph], launched in May 2011 is growing consistently and is proving a distinguished offering for B and C public. A new marketing campaign in the Third Quarter of 2012 and the Fourth Quarter of this year is in place and reinforces a+ single attributes.

All these efforts resulted in a market share growth. And an increased market share. It is worth mentioning that we have already reached a conclusion about our brand strategy in Rio de Janeiro and this will soon be announced. We will focus on Fleury's brand in 2013 and many investments will be directed for this brand. The same will happen for Weinmann, which is our premium brand in the south of the country. Both brands are very recognized by patients and physicians, thanks to their quality and many differentials that are delivered.

Quality will be further reinforced by Fleury and Weinmann. And talking about quality and differentials, knowledge is one of our main differentials of Grupo Fleury. We developed and share knowledge in a daily basis. Just to give you an example, our 22nd consecutive Annual Group Scientific meeting has been very successful. This meeting takes a whole week and is dedicated for the presentation and discussion of scientific articles, oral presentations and posters, coming from all the medical, technical and management areas in the Company.

This year, more than 350 presentations were done. And this is part of our corporate culture. Regarding perspectives for revenue and margins growth, we will continue to carry several actions directed to organic growth. Pricing is one relevant component of our growth. We plan to further adjust our prices at levels that equal inflation. For example, in 2012, we reached price adjustments at better levels than in previous years. And this is an evolving process.

This is one of our goals. Many actions and projects are underway to increase volume and then reach our mix of services even more. We discussed with our board our revised expansion plan and we will certainly select projects that brings the best returns for the brands we have. As a consequence of that, we already have rented the space to build up new and complete PSCs that are larger than previously planned. And this will mainly be delivered in the first half of 2014.

In this context, 2013 will be dedicated to build up these new facilities. And obviously productivity of the current PSCs will be enhanced, targeting the acceleration of the maturation of these PSCs. As for diagnostic operations in hospitals, we are looking for new contracts in addition to the new acquisitions of Rede D'Or hospitals.

We recently announced the acquisition of Grupo Papaiz, a dental diagnostic company as shown in slide four. After CADE's approval, Grupo Fleury will hold 51% of Grupo Papaiz. And Odontoprev will hold the remaining 49%. This deal will present new opportunities for Grupo Fleury in the high-potential dental diagnostics market.

Let's move on to slide five. Labs integration continues to evolve, confirming to be a strong basis for our profitable growth in real. Cultural integration and a rising commitment of a highly qualified personnel, together with other important steps as shown in slide five have been accomplished. Out of these accomplishments, let me stress the importance of the ERP integration and the call center unification.

Regarding next steps, we will soon implement the Company's IT front office system in all operations of clinical analysis. We also plan to have a single technical area for the lab tests are analyzed and this should happen in the First Quarter of 2013.

Now, I'm going to pass on the word to Joao Patah who will detail the quarterly results. Please, Joao.

Joao Patah

Thank you, Omar. Good morning, everyone. It's a pleasure to be back to Grupo Fleury and talk with you. Let's start with the financial highlights in slides six and seven. We show that the top line growth margins and cash generation continue to be consistent, despite the persistent slowdown of our economy, with lower forms of job creation, Grupo Fleury's revenue increased by 28.5% year over year, achieving BRL447 million.

Double digit organic growth of 12.2% in PSCs and 10.4% in the Group is still well above market. Gross profit in EBITDA values have reached the highest numbers in history, as a consequence of the sustainable balance between growth and margins. EBITDA margins are stable when compared to 2011, recurring basis with 20.5% in 3Q'12, including the strong marketing expenses for a+.

Operating cash achieved BRL62 million in the quarter. And that's for the investment activities and the payment of BRL20 million as anticipated dividends. Operating cash in nine months of 2012 accumulated BRL149 million, 164% above the same period of last year. Also, cash net income, which excludes accounting effects of the deferred income tax grew 96% year over year to BRL42 million.

In slide eight, we show the breakdown by the mix of services. Imaging services continue to expand strongly as an outcome of authorization and expansion of imaging services. The implementation of the one-stop shop concept in more locations together with integrated diagnostic medical centers, we have readily balanced the mix offering in the patient service centers network.

On the next slide, let's talk about PSCs, which outperformed the market again, where revenue increased by 25%, with 12.2% organic growth achieved through expansion over all brands. Consistent growth in Fleury environment has been complemented by large and is a leading mark towards the potentials and by the a+ brand gain of share in DC plans. Assets usage is also improving as the portfolio of services expands, jointly with the maturation of square meters recently launched an improvement of Labs D'Or productivity, thanks to the integration efforts.

Revenue per square meter has already achieved a peak before the expansion plan and Labs D'Or acquisition. Optimization process in Labs D'Or will also further contribute to an advance in the metric throughout next quarters.

Moving to diagnostic operations in hospitals in slide 10, the 71.8% increase was driven mainly by Rede D'Or's hospitals' consolidated action 4Q'11. Same hospital sales grew by 5.7% and cancelled contracts caused organic growth to decrease 2.4%. We remain optimistic about this business line in the development because of three main reasons.

First, hospitals show add capacity in medium-term. Second, the portfolio of exams making it reach in existing contracts. And third, we see room for new quality hospital operations. As one example, we began operations in some regions of quarter[ph] this October. This hospital, previously known as Noce Sino Dilruges[ph] has been recently acquired by Rede D'Or.

Moving to slide 11, we'd like to add focus in medium and high complex exams, its improving revenue and profitability per test, bringing good outlook for growth and results. On the other side, Anvisa's strike in 3Q'12 affected this business line, reducing revenues by 9.7% year over year. As for Preventive Medicine, the business line continues to grow and is in line with our diversification strategy.

On the next slide, number 12, let's analyze consolidation and the receivables profile. The Cash Collection Program is bringing improvements, reducing the cancellations level to 4.3% of gross revenue, compared to 5.5% in the first half of 2012. Provisions coverage for receivables due to more than 120 base, which is also 100% under the provision policy, reached 60%. Here it is important to highlight that profile has improved with a clear percentage of receivables under -- older than 180 days.

In slide 13, we will talk about the cost of services. Improvements over the previous quarters have been accomplished readily as a consequence of already mentioned assets usage and developed the relationships with strategic partners in materials and outsourcing. At the same time we continue to expand our qualified personnel and the participation of human interface services be that on Lab D'Or operations or in organic expansion.

Call center capacity has expanded and physicians are now 1,522 members. Gross profits achieved BRL120 million in the quarter, the highest value in the Company's history. Gross margins increased 293 basis points over 2Q'12 achieving 30%.

Now, moving to slide 14, operating expenses presented improvement over the previous years. Increase over the previous quarter is related mainly to a+ marketing campaign which is concentrated on the second half of the year. Also to one-off expenses related to the (inaudible) restructuring and to bettering of the SG&A services in the reals.

Moving to slide 15 we can see that EBITDA and EBIT were stable when compared to the previous year. Considering marketing and pre-operation expenses in both periods, EBITDA achieved BRL82 million, also the highest in the Company's history. About EBIT, it repeated at the previous quarter's level at BRL56 million.

In the next slide, we analyze net debt and financial results. The level of financial leverage and the debt profile are conservative considering the Company's strong financial health. The cost of debt has decreased as a consequence of Brazilian interest rates and as of the participatory cash management. BRL145 million will be due over the next 12 months. And our current cash position of BRL239 million is enough to ensure liquidity.

As already known, two series of debentures were issued in December 2011, affecting the deal over real financial expenses comparison. Net financial expenses was BRL13 million in 3Q '12, compared to BRL6 million in 3Q '11. In spite of this fact, net income cash as shown in the next slide, number 17, increased 96% year over year to BRL42 million as already mentioned.

Net income remained stable and achieved BRL26 million due to higher deferred income tax. It's important to emphasize that amortization of goodwill is expected to maintain low cash tax in the following years.

Moving to slide 18, we talk about CapEx and expansion plan. CapEx achieved BRL33 million in the quarter and BRL130 million year to date, as expected. Investment focus was once again on the acquisition of image equipment and on the optimization and productivity of the PSC network. Omar has already mentioned plans for 2013, reflecting enlarged offerings for 2014.

In slide 19, we clearly observed that cash generation remained one of the business trends. Both operational and free cash flow were positive during the quarter and operating activities generated enough cash to support the Company's investments and financial activities. Year to date operation cash flow also support organic tax[ph] in the period. BRL62 million in the quarter and BRL149 million in the nine months of 2012 are strong numbers, compared also to previous years.

EBITDA converted in cash, the cash converted generate also improved. Moving to capital market in slide 20, we would like to comment that liquidity is growing as measured by the negotiability index. Or by the ATTV[ph], which achieved BRL5.2 million year to date, a 16% growth compared to last year.

Finally, in slide 21 shows the coming IR programs. And we hope to meet you soon in the next event.

Now, thank you very much. And now I would like to move to the Q&A session.

Questions And Answers

Operator

Excuse me, ladies and gentlemen, we will now begin the question and answer session. (Operator Instructions) Excuse me, our first question comes from Rafael Frade with Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Good afternoon. I have a few questions. First I would like to explore a little bit your purview on the market growth, looking for the insurance companies that already report their results, their claims are growing around 20%. So I would like to understand if your view is that the medical diagnostics in general is losing share in terms of ability to view in terms of costs for insurance companies.

And for some points in your presentation, you mentioned that you gained market share in the quarter. I would like to know what would be the base compared to this gain of market share, what's the total number for the market, or what's the reference for that?

The second question would be regarding hospitals. Omar mentioned that probably you can have new contacts with Rede D'Or and but[ph] mentioned that now you're at reaching an agreement with (inaudible) so if you could talk a little more about that. And maybe if you can disclose some numbers related to those hospices.

And finally, regarding the expansion for 2013, you mentioned that you are already rented the place for the new facilities for 2013, if you could give us any indication or analysis of the previous numbers of around 14,000 square meters, to your targets, or if there are any changes on that?

A - Omar Hauche

Okay, Rafael, thanks for the question. This is Omar. Okay, let's start talking about the market group. You mentioned the insurance companies claims growing and how this can be compared to our growth.

What we know is that there is usually a clear alignment between our growth and the health insurance growth. When they usually present very good results, when their medical loss ratio decreases, it's usually associated with a worse scenario for us. On the other hand, when we present very good growth, we've gotten volume and we've gotten revenues, it usually has a certain pressure regarding medical loss ratios.

In this last Third Quarter, I think that we are witnessing this kind of loss of this balance. I think that we are reaching, at least during the beginning of this Fourth Quarter a better scenario so far. So if they are really, their claims are really growing this should reflect later for us more potential for growth. We expect this should happen. This is, in a way or not, this is already happening. But the Third Quarter in general, the overall growth of 10.4% is still over, still superior to the market. And it's still in a way superior to the competitors and this is in line with your second question, market share and growth.

We don't have this clear basis to compel of course. What we have is our numbers compared to the competitors and in this way, we can expect that our growth has been superior and one major drive for this growth is a+, a+ has been growing consistently. And we are targeting B and C classes. And we know that we are competing with some competitors for these same B and C classes. The rate of growth of a+ has been surprisingly positive.

And so hospital new contracts that you mentioned, we have already started our operations at (inaudible) that is from now is going to be called San Luis Chabaquare[ph], it's the same hospital. We have already started our operations in this new hospital that has just been acquired by Rede D'Or and we are looking for more contracts.

I think it's worth mentioning, once more, I've already talked about of in our previous calls. When you talk about this business line, which is diagnostic operations in hospitals, there is limit for our growth which is directly related to the potential of growth of the hospitals where we are in. If the hospital stops growing of its patient charges for more growth, we will just follow the growth of that back hospital where we are in.

What is new is that the major part of the hospitals where we are providing services, are expanding. But this expansion will not be delivered in the next month. So we should await for these expansions to happen. And if they do really expand, our growth will continue to happen.

You asked about expansion plans. We are in a state about that. This is what I said, we have just revised our expansion plan. We presented this to our board. We are targeting with internal investments, even better than we had. So we are more selective. And in this context, we revised our expansion plan targeting, the larger patient service centers and with more complete service centers. There's now more of a complete mix of exams and services.

And in this context, now this will take a little bit longer time to probably deliver. It will happen probably during the Fourth Quarter of 2013. And some of this will be delivered in the Second Quarter of 2013, of 2014, pardon. 2014. And this will be built up during 2013 and we will be delivered in the first half of 2014. It can be even more then 14,000. This is not a metric for us to follow right now, because it can be even more.

We have rented spaces that if accomplished, if it can build up in this 2013 year, we'll have even more than 14,000 square meters, because we are targeting larger facilities to be delivered. And which is an update about this topic.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Great. Just a follow-up, Omar, regarding the (inaudible), if you could give us any idea of the size, at least -- would be great.

A - Omar Hauche

We usually don't disclose the size. But just for you to have an idea, I would say that a hospital like San Luis Chabaquare, which was (inaudible), it's about the same size of a hospital like Santa Catarina for instance. And it's a good contract, some with good prices, I think -- I can even check the number of beds is has. And I can tell -- I think it's (inaudible) for you to follow, we can talk rates about that. I don't have these figures right now to give to you.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay, thank you, thank you very much.

Operator

Our next question comes from Pedro Montenegro with BTG Pactual.

Q - Pedro Montenegro {BIO 17225319 <GO>}

My first question is on top line growth. We have seen this strongest relation in this last quarter. I would just like to know if you expect a rebalance to at least 15% expansion. If we could expect this level of growth rates for 2013 or if we should now see more moderate growth going forward?

And also, following this question, I'd like to explore your administrative structure. And we know that current top lines is below your targets. And therefore driving low fixed cost solutions. How should G&A costs behave going forward and should we expect to control or any adjustments in your structure. And to face these let's say a lower growth scenario. And should we still rely on fixed cost solutions through higher top-line expansion? Thank you.

A - Omar Hauche

So regarding organic growth, I think it's very clear that our organic growth. And this is good for the whole health sector, of course, it's very much dependent on the macro-economic growth. What we witnessed in the last two quarters was a clear slowdown of the Brazilian economy and this obviously is related to our deceleration of growth, no doubt about that.

We expected a larger volume for the Third Quarter and this didn't happen. And this should start to happen in the next quarters if the Brazilian economy really starts to recover. So we are dependent on that and any adjustment on our fixed costs or other costs should be addressed if the Brazilian economy doesn't recover, at least at the pace that we are expecting.

So we are obviously very, very much in line with the behavior of the market economics and parameters. We expect this volume to come in the next month. And this will help offset our fixed costs. This didn't happen in the way that we had wished in the last quarter. But even though, even considering this, our costs were strictly under control. The G&A, what happened here, was the marketing expenses that we mentioned -- that I mentioned during the presentation, there was a strong marketing expense during the Third Quarter. Part of this will again happen in the Fourth Quarter. This is directed for the a+ campaign.

Another thing that helps sustain this G&A that you mentioned is the fact that now after we switched off the services that Rede D'Or provided us regarding administrative services in Rio, we assumed the administrative services. And we felt like it was better for us to increase a part of these services. This implied in more head count, this implied in more costs. But we are really confident that we will get better services for this.

One other thing was the provision of contingencies, Patah, would you to comment on that?

A - Joao Patah

Yes, there is the provisions and contingencies are related to mainly to working things, completely different from what happened in the civil hatch[ph] auction to Combidaza[ph], was specific and individual, some individuals that went into process. And we decided to be conservative to make provisions of this number. It's a number that can, depending on what is happening on the process, on a later basis can return. But we cannot tell about that.

A - Omar Hauche

And I would like to just complement the answer -- the product -- the question you asked, regarding what we predict for the next quarter, regarding growth. If the economy remains in this space, I think it would be reasonable for us to talk about growth in the same range that we have presented in the First Quarter, in the low teens, something like that, still double digit. But nothing more than that. Again, we are very much aligned with the behavior of the economy. If the economy improves, we certainly have room for further improvement. And we are prepared for this. We have the structure prepared for further growth.

Q - Pedro Montenegro {BIO 17225319 <GO>}

Okay, thank you very much, guys.

Operator

Excuse me, our next question comes from Andrea Teixeira with JPMorgan.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Yes, thank you for taking my question. Good afternoon. I just wanted to kind of like get a sense of some of the changes in accounting. You had some provisions. And I know it's not very material, it's just BRL2.7 million I think, BRL2.7 million in the quarter. I just want to know the source of that. I know in terms of the clauses and the provisions for doubtful accounts, it seems that you have a stabilized curve. I just want to make sure that I have the right picture here.

And just in terms of the deceleration, I guess you commented and that was kind of like expected, that you'd have a deceleration, even from your Second Quarter conference call remarks and the analyst day. But can you comment now how devolution has been in October? I understand that the market has bounced back. And if you're seeing any signs of moral hazards which I would believe would be positive for the labs, thank you.

A - Omar Hauche

Hi, Andrea, this is Omar. Thanks for your questions. Let me start by the end, you asked about the deceleration and how October already behaved. Again, the deceleration pull is very clearly related to the market conditions. And the slowdown of the economy. But October is good news. October, I think we already, we've seen better results here. But still after the Fourth Quarter seasonally, the seasonality is really low because of December, especially because of December.

And November, it's full of holidays here, when compared to last year. So I need to be very cautious in spite of October, which has just ended yesterday, was a relatively good month, I believe. It's too early for us to say. But the Fourth Quarter will improve this rate of growth. I mean we still need to wait for obviously for November. And especially December.

Let me pass on the word to Joao, to Patah, to comment on the first question as well.

A - Joao Patah

Andrea, about -- let me just understand your question. You asked about specific accounting changes, what specific accounting changes, can you repeat please?

Q - Andrea Teixeira {BIO 1941397 <GO>}

No, it actually wasn't an accounting change, I'm sorry. It was just like a provision that you had to book this year for BRL2.7 million and the last question also which I failed to mention, is regarding this change of the civil action that took place with one of your competitors. And also clarify what is your market share in imaging in Rio so that we can kind of reconcile what is your exposure to the doctors in case this injunction becomes spread through the whole factor and opens a precedent for the doctors to become (inaudible). Thank you.

A - Joao Patah

Okay, Andrea, about the BRL2.7 million, as I already mentioned, it was related to labor processes. Individuals in previous periods, some years ago, as you know, processes can take years to go on. So some changes in the process have triggered in our policy the need to make this provision.

So that's a question what is developing in the process of individual labor processes. There is nothing to do with the civil action. I'll pass the word onto Omar, if he wants to comment something more about this civil action in Rio.

A - Omar Hauche

Yes, I think it's what, I was imagining something about that. And this is a fact of concern for the whole sector. The whole sector, with very, very few exceptions practices the same practice, in the same way of hiring the doctors. So what happens to that in Rio office, it's a major concern for the whole sector. And the whole sector should behave as a sector here, right?

I think I can add here, that we believe that our current practices is entirely legal first of all. It's ethic, it's approved by the physicians with whom we work and although we have not yet settled any public action, this happened to gaza[ph], we are working together with other companies and organizations of the sector, we are starting a joint effort here. This joint effort will be made through the Brazilian Bar Association, the Cestro[ph] Federation, even business entities to demonstrate that this current process are desperate and they are fully inserted into legality, we really are very confident about that.

Legal costs have also been involved as well. And this expense, our conviction with their opinions. And we have, moreover, some previous court decisions are very favorable to us in these past years. We've demonstrated vision that should prevail. Our history here in Sao Paulo, in Rio de Janeiro, there's very few individual actions that we're served but it's 100% favorable to us, which means that we won all these actions.

And the medical practice does not imply legal subordination and this has maintained an efficient follow-up of operation and compensation. So, just to enforce any such action, if it happens, it's all of our companies. We'll be challenged with all the legal tools that are available. And again this is a major fact of concern for the whole sector. This doesn't have to do only with surgeons[ph] clearly. So we should behave as a sector and our company itself should be prepared to defend itself. I mean, this is what is going on right now.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay. And is it fair to assume that 50% of your sales in Rio are from imaging, roughly?

A - Omar Hauche

If we consider a+ which was already present in Rio. And the big acquisition of Labs[ph] and Philippe Martose[ph], a+ is still not very strong in imaging in Rio, since growing up, it's not very strong. Opposed to that, is Labs[ph] is very strong. So if you consider our whole operation in Rio, roughly 50%, a little bit more is really concentrated in imaging. And this involves -- this is where radiologists, which are hired in this greater financial.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay, wonderful, thank you very much.

Operator

Our next question comes from Josh Milberg, with Deutsche Bank.

Q - Josh Milberg {BIO 2004065 <GO>}

Good afternoon, Omar and Joao and thanks for the call. My first question is just on this one-stop concept that you discussed in the release. You highlighted once again that the lack of this approach has been a source of operating inefficiency in the Labs D'Or network. And I was just hoping you could provide some additional color on your plans to expand that concept and maybe give us a sense of what the magnitude of the benefit from doing so could be in the next 12 months or in 2013. That's my first question.

A - Omar Hauche

Okay, Josh. Yes, you're right, I'm going to reinforce what he has mentioned before that the concept of one-stop shop is really of our interest. And in Rio de Janeiro, as I just mentioned to Andrea, the Labs D'Or and Philippe Martose are very much concentrating in imaging. So there's a clear opportunity and we are already addressing this opportunity to enhance the participation of clinical analysis in these patient service centers that currently have only imaging services. This is very convenient for the patients who look for services in a single patient service center, especially in cities as Sao Paulo and Rio, they're big cities, Salvador, where the traffic jams are really very heavy.

If you can go to a single place and have everything done in the single place, it's very convenient and we are able to integrate knowledge in that single facility. This is very much aligned with our cost of differentiation, our strategy of differentiation. And of providing the solution for the patient that looks for our services. So there is reasonable opportunity in Rio. We are already adding clinical analysis services in some of Lab's facilities and even for Philippe Martose, for instance, we launched a big patient service center for Philippe Martose in Rio, in Lebron[ph] which is a very wealthy neighborhood in Rio. Already, with clinical analysis inside. So we are already doing this kind of integration.

Q - Josh Milberg {BIO 2004065 <GO>}

Okay, very helpful. And then just on your hospital segment. I understand the point you made about the growth in this segment being limited by the performance of the hospitals and also that you have some upside from new contracts. But just looking backward, could you review variable other than the macro ones that could explain the pressure that we saw this past quarter on your organic growth in this segment?

A - Omar Hauche

I think the major factor, again it's what you described very well, is the many patients they have, this is a challenge for the hospitals, especially here in Sao Paulo, they are facing some limitations for growth because of the internal capacity they have so far. This is why they are expanding so much right now. I think this is the major explanation for this reduced growth that we are witnessing in the last quarter and this quarter. And to be honest, we don't foresee that our growth will increase a lot in the next quarters. And that will expense even faster. So this is one of the major drives to explain why didn't go much for this business line.

This is why we are looking for new contracts. We depend on new contracts and these new contracts, they may come from new Rede D'Or's acquisitions or they may come from new commercial quarters that we may have with other hospitals other than Rede D'Or's operations. There are no causes that may help to explain why this reduced. We lost one contract at the beginning of the year. Usually, we are always calculating what would be our growth without -- we do not consider the loss of this contract, just to help you out to see what the difference it made.

But again, I think it depends here Josh, of new contracts that keep on going with this business line. And the Rede D'Or's facilities, they are expanding a lot. Some (inaudible) it's expanding in Sao Paulo, the hospitals in Rio, they are expanding. But this is not going to be delivered, the new beds, the new structure, in the next quarter, for instance. So I think that position will remain, this limited close for several months yet to come.

Q - Josh Milberg {BIO 2004065 <GO>}

Okay, thank you.

Operator

Our next question comes from Manuela Thez with Modale.

Q - Manuela Thez

Hi. I think a major concern that many people had is whether this new high tax is a one-off or is it a new normal, because if we look at what happened, relative to income, we went from a 20% to a 40%. And what is this, is this related to the Labs D'Or acquisition which was exactly in the Third Quarter last year, or is it something new?

A - Omar Hauche

I'm sorry, could you please repeat the question? It was really hard for us to understand, please, could you please repeat?

Q - Manuela Thez

Yes, sure. I'm worried about what is the new taxation normal, because if we look at what happened to your income tax, it went from 20% of income to about 40%. Is this a one-off, or is this a new normal because of something related to the Labs D'Or acquisition.

A - Omar Hauche

Oh, now I understand, thank you very much. The major explanation for this is that this last quarter, this last semester, we distributed dividends instead of interest on capital. We were in the last three quarters distributing in the form of interest on capital and this quarter, this was in the form of dividends. I think this is the major explanation, for sure, it's the major explanation. And we are just now reviewing with the board what we are going to do with the next quarter. I think that this is one major impact that we have.

Q - Manuela Thez

Okay, thank you.

Operator

Our next question comes from Luciano Campos, with HSBC.

Q - Luciano Campos {BIO 16181710 <GO>}

Hi Joao and Jerome. Good afternoon. I'd just like a few question, related. I'm reminded here after the one that you already answered. Just confirm here, in the expansion plan, do you expect to deliver any additional square footage in 2013, or it will your plan be fully concentrated in 2014. That's my first question.

A - Joao Patah

Luciano, there will be some square footage delivered during 2013. But again, considering the revised expansion plan that we have just discussed before square footage, this will include larger facilities, much larger facilities that will take more time to be built up and delivered. And with lost costs, that delivery will happen in 2014.

So still eventually there will be some of this in next year. But the major part of this square footage. And again, due to the fact that they are talking about larger facilities, with more mix of services, larger square footage, this will be delivered mainly in 2014.

Q - Luciano Campos {BIO 16181710 <GO>}

Okay. I understand. The second question is about hospitals. The cancellation that you mentioned, is it something that happened in this quarter, or is the same one that happened in the beginning of the year? And if you can, just give a little bit more of color on the dynamics around this cancellation, if those are contracts that got to an end and you could not find common ground to renew the contract, or those were contracts that were ongoing and after December they are cancelled by the hospital. And what reasons. That's that question, thank you.

A - Joao Patah

No, his is the same hospital, the process that we did not renew at the beginning of the year. This is the single quarter that we lost and that we are again mentioning, is the contracts that we lost, that was by the end of March, this year, right? And we didn't renew because we didn't reach an agreement with the hospital regarding commercial issues here. We didn't reach a renewal of the commercial agreement.

Just that. So it was not of our interest to continue because they wanted a different price that we did not agree. We did not agree with the price they were looking for. So we didn't reach an agreement. As simple as that. But we're taking about the same hospital that we mentioned in the First Quarter.

Q - Luciano Campos {BIO 16181710 <GO>}

Did, like when it ended in March, did it affect the kind of growth until next February. But this, is it the same contract?

A - Joao Patah

Yes, we remained with this contract until March 31st. On April 1st we discontinued, we were no longer that.

Q - Luciano Campos {BIO 16181710 <GO>}

All right, thank you very much.

A - Joao Patah

Okay, thank you.

Operator

(Operator Instructions) This concludes today's question and answer session. I would like to invite Mr. Omar Hauche to proceed with his closing statements. Please go ahead, sir.

A - Omar Hauche

Okay, thank you all for being here with us today. And again, if you have any doubts, please be free, feel free to contact us. We are always available to clarify any questions you may have, thank you all. Good morning.

A - Unidentified Speaker

And please, we will have conduct the conference in Portuguese in one hour. If you are interested, we are here to talk with you. Thank you.

A - Omar Hauche

Thank you, bye, bye.

Operator

That does conclude the Grupo Fleury audio conference for today. Thank you, very much for your participation. Have a good afternoon and thank you for using Chorus Call.