Q2 2013 Earnings Call

Company Participants

- Joao Ricardo Kalil Patah, Investor Relations Officer
- Omar Magid Hauache, Chief Executive Officer

Other Participants

- Andrea Teixeira, Analyst
- Guilherme Assis, Analyst
- Javier Martinez, Analyst
- Joao Carlos dos Santos, Analyst

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2013 Second Quarter Conference Call. Mr. Omar Hauache, CEO; Mr. Adolpho Souza Neto, CFO and Mr. Joao Patah, Head of IR will present the results.

This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After Grupo Fleury's remarks there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions)

This event is also being broadcast live via webcast and may be accessed through Investor Relations website at www.fleury.com.br/ir, where the presentation is also available. 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-looking statements are based on the beliefs and assumptions of 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 that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward looking statements.

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

Omar Magid Hauache {BIO 16579589 <GO>}

Okay, thank you, good morning everyone. So first of all let me give you some highlights on our second quarter performance. As you can see on slide three, Grupo Fleury keeps a double-digit organic growth for the 12th consecutive quarter. This 14% gross revenue growth confirms once more our growth potential even in this current slowdown macroeconomic scenario. Our accounts are strong and even considering the higher number of working days in the second quarter of '12, '13 [ph], this solid topline growth is a good indicator that we are still seeing a strong demand in our PSCs and hospitals where we have diagnostic operations.

We still see potential for double-digit growth and I would say that it may be prudent to think about low-teens growth in the next coming quarters. Anyway these high levels of growth give us strength to accelerate the portfolio selection through this reduction of participation of payers that doesn't pay what they think they deserve and/or delay payments or even present these high disallowances ratio that we consider unacceptable.

Now let's move to slide four and here we will mention some corporate highlights. Our compromise with sustainability and quality of services to patients and physicians are well illustrated here. The third consecutive edition of our annual sustainability report was prepared according to a global reporting initiative. The application level of this report improves from C+ to B+ and this reinforces Grupo Fleury's commitment with sustainability management and transparency.

A new marketing campaign was launched for Fleury brand emphasizing the outstanding focus in solving each patient needs through personalized services. As for recognitions we were awarded with the so-called benchmarking award for healthcare in Bahia, meaning that Diagnoson and a+ brands were recognized among the top three best diagnostic brands for their respective categories imaging and clinical analysis in Bahia.

Grupo Fleury was awarded as the first healthcare company in the Brazilian Corporate Reputation ranking by IBOPE. Grupo Fleury went first among the Brazilian Medicine Services companies; fourth amongst all services companies at Melhores e Maiores or best and largest companies by Exame business magazine. And finally we were considered once more the best medical diagnostic customer services in Brazil in accordance with Grupo Padrao and GFK Institute.

In slide five, I like to summarize what Joao is going to detail later on. Grupo Fleury continues to grow consistently and gross revenue achieves R$485 million or 14% organic growth. Net revenue growth is 15.9%. PSCs grew 14.1%, mainly driven by the consistent growth of Fleury, progressive maturation of a+ new PSCs and the enrichment of the portfolio of services.

Same store sales increases by 12.9% and I would like to highlight that the revenue per square meter achieves R$4,100, an increase of 13.2% year-over-year. Operations in hospitals increases by 19.7% driven by the enrichment of services and increasing demand in the medical institutions.

EBITDA amounts to R$84 million in the second quarter, meaning a 19.4% margin on net revenue, which is 77 basis points higher than the first quarter of '12, '13. Net income achieves R$22 million in the second quarter, which represents a net revenue margin of 5.1% or 5.3% in the first half of the year.

Cash net income achieves R$43 million in the second quarter of 2013 and R$73 million in the first semester of 2013. Operating cash flow of R$52 million in the second quarter compared to 74 million in the second quarter of the last year and R$90 million in the first half of the year versus R$87 million in the correspondent period of 2012.

As for dividends we are going to distribute R$43.6 million which corresponds to a 100% payout. The Board of Directors approved on the meeting held on July 31st this dividend distribution to its shareholders and this refers to the first semester of 2013 and corresponds to 100% of the accumulated net income in June 30, '12, '13.

Now I will pass the word to Joao and later on I will make some additional comments. Please Joao.

Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Thanks Omar and good morning everyone. I will continue with the slide six, the revenue breakdown. We could notice in the quarter a balanced growth of clinical analysis and imaging in the operations where one-stop shop is more advanced, at the same time that an accelerated growth in regions where a+ brand has only clinical analysis can increase slightly its participation. Also advanced diagnostic keeps enriching mix in both services of imaging and clinical analysis.

With this brief introduction, I remind you that the average revenue per exam in PSCs shown in the beginning of slide seven, which is growing 2% year-on-year, reflects not only the inflation and what we -- we are going to put on the next cycle of prices, but also this dynamic of the services portfolio, the dynamics of brands and the portfolio of payers. This slide also shows that growth of volume was robust on the second quarter of '13 driving the revenue per square meters to increase 13.2% and the same store sales to expand 12.9%.

In the next slide, we begin to disclose the number of the double-digit long-term trend for Fleury brand as well as the strong growth of regional brands led by a+ mainly in the last two years. We expect to disclose annually the development of Fleury brand and the regional brands separately for your viewing of the long-term developments on the brand of that portfolio. Further comments on these will be connected to specific productivities, margin progressions and CapEx plan.

Slide nine shows the continuous potential of our partnerships with hospitals. In this sense our plan is to keep focusing on clients, hospital clients that have the appropriate combination of specialization and volume, allowing us to deliver our qualified complex analysis in a consistent basis.

About lab to lab on slide 10, it is delivering the planned higher-margin with reduced low-complexity exams volume. In preventive business, preventive medicine business, will be better commented further on by Omar.

On the next slide, net revenue accelerated to the lower cancellation compared to the second quarter of '12, but we would like to observe that we are not satisfied and improvements are under way to projects for internal processes and for payers' relationships. About costs, expenses and EBITDA on slides 12, 13 and 14 it is important to highlight that dilution of fixed costs, as commented on 1Q '13 conference, are beginning to evolve. Our main costs lines, personnel and medical services as well as rent and other services may now increase in lower speed when compared to revenues, as we can see comparing second Q with first Q of this year.

In materials relative reduction is consequence of the productivity and mix effect and the plans improve margins are underway as Omar will comment at the end of the presentation. Here we always like to emphasize that the quarter levels and patient care are part of our history and of our future, and the basic premise is to certify that we care about them and we care about quality.

For this reason we minded to keep marketing plan, research and development and talent retention. Anyway EBITDA margin reached 19.4%, 249 basis points below 2Q '12 but above previous quarter margin, showing that the potential improvements for the second half of the year continue.

Briefly commenting on that cash and financial result, the company paid 65 million of debt linked to the dollar. The cash effect was 54 million after the hedge credit. In addition semiannual interest on the first debenture issuance amounting 18 million was paid. Even so with all these payments the operational generation of cash allowed the company to decrease leverage with net debt over EBITDA lower than 1.3 times as shown in slide 15. Financial results was approximately 14 million per quarter as expected.

Advancing to net income analysis numbers before income tax and social contribution grew from 40 million on 2Q '12 to 43 million this quarter. Higher deferred taxes mainly related to hedge results impacted negatively this comparison of the quarter with the previous year, causing net income to decrease to 5%, even with net income cash margin almost stable at 10% level.

In slide 18, we explain the tax effect in the quarter and accumulated as well as the expectations of the tax cash for the next periods.

In slide 19, we see EBITDA conversion in cash reaching 62% in the quarter and 58% accumulated. Working capital has improvement opportunities as observed in the cancellation slide, but we had relative improvements in the accumulated numbers resulting on 19 million [ph] of operational cash.

As we can see in next slide the profile of receivables is relatively stabilized and under control. We must now reduce percentage of payment delays for next quarters.

About the CapEx in this quarter on the slide 21 it summed 24.7 million in the quarter and 56.6 million accumulated, mainly concentrated on the expansion plan and the imaging equipment renewals mostly in Rio de Janeiro. The so-called end-of-life equipment changed affecting slightly some operations, but productivity and quality of the new machines may help to recover demand and volume for these places.

I would also like to remind you that the investment disbursements on the CapEx plan will be concentrated in the end of the year as mentioned last quarter. The CapEx plan revision will be commented by Omar further on.

To finish my presentation before moving back to Omar, I highlight again the increased liquidity of the shares. The average daily trading volume was 8.5 million -- sorry, yeah, 8.5 million per day in the last six months. Also I invite everybody to save the date for our Fleury Investor Day to be held on October 3rd of this year.

Omar will now talk about the two years evolution and the next plans for the near future. Please Omar go on.

Omar Magid Hauache {BIO 16579589 <GO>}

Okay. Thanks, Joao. So before we move on I would like to mention that we do value the fact that we are now disclosing more clearly some details related to our businesses lines and brands. In this context as you can see in slide 25 we disclose for the first time revenue per square meter and evolutions in the last two years for Fleury and a+ brand as a whole.

Both have been showing a very good progress recently. As you know Fleury has a more complete portfolio of services, a premium price positioning and offers more advanced in integrated diagnostic services. Its revenue per square meter has increased by 9.6% year-over-year in the first semester of 2013.

As for a+ revenue per square meter increased by 31.8% year-over-year in this first half of the year and let us remember that outside Sao Paulo a+ offers predominantly clinical analysis services. So this is one additional reason to explain the lowest figures when compared with Fleury. a+ brand has opportunities to keep improving its productivity and this is related with the assets that were added by the end of 2011 and not only that, with further optimization of profitable services and PSCs and selection of profitable payers this revenue per square meter is expected to increase even more.

Slide 26, reinforces a growth strong for Fleury and a+ brand and up margins have been improving for both brands. Expectation trends for the next years are good regarding revenues for Fleury, Weinmann and Felippe Mattoso brands, which are our premium brands with strong margins running in parallel.

Our CapEx plan that I will comment later on prioritizes Fleury, which is by far our most profitable brand and this will benefit our future margins as new capacity and enrichment of services advance. At the same time margins should improve for the other brands and business lines. Labs D'Or as an example has big potential for growth and margin improvements. We dedicated these first two years to structure the PSCs of Labs D'Or to be able to fully capture all this potential. We expect Labs D'Or to really start contributing to our margins gradually in the second semester, but in a more relevant way as from 2014.

Now a special comment about some preventive medicine business lines. As mentioned before we are focusing on profitable services and businesses. We decided to rapidly phase out our Chronic Disease Management and Health Promotion services. Even though these were small businesses regarding revenues our decision was based on the fact that they have not been delivering profitable results and the perspectives for this to happen are not positive.

Slide 27 shows a different view about Grupo Fleury businesses evolution during these two years. Robust organic growth for hospital operation and PSCs and all brands were complemented by acquisitions. We are now more diversified and ready to concentrate efforts on profitability and higher returns of current and future businesses. Quality levels better than the competition is proved and shall bring qualified growth.

The mentioned prioritization of high-return projects was the basis for the CapEx revision detailed on slide 28. Increased capacity for our premium Fleury brand is intact as demand remains strong, but we will be more conservative for regional brand expansion in this cycle as the economy outlook is uncertain and that selection of demand is possible and needed to preserve healthy and profitable growth.

Relatively speaking now 84% of this CapEx is concentrated in Fleury brand. In summary, the total CapEx for 2013 will be reduced by 17% of R$50 million. This CapEx reduction altogether with the fact that we still have a very good cash position, considering all of this we decided to distribute 100% of our second quarter net income as dividends.

Now let's move to slide 29 and here I point out the major initiatives directed for this gradual improvement of margins in line with what is going on since the last quarter of 2012. So that the major initiatives are relatively PSCs maturation; accelerated efficiency of square meters related to the 2011/2012 cycle; the expansion plan under way, the cycle regarding 2013 and 2014 with the focus on Fleury brand delivering higher and faster returns; qualification with profitability of Labs D'Or, and there are some one-off items from Labs D'Or that impacted our results during this first semester of 2013, and we consider most of these initiatives that they are already completed.

I mean, by that I'm talking about management centralization and standardization of processes at Labs D'Or; clinical analysis automation; efforts to improve quality control management; training; the need to equalize salary and benefits; SG&A improvements; we invested a lot in new equipment's for both clinical analysis and imaging; equipment maintenance and infrastructure of hospital plants were really a focus of our investment in the first semester of this year in Labs D'Or or Labs D'Or in Rio de Janeiro; and the same is good for IT infrastructure.

As you know we have already implemented SAP in Rio de Janeiro and the front office system integration is already good for clinical analysis and the next plans are related to the imaging portfolio. And finally, we also dedicated some time to solve some compliance issues in Rio and this is already completed. Given that most of these initiatives are already done we expect that from now on Labs will gradually contribute for Grupo Fleury's margin expansion.

One other initiative which is very relevant for the margin gradual evolution is the portfolio selection of payers, services, products and PSCs. As you know we aim to have best price negotiations coming from selection of payers portfolio and focus on 100% inflation pass through. More initiatives to reduce cancellations are under way, such as improvement of internal processes and increase in the use of electronic transactions with HMOs.

We are always reviewing process and cost structures always having in mind that we should keep quality levels and Fleury branding in mid-2013 with this recent marketing investments had strengthened further more the Fleury brand and additional offering in the first half of 2014 will certainly increase margins a long time.

Finally, what I've already mentioned is the restructuring of the preventive medicine businesses lines, focusing on margins and again, I just emphasize that we are phasing out our Chronic Disease Management service and Health Promotion services as well. Finally, some initiatives to improve operational efficiency, and I have just one example to give you, a very good example, such as revision of the customer services model.

This is all for now, I'd like to thank for your attention and we are now available for Q&A session. Thanks.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. (Operator Instructions) Our first question comes from Ms. Andrea Teixeira with JP Morgan.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hi, good afternoon everyone. Thanks for this call and for taking my question. I wanted to go back, and I know you explained that in the Portuguese call about the margins and the marketing expenses that you incurred with this new -- with the roll out of the new Fleury brand.

But I was just curious when we reconcile your guidance to keep margins flat year-on-year given the weak first half, how can we kind of think of margins like the components making to the margins, especially SG&A and the marketing spend that you are going to have, especially also as you have the pressure from the new salaries that took -- that were effective in May? I mean I know it's affecting the whole industry, but I was just curious to see if there is any major price renegotiation or anything that gives you more comfort to keep your guidance flat.

And lastly, also on the expansion of your CapEx cut, I understand that probably you're going to be spacing those labs out into 2015, or if there is any project that you are now believing the new context, the new market environment does not make the cut anymore in terms of your hurdle rate and then you are becoming more conscious about returns and they're going to remove completely those projects? So I would love to hear what is your long-term beyond 2014 growth for capacity. Thank you.

A - Omar Magid Hauache {BIO 16579589 <GO>}

Okay. This is Omar, thank you for your questions. Regarding margins and G&A, you also mentioned the marketing expenses, of course you are right, the pressure of salaries do exist and as you said this is affecting the whole industry, so this thing is happening to us. This inflation cost is really, really hurting our margins. But we need to offset this -- plenty of these initiatives that I already commented in my last slide. So we need to offset and even overcome these initiatives.

One example is price negotiation. As I mentioned we are going for 100% of inflation pass-through of 100%. And we are pretty much convinced that we are going to be successful in this, the negotiations are already under way. Some negotiations will start in about one week, two weeks, and we plan to end these negotiations by the end of September, and this may benefit even our fourth quarter this year. So price is certainly a very important component for us to offset the cost pressures that we have especially regarding personnel and brands.

You talked about the marketing expenses. Of course this also puts some pressure in our G&A, in our margins, but we believe that these marketing expenses, which are maintaining -- keeping the same average marketing expenses that we have been concentrating in the last years, exactly 2% of the net revenues, so nothing different about that. It's only more concentrated in the second and third quarter of this year.

But we believe that this marketing campaign will certainly bring benefits to Fleury and ultimately for the whole group. It's important this marketing campaign because of the branding initiative that we have for Fleury, so it makes all sense for us not to give up on this marketing campaign for Fleury. It has been very successful. This certainly is hard to measure the true benefits it will bring; but we really believe that this is in the right way.

Joao would you like to comment something more about that before I mention something about CapEx?

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

No, I think that's all.

A - Omar Magid Hauache {BIO 16579589 <GO>}

Regarding CapEx, Andrea and we can go back to some of these topics later, we really decided to prioritize Fleury. As you know Fleury is by far more profitable than the other brands. It gives better returns, faster returns, so this 2013/2014 cycle is really focused on Fleury. We canceled some of the regional brands projects. This is why this 50 million decrease of CapEx has just been announced, this has to do with the regional brands projects that were canceled or at least left in standby, but some were really canceled.

Going forward or moving forward for 2015, 2016 on we still see plenty of room for Fleury to grow here in Sao Paulo, but this doesn't means that we will stop investing in the regional brands. We just need to find the right balance for the services to be really profitable, depending on prices, depending on a good cost structure.

As I mentioned, we are reviewing the customer services model for a+ as well, and for Labs looking for more operational efficiency. So we need to make the other brands more profitable. We will never believe at the same levels of profitability as Fleury, this is for sure, we know that, but they need to be more profitable. a+ is in the right way, Labs now is beginning to deliver the margins that we were expecting, but it still has some room to grow.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Okay. And just to -- and I appreciate your comments regarding the pricing and the negotiations. So, Omar, if you can, just say, I mean, if that is a good assessment of (inaudible) to think that if you -- and you put that and I appreciate you put that in the press release that your clients, especially the MCOs are -- the HMOs are actually going after the price increases in the order of 15% on the back of this 9% price increase that was allowed for individual plans. Do you think that's going to help you or that is also an indication that they are suffering much more on the cost side and so the negotiation will be even tougher?

So, I wanted to hear from you if that is a positive thing for the industry or maybe -- it's slightly positive, but it's also an indication that the cost pressure that the payers are having is very high.

A - Omar Magid Hauache {BIO 16579589 <GO>}

Thanks, Andrea for these questions. Yes, it's hard to predict, Andrea, but one thing is sure, that's for sure, the ANS, the National Health Agency, as you said for individual plans, they pointed out that the HMOs can increase the prices up to 9%, which is even higher than inflation. We should consider this good news, (inaudible) for us to get at least inflation.

One other thing, as you know the same HMOs, we have been negotiating in a very objective way with the companies where they are -- they are in. They have been negotiating even much more than inflation, because they are worried about the medical loss ratio, that's for sure, this is an issue for them and it's an issue for us. So we need to find this right balance.

As you know historically speaking, we have been able to adjust our prices at 50% of inflation and in the last year we were more successful, we were able to adjust at 70% of inflation. And this year, again I insist, we are looking for -- we are going for 100% of inflation, at least 100% of inflation. It makes no sense for us to get less than that. So I think that the environment here for the private healthcare system is always -- I'm talking about tough negotiations here; but we are very positive because we are seeing that the HMOs are getting what they deserve and we are going with the same kind of attitude. We are going to get this 100% inflation at least.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Andrea and to complement two points here, first thing is that most of these managers of our clients they understand the cost pressure, they know that our services depend on good qualified personnel. What we are doing is also explaining it for them. They have to understand that we cannot accept less than what is impacting our costs, because part of us delivering the quality in the services.

In this, the second point that these complements with the portfolio selection of payers because for those players that are not paying correctly and on addition to that are not understanding that the impact of good quality is that we have to keep inflation on our personnel, on our wages, salaries and benefits, those that don't understand and want only price and price and price, we have to explain to them and if even though they don't understand we have to go on for our portfolio selection and privileges of the good quality services for those who knows the fair price of the services.

A - Omar Magid Hauache {BIO 16579589 <GO>}

One more thing, Andrea, I know I'm sounding repetitive when I talk about selection of payers, but it makes all sense, because when it -- when we negotiate with these HMOs, of course we know these guys very well, they know us very well for long time and there are some payers that particularly are very hard to negotiate prices but worse than that; it's very hard to negotiate disallowances, it is very hard to negotiate that they pay with no delays. So when I say that we are now aiming to select even more some payers we do mean that, right. We want to work with payers that really recognize the value of our services, right. So this also is linked to this topic of price adjustments, of working with the right peers as well.

Q - Andrea Teixeira {BIO 1941397 <GO>}

I understand, thank you very much Omar and Joao for the answers.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Thank you Andrea.

Operator

Our next question comes from Mr. Joao Carlos dos Santos, BTG Pactual.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Hi, good morning everybody. Let me try to tackle once again Omar, sorry for insisting on the margin -- margin part of the -- and we had an extensive talk on the Portuguese call regarding margins. You have listed a lot of those issues on the margin, on the marketing expenses, the restructuring of leaderships, some non-recurring items, the pre-operating costs -- some non-recurring items in Labs, the pre-operating costs from rental costs for the opening of new units (inaudible).

But, when you put all of these together, it's still kind of intriguing for me, because in a scenario where you are growing revenues 16%, you are still seeing, in this quarter specifically 250 basis points of margin contraction and eventually in an industry that we presumably would have like a strong operating leverage. And as a matter of fact, as you put a brilliantly in the end of this presentation, by the way we thanks for the additional disclosure. But we are clearly seeing already the increasing efficiency of the assets, right? I mean, the sales per square meter is going up, right? So it would be reasonable to assume that you would be already reflecting your numbers, some sort of margin expansion.

So from more a strategic perspective when you look into what were the expectations that would have led to these flattish margins this year, where is the bulk of the mix coming from? Is it because, I don't know you needed to beef up your team more in Labs, so there is more like personnel being put in Labs because of the minimum level of service quality that you guys have in your network? Or is it, because maybe you are seeing and even higher growth in these other brands than in the Fleury brand, which ultimately would lead to a softer mix in terms of profitability because of the softer, relatively lower profitability of the other brands?

I am just trying to understand where the bulk of the mix in the margin is coming from as of now. Could you give some clarity on that matter?

A - Omar Magid Hauache {BIO 16579589 <GO>}

Okay. Thank you for your question. I understand your doubts, let me try to clarify this in a very illustrative and objective way. Please just take a look again at slide 27, right. Here is, what -- I am going to go through this slide in a more detailed way. You see here the composition of the company's net revenue that has changed in these last two years.

So in 2011, the first half of 2011, Fleury brand represented 60% of our revenues, right? And now, two years later it represents 46%, this CAGR is very good, it's 14.1%, but you can compare with the CAGR coming from the brands, the regional brands. So take a look, the other brands in blue and orange they represented much less than they represent today in absolute values, they grew a lot and the CAGR is more accelerated.

So what do I mean by that? Fleury still is a very important brand and should be very important a long time; but its participation in the total revenues of the group decreased and this is just a natural phenomenon coming from the growth from the other brands that grew more -- in a more accelerated way.

Not only that, now 26% of our current revenues they come from these acquisitions that were recently performed and these acquisitions right now is a different part in our profitability, and as I mentioned in the last slide of my presentation there are plenty of initiatives that are already been completed for Labs and Labs will finally, then gradually start to add margins to our group.

This move was not happening in this last semester, so this is -- in the last quarter and this is about to start right now. So it has to do with the representation, the participation of the brands along time which changed a lot, and again it makes all sense -- and now I'm going just to close these remarks by telling that it makes all sense what we chose to do with the CapEx.

Again we are prioritizing Fleury, which is by far more profitable, there is plenty of room for Fleury to grow, it is growing a lot and so we need to put Fleury with even more conditions to capture all this demand and to give all the return we are expecting, the faster returns and higher returns.

We are not just -- we are not -- necessary -- not going to expand a+ or Labs, we are, but first of all we want to qualify even more these brands especially in Rio de Janeiro. a+ when compared to the previous fragmented brands we have now is more profitable; but it still has room to become even more profitable. But this is especially good for Labs in Rio de Janeiro. So I think I'm trying to explain to you that first of all the participation of each brand in our current revenue they change a long time and we want, again, to prioritize Fleury in the context that Fleury needs to contribute even more for the profitability of the group, the whole group.

We have already did a very good job for a+, it is now more profitable than it was in the past and it still has room to improve, especially the focus in Labs D'Or to become more profitable than it has been behaving in the last quarters and semesters.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

That's awesome Omar. Thank you very much, that is pretty much the way that we are kind of looking into this as well. I understand that this kind of change in the mix is something that you guys obviously were already expecting after the transactions, et cetera. But it seems to me that, I could take the conclusion here from your speech that, okay, Fleury is still pretty much in place, I mean, it's not suffering any changes in their profitability and it's growing healthy, you are not seeing that much of an impact from additional competition, et cetera., and maybe these additional revenues that came from the a+ growth, Labs D'Or, et cetera., that they might be a little bit below the previous expectations for their margins but the ramp-up process is still pretty much in place. That would be like -- pretty much the view, right?

A - Omar Magid Hauache {BIO 16579589 <GO>}

Perfect summary that you just said, Joao. You are right, you are getting the idea, and this is why, again, it makes all sense what we are planning, how we are planning to expand our Group.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Great.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

And the good news, Joao, is that, when you see that's the reason why we decided to disclose the productivity per brand or per regional brand and Fleury, the good news is that the productivity increased and that we have still space, we see a lot of space to visualize this space both on the a+ brand and Labs.

There is space to gain productivity, revenue per square meter if you qualify what we call qualification of the revenue, to see the space for this qualification of the revenue that comes to our square meters is what made us believe that in the future it will come with better conditions, and that made the company decide to stop for a while new investments for these brands until we get a better level of productivity and margin for them.

We are not telling that we are going to stop this growth in the future. But in this moment, the prioritization, we will prioritize the productivity and the right use, the right revenue in these square meters.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Got it.

A - Omar Magid Hauache {BIO 16579589 <GO>}

And Joao exactly what Patah said -- what Joao, Patah said, this is one more reason that made us -- this was even more figures, more details for you, because we felt like it was important for you guys to have these kind of perception of data to better understand what's going on here. So I'm talking about a company that change a long time of course. We are very happy with a+ regarding growth, it needs to be more profitable, and especially Labs we wanted to see better net levels of profitability and I think that things are in order to start getting the better levels of profitability a long time with Labs.

This is why we are so prudent when we say -- when we talk about margin increases, they should be gradual. We want these to be gradual, to be there in a very sustainable way. But you really got the idea, perfect analysis you made.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Okay. Thank you very much. Second and last question if I may. We have seen with the reduction of the CapEx, you guys accelerated the dividend payment, you had a 100% payout in the first half. Would it be reasonable to assume that it's sort of the new normal for the company with this potential deceleration of the CapEx plan or is this something that is going to be reanalyzed by the end of the next semester or so?

A - Omar Magid Hauache {BIO 16579589 <GO>}

Again thanks for your question, Joao. Actually what happened is, I will explain, it is as simple as that. We reduced the CapEx, right? R$50 million, we have an excess of cash right now because we captured money coming from the debentures recently and this is directed mainly for organic growth from our expansion plan, the expansion plan even though it was reduced we had still a very good application for this cash. But the fact is that we have an excess of cash, it makes all sense to distribute this in the form of dividends. I mean, it wouldn't make sense for us to keep on distributing only 30% of the net income.

So we had this discussion with our board and this was approved and if this is the scenario ahead of us we are going to sustain this, and we are going to distribute more dividends, it makes all sense.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Great. And I promise that this is the last one. When we look into receivables we've clearly seen the coverage ratio pretty much in place. But it caught my attention a little bit the growth in the due payment here that was a 20% growth in the first line up to 120 days. So I was just wondering if that's -- so it doesn't seem to be in line with the seasonality, I mean seasonally speaking you should have seen an increase in this initial portion in the first quarter and then in the second quarter sort of, kind of flattish. So I just wondering if this -- what should have driven this 20% increase in the due payments here?

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Joao, this is Patah. I think what we have to analyze in this figure is that most part of this growth on what we call here the current, is the kind of the growth on the revenues and a small part of that is because of adjustments on the process of the billing. What we have to analyze, the most important for us and for the future of these receivables is that when we go to the, for example, the 121 to 360, this is very stabilized and this is where we focused.

The company focused mainly to what we call stabilization in the portfolio is because we don't want the former billings to be older anymore, we are controlling, trying to control what is starting to be delayed and what is happening right now when we analyze, for example, what is up to 180 we reduced the number in the up of 180 until 360.

So the part that is up on the 360 and more are mainly related to the negotiations and this that Omar is commenting a lot about the portfolio selection. But the good news is that we are controlling what is getting old here and what we want now to go is to stop delayments, even the delayments of some days. But yes, there is a growth coming up on the growth of the company, but we are controlling this for the future.

Q - Joao Carlos dos Santos {BIO 15122452 <GO>}

Okay, Joao. Thank you very much for that. Thanks.

Operator

Our next question comes from Mr. Guilherme Assis with Brasil Plural.

Q - Guilherme Assis {BIO 16143141 <GO>}

Hi, good afternoon everyone. So I have a question. And first of all thanks for giving us more color on the breakdown of the brands of Fleury brand and a+ brands. And I have a question on the page 25 of your presentation, you show the productivity of your PSC area for the Fleury brand and it has been pretty steady for the past five semesters, right? And there was a spike in the first semester of this year.

So I would like to understand with the investments that you are making to improve the level of quality, do you think you are going to be able to sustain the 6000 per square meter that you had in the first half of the year or do you think in order to provide a better level of service you are going to go back to somewhere close to what you had in the past, 5.4 or somewhere in between? That is my question. Thank you.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Guilherme, this is Joao. I will begin and I will pass to Omar to complete. But the first analysis on the history that we have to mention is that the square meters that is in this figure is the square meters in the end of the period. So to analyze correctly this figure you have to consider that, for example, this stability relates to a growth when we would compare to the average square meter.

This is one thing you have to take care on these analysis. If we would consider in this figure the average square meter, the figure will be growing more steadily than stable during some periods. And also as a consequence there is a period of maturation that is very short for Fleury brand, but the period of maturation and currently in the last quarter's the usage of square meters or the mix of services are also beginning to be reached. We are looking better on these details of the portfolio of services. What we expect in a sense in this new investment is that is natural to expect that in the quarter where we open new square meters this revenue per square meter will decrease slightly. But the good thing for us in our expectations is that, we know about Fleury brand that it recovers strongly, and more than that, when we analyze the new CapEx, the new investment, it's more complete, it's more enriched. It has integrated centers, for example, diagnostic centers, more advanced diagnostics, more advanced analysis. So the trend for the midterm and the long-term is to be even more than this 6,000 per square meter.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. So you are saying that I would, even with the investments that you are making, like you could see potentially a small decline but the trend should be to top the 6,000 per square meter in the longer run, right?

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

The trend is to keep growing. If we -- yes, we will see a small decrease probably in the first quarter after the launching. But the trend is to increase and it is very possible to be even more on the midterm than the 6,000.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. And my follow-up question actually is, even with the spike like 10% increase in the productivity, it did not reflect at least in the first half of the year in higher margins, right. I know there is a lot going on, a lot of pre-operating expenses and extra marketing efforts, but if we look even at the gross margin level, like -- it hasn't actually translated directly into higher margins right? How do we reconcile that? Do you think like going forward keeping this square meter 6,000 per square meter, should that translate in higher margins?

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Guilherme, I think the answer is on the next slide. If you look at the Fleury brand on the next slide, on the 26, you'll see that the margin under Fleury brand, yes, was better. What we have to analyze for your answer about the consolidated margin is the analysis of the mix of brands, the mix of business lines, and that's why we decided, for example, discontinue some business lines that are losing money or to, for example, close some patient service centers that are not profitable.

So to analyze the consolidated figure, is not only analyzing these 25 (inaudible) you have to complete this with the portfolio of brands, business lines and everything else and also portfolio of payers.

Q - Guilherme Assis {BIO 16143141 <GO>}

Okay. That's clear. Okay, thank you, Joao. Thank you guys.

Operator

Our next question comes from Mr. Javier Martinez with Morgan Stanley.

Q - Javier Martinez {BIO 15226046 <GO>}

Yes, thank you. Thank you Omar, Joao. I understand that what you are saying about the mix makes sense. But I want to continue a little bit more with this way of thinking that Guilherme was opening on slide 25. So, the 6,000 looks like a quite impressive figure in my opinion. And I'm trying to understand -- and obviously is a figure that shows, explain why do you want to grow in Fleury and also it shows the maturity you have on Fleury that you still do not have on a+.

I am trying to understand where do we go? Where is the level of sustainable margins in the future? Where is the level of sales per -- thousand per square meter every quarter you can do in a+? Are we talking about 3,000 or we talking about 4,000? So how far do you think or maybe with your experience so far what is the level you get in the units that are more mature, that they have been open for a little bit longer period of time? Is it closer to Fleury or is still a kind of half of Fleury or can you give us some reference of the mature a+ brand stores?

A - Omar Magid Hauache {BIO 16579589 <GO>}

Javier, this is Omar. Yeah, when we compare Fleury to a+ there are many differences, you know that just some differences here, Fleury has a more complete set of exams and services, the price positioning of Fleury is higher. It offers this integrated diagnostic services. It's hard to speak if you are talking about much higher margins here.

So this explains in a very simple way why Fleury has this higher average revenue per square meter. And it has been growing, as you can see as Guilherme asked and we explained to him there is still room for Fleury to grow its productivity here, its average revenue per square meter. After the expansion plan is delivered in 2014 of course for a time, we are going to see a slight decrease of fees until the new PSCs matures but later on we can even see figures as higher than R$6,000 per square meter.

As far a+, here you are looking at the a+ as a whole. You are looking at a+ in Sao Paulo, in Rio, in the Northeast and in the South. So this is very heterogeneous because a+ is more complete here in Sao Paulo when we talk about clinical analysis and imaging. When you take a look at a+ in the Northeast or even in the South, it's only clinical analysis, so it is hard to compare these figures with Fleury because of this.

The mix of services, of products, is really different when you compare to a+. If you take a look at a+ in Sao Paulo where we already have more imaging services, maybe it is easier to compare; but still Fleury is like half imaging and clinical analysis regarding revenues. a+ here in Sao Paulo is still 70% clinical analysis, so it's hard to compare.

So we still prefer to disclose the numbers for a+ as a whole, we look at a+ as one single national brand and 2.4 is still far away from a good level of productivity for a+, its increasing, that's good news. But it still has plenty of room to grow, this has to do with the opportunities for increase its productivity, it has to do with price, this has to do with enrichment of the mix and this has to do with small operational efficiency, we are looking for more operational efficiency for a+ and even for Fleury as well.

As I mentioned, we are reviewing the customer services model. This is going to benefit this kind of indicator of average revenue per square meter as well, especially the average cost per square meter. This is another indicator we have paying a lot of attention, that's for sure. We want to see the balance between the average revenue per square meter and the average cost per square meter.

Q - Javier Martinez {BIO 15226046 <GO>}

Omar, thank you. I understand your argument, but just trying to get a sense of where we are going, it's not the same to grow from 5.4 to 6, that's great, that to grow from 1.6 to 2.4. So obviously there is a maturity, a maturation impact there, so you have more upside, let's say, probably on a+.

So, I am trying to understand where is this going to take us. Is this going to take us to 3, to 4 to 5? So where do you see -- I understand that these are more heterogeneous, but I am trying to understand (inaudible) if they're reading of this on page 26 that you do a reading of margins versus growth if we will do the same reading in terms of ROIC probably it would be better right? So a+ has been growing faster on ROIC that it has been growing on margins? Is this a good assessment of the situation?

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Javier is Joao speaking. I think the number is not as important for us as the trend and the possibilities. One thing that we have to analyze about these numbers when we separate, for example, a+ for the new PSCs or the new square meters that were launched two years ago and compare this with more matured ones, it's natural to see numbers that are up to three in this figure for the matured ones. But the same time when you see the portfolio of services for a+ even in Sao Paulo, most part of the imaging services are concentrated on new PSCs, not on the older ones.

So the trend here is to grow, this is the first question. The trend in the mix of services is to better, is to improve. The trend of the portfolio selection of payers will also help growing not only in the mix of services, not only with productivity itself, not only and even better the square meters, and have the (inaudible). But also having the right payers on that places. This is one question.

The second question that is difficult to give you an answer is that these possibilities also depend on how the other regions of Sao Paulo will evolve. As you know we are beginning to unify the potentials of a+ and Labs D'Or in Rio because Labs D'Or is concentrated on imaging but productivity is not enough yet. We don't disclose here the figure because we don't think it is mature for this disclosure. But you can analyze that we still have a lot of space to grow revenue per square meter also in Labs D'Or in Rio and so the unification of Labs D'Or and a+ in Rio we also have a lot this number.

And in the other states of Brazil, we are still concentrating on clinical analysis, so the velocity that we can implement imaging, for example, in a Greenfield, imaging in Recife, or after the acquisition of Diagnoson to implement imaging in Salvador, this velocity will tell the number in the next one to three years. What is important for us is the long-term trend that this can grow, we could say, four times here for a 4000 per square meter? Yes, it's possible. But it is difficult to tell you how long it will take for that and where it will be achieved on the next two, three years.

What we know is that we are concentrating the expansion of revenues for a+ on these square meters that we have, that's why the company decided to decrease the CapEx level for regional brands, because we will continue to expand but with quality of payers, with quality of products and in the square meters that we already have, in the assets that we already have. Efficiency of assets for us is very important on that.

So giving you the next answer, return on invested capital is going to be in the right levels for this organic growth. To analyze the total return on invested capital in the company we will have to separate what is the goodwill, with or without the goodwill of Labs D'Or acquisition. But the good thing that we can analyze that, we are on the right way of recovering return on invested capital and when we analyze only the organic it's already on good levels.

Q - Javier Martinez {BIO 15226046 <GO>}

Understood. Understood. Thank you, Joao. May I ask two very punctual and specific questions also? One is on the tax expenditure. I know there is a non-cash thing, this deferred thing, but it's more than doubling in the first half. Is this related with hedging? What is the reason for that?

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

The first thing, if I understood you rightly, you are asking about the 40% of the deferred tax on the first half of the year.

Q - Javier Martinez {BIO 15226046 <GO>}

Yeah, that is moving from 12 million to 30 million, basically.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Yeah. The 30 million, it's now 40% of the net income before tax. If you take the hedge effect out, it's going to be 35%. This 35%, why it's 35 and not 34? It's a sum of effects, we will have to detail a lot of this, it's a sum of, for example was more provisions that are not deductible on the tax. But anyway the trend that we see is that, if we disconsider the hedge effect, it's natural to see this number going to the 34% on deferred.

The cash tax we have space to keep on the zero level for this year and next year. But the deferred it's -- one could expect this number to be 34% on the average of the year, if you don't consider the hedge effect.

Q - Javier Martinez {BIO 15226046 <GO>}

Fantastic. And finally, just to try to understand this -- the logistic or the details of this discontinuation you are going to do on the chronics and the promocao de saude, is this going to be a gradual movement? You do it everything in one day? Do you have any one-off impact? Any impact on margins, on cash flow? How does it work?

A - Omar Magid Hauache {BIO 16579589 <GO>}

Javier, no. This will be pretty much fast. We have already been talking to the clients that hire these services and so we are phasing out all these services coming from chronic disease management and health promotion in the next month. So we are about to finish these services in about one month.

Q - Javier Martinez {BIO 15226046 <GO>}

Okay. And do you have to pay a penalty or any -- or are you just discontinuing?

A - Omar Magid Hauache {BIO 16579589 <GO>}

Javier, you have to know the (inaudible) are really not an issue, it is not an issue. We are negotiating with each player and obviously, we respect the physician phase and we are indicating other providers regarding these services. So it's really not an issue.

Q - Javier Martinez {BIO 15226046 <GO>}

Okay. Thank you, Omar. Thank you, Joao.

A - Joao Ricardo Kalil Patah {BIO 16560401 <GO>}

Thank you. Thank you, Javier.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Omar Hauache to proceed with his closing statements. Please go ahead sir.

A - Omar Magid Hauache {BIO 16579589 <GO>}

Thank you. So I would like to thank you all for the attention. I hope you found the disclosure with more data, more information to you useful. I hope you found these useful and we look forward to getting your feedback regarding this disclosure of more data. This will be very useful to us as well. Thank you and have a good day.

Operator

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