Q1 2012 Earnings Call

Company Participants

- Fabio Marchiori, CFO, IRO
- Omar Hauache, CEO
- Unidentified Speaker, Unknown

Other Participants

- Andrea Teixeira, Analyst
- Flavio Barcala, Analyst
- Joao Carlos dos Santos, Analyst
- Rafael Frade, Analyst

Presentation

Operator

Good morning, everyone. Welcome to Grupo Fleury 2012 First Quarter Conference Call. Mr. Omar Hauache, CEO and Mr. Fabio Marchiori, CFO and 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 the Grupo Fleury 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 relation website at www.fleury.com.br/ir where the presentation is also available.

Those following the presentation via the webcast may be -- may post their questions in (inaudible) 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 the Grupo Fleury's 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 the macroeconomic conditions, industry and other factors could also cause the results to differ materially from those expressed with such forward-looking statements.

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

Omar Hauache {BIO 16579589 <GO>}

Thank you. Good morning, everyone. First of all I would like to say that we are satisfied with our First Quarter 2012 results. We see our accelerating organic growth and our improved margins as a consequence of our strategy and the way we keep on sticking to our strategy.

It's not only about growing fast and delivering (inaudible) figures to the market. Actually our business is deeply related with differentiation, knowledge, innovation and quality of services. This is true for all our brands and business lines and should remain the same for the last quarters of the years.

Our challenge is to pursue more and more growth with even better margins. And this should be achieved keeping in mind that we do care about sustainable growth. To be even more successful than we are today, we currently depend on several key factors and most of these variables are included in our main strategic projects. Let me give you some examples.

We are talking about progressively integrating all the operations coming from the big Labs D'O recent acquisition and exploring all the potential synergies, this is an evolving process and I believe we are in the right track. In the next quarters we need to further accelerate this integration and is still like [ph] that is going to increase productivity and improve margins for the last year since.

As we conclude from our strong organic growth we should be even more prepared to be able to capture this clear increasing demand. And this is good to all others. In this context our organic expansion plan should be complete. By that and you helping me [ph] to offer more and more clinical analysis and imaging services and do to that we depend on optimizing our current construction tips [ph]. And when necessary increasing our floor space.

Last year, as you know we delivered more than 14,000 new square meters and this obviously does not include Lab D'Or acquisition which has added more than 30,000 square meters. We look at this new floor space which includes the Labs D'Or floor space as an opportunity to increase our revenues and progressively improve our margins.

One important additional components of these expansion plan and probably the most important one is related to people and here I'm talking about qualified professionals that we train, develop, hire and retain. This is certainly one key variable that influence our growth. One can infer [ph] personnel as our major cost but no doubt is our main competitive advantage.

Anyway, now we need to focus in making our new square footage even more productive, without losing sight of delivering additional new area for expansion. Our capital expenditure once more accelerated this quarter, reaching BRL60 million or half of the BRL120 million we plan to invest in 2012.

Half of this BRL60 million were invested in acquiring new equipments such as MRI scans and CT scans. And the other BRL30 million were really concentrating in expanding the PSCs. We are not planning to increase the value of CapEx for this year. And once more, I'd like to stress that this is a very good moment to personally optimize our productivity, meaning that we want to add even more value to every single penny we invest.

Still, in 2012 and 2013 we expect to have more than 14,000 new square meters and we are right now reviewing the phasing of delivery of new areas for 2012 and 2013.

I'd like to address one quick comment on receivables. Fabio is going to explore this topic later on but I'd like to emphasize that as we anticipated in the market during the last call our new bad debt policy has already been established since January the 1st. And the consequent non-recurring impact of BRL10 million as we also announced was included in our First Quarter results.

We continue to face receivables with the same commitment we did in 2011 and this is part of high impact project I am personally involved.

Finally, we expect a higher inflationary pressure on some P&L components but still we believe it can keep our recurring EBITDA margin in the range of 23% to 24% during 2012.

Now, let's go to the presentation on slide three. We discuss some operational highlights. On January 13th the Company paid Labs D'Or the acquisition second installment corresponding to BRL186 million. On February 13th Grupo Fleury had the second supply chain relationship excellence program when the group recognized the five best suppliers in 2011.

Due to our size and relevance the supply chain relationships excellence program is an important initiative to value our best supplies and to make the case to all of the suppliers the opportunities for them to improve their services to our company.

On February 22nd a+ incorporated the eighth Campana's PSCs. This transition ranks move [ph] and is important to say that this already proved to be a right decision. All this PSCs now operating under a+'s brand show increasing volume of patience with better contracts than Campana.

From March 1st Weinmann was awarded one of the Top of Minds brands in Rio do Sul according to a research from Jornal do Comercio and I've only to report it was announced that the board of directors approved a capital increase of BRL1.6 million represented by eight -- more than 89,000 new shares which will be delivered to company's director as all the stock option program approved in February 2010.

Now let's move to slide four, here I give you some financial highlights. Loss revenue increased by 61.4% reaching BRL398 million. As we said, organic growth continues to be very strong, keeping 18.7% in the First Quarter, very well distributed above the brands and cities [ph]. All our brands with more than 15%, as you may be seen the right side of this slide.

The blue bars chart illustrated the progressive increase of a very close quearter-over-quarter. in this context we are planning to keep our organic growth of more than 15% targeting high teens growth. I will give you some more details on the gross income [ph] information this [ph] slide -- in this next slides.

Gross profit in the First Quarter of 2012 reached BRL93.8 million which means a 14.7% increase quarter-over-quarter. Our EBITDA shift BRL77.4 million with a corresponding margin of 22%. This same margin which have been 24.1% if we do not consider the effect of the BRL10 million associated to the non-recurring adjustment of bad debt plus provision policy.

Our EBIT -- our operating reached BRL54.6 million with a margin of 15.5% and a recurring margin of 17.9% and our net income with 15.8% to BRL31.7 million meaning a 9% margin on net revenue.

Now let's move to slide five which illustrates our net revenue and EBIT performances. Net revenue increase 52.6% this time and from now on, we want to highlight the performance of net revenue as well since we recognize the impact of cancellations in our net revenues. As I said, we are looking forward to reducing this gap between gross and net revenue.

As our EBIT performance, it increased 32.3% of EBIT is certainly a good indicator to be followed when we think about the efficiency improvement, especially during this moment of high depreciation levels associated with our recent advance [ph] expansion.

On slide six, here's some more words on our growth. Here we illustrate existing contributions of organic growth and acquisition to our total growth during this First Quarter. The table shows the evolution of our total organic growth according to the different business lines. It is clear from this table, that our major business lines have been growing consistently and that there are some additional opportunities to increase growth for some specific businesses.

And slide seven, slide seven illustrates a break down by type of test. And here we can see how imaging diagnostic participation increased in this First Quarter of the year. This is basically due to Labs D'Or and diagnosing acquisitions and organic investment in equipments. Right now, imaging corresponds to 47.8% of patient service centers gross revenue and 19.9% of diagnostics operations in hospitals revenue.

During the First Quarter of 2012, more than 90% of Labs D'Or operations were consolidated. And the remaining 10% or less when it was [ph] consolidated as of April the 1st.

On slide eight, we breakdown the First Quarter's net revenue. Revenue tax rate is 6.4% and cancellations totaled BRL21 million, this includes the mentioned BRL10 million adjustment of bad debt provisions policy. The pie chart shows the contribution of each business line for our net revenues. 83% come from PSCs and operations in hospitals already correspond to 13.6%. And this would reach more than 15% after the full consolidation of our Lab D'Or.

On slide nine, let's talk about PSCs performance. PSCs gross revenue, organic growth was 19.5% and recurring net revenue growth was 16.5%. All our brands grew about 15%. Fleury brand, a+, (inaudible) all delivered strong organic growth.

Fleury keeps on growing high teens on the recently launched a+ shows a consistent similar growth in all the regions in it is present. As for Labs D'Or progressive integration is contributing plus [ph] even more its margins and now it's becoming more clear how we can be more competitive in Rio de Janeiro with both labs and a+. Still many synergies are to be explored.

The left chart showed the number of debts and net revenues growth quarter-over-quarter. And the last two [ph] is about assets efficiency. We see a stable PSC growth and net debt (inaudible) square meter. But actually this means that with the recent addition of more than 40,000 square meters coming from our expansion plan and Labs D'Or acquisitions, we should explore opportunities to improve this productivity, focusing the new square footage so as to master productivity related to our previous major [ph] floor space.

And this context since our sales growth 19.4% in the quarter. After the (inaudible) this company and we decided to shut down four PSCs that was not at all profitable but this area was almost fully compensated by the new square footage added during the quarter.

Slide 10, as for diagnostic operations in hospitals, gross revenue increase 19.6% and recurrent net revenue growth was 16.5% by 2012 when the operation in Rede D'Or hospitals are fully consolidated. This participation should increase above 15%. Still, this will happen by the Second Quarter -- in this Second Quarter of 2012, still we are looking for new contracts. But we are obviously not interested in any kind of contracts.

It is of our interest to keep on growing this business line with healthy margins. And the contracts we have with the current hospitals and the potential new hospitals should bring new margins.

Slide 11, we post to naps [ph] to reference labs gross revenue which decreased 8.2% when compared to the First Quarter of 2011. Reference lab net revenue reaches BRL6.8 million in this quarter. As we mentioned in the previous call, this business line is deserving a new focus from now on. Now we have a specific management team and this team is right now restructuring the business, starting a new commercial policy and approach and making sure we will deliver differentiated levels of service for these clients.

Slide 12, now some words on preventive medicine. Gross revenue increased 32.6% and net revenue increase 24.8%. Health assessment continues to grow very strongly with a revenue increase of 30.6%. Health promotion net revenue reached BRL1.1 million and chronic disease management net revenue reached BRL1.3 million.

I think pass on the word to Fabio Marchiori.

Fabio Marchiori {BIO 16680005 <GO>}

Thanks Omar. Good morning everyone. We have to start analyzing what's happen with the cost of services. And in order to be able to understand the main variations in the cost of services when we compared the First Quarter of 2011 against the First Quarter of 2012 we will need to analyze slides 13 and 13 all together.

In slide 13, we will highlight specific elements which affect each expense by type while in slide 14 we are represented gross margin reconciliation. We detail some aspects which affect the margin as a whole.

Let's get start with the expense by type break down show in slide 13. Let's speak about personal and medical services. The cost has increased by 640 basis points to 336.5%. The main elements of this variation can be explained as follow. First, as from 2012 on, valuable pay expenses from operational personnel which were previously allocated as SG&A will now be recorded as cost of services, impact in this quarter is 130 basis points.

Second, the increasing the demand for human resources in the health care sector during 2011 and the beginning of 2012 has impacted hiring cost and unions negotiations regarding no salaries and benefits to employees. Impact felt by the group represent 150 base points which is 50 base points higher than our initial forecast for the year.

At this point, it's important to highlight that the good has already developed and started the execution of action plans aiming to increase productivity and rationalize activities mainly in the view patient services centers and also speeding up the maturation of new services in order to reduce these by at least 100 base points over the next 12 months returning the efficiency gains to gross margin.

Speaking about materials and outsourcing, quarter after quarter over the past 24 months, the group's supply chain continues to improve relationships with our strategic partners. As a result, this cost line has further decreased by 13 base points as a percentage of net revenue.

Speaking about general services, rents and utilities the clock has reduced by 50 base points as we continue to pursue high levels of assets utilization. Not only key to the obvious financial effect but also to continue to improve the already high levels of customer satisfaction related to the one stop shop concept.

Speaking now about general expenses, the cost is up by 170 base points. This increase can be explained by the effect of cost inflation which represents 80 base points and infrastructure improvements, 90 based points mainly related to equipment and facilities maintenance, call center costs and IT costs which are necessary to support the expected volume growth for future periods.

Therefore, the group still expects to dilute at least 60 base points of this increase over the next 12 months, we're targeting again the efficiency gains to gross margin.

Speaking about depreciation as from the First Quarter of 2012 on, the depreciation of clinical analysis and imaging equipment as well as of the patient services centers duties will be reported as cost of services. Cost is up by 130 base points and most of these increase 110 base points is the result of recent investments made, mainly by the end of the First Quarter of 2011 which is expected to take up to 18 months to mature.

Moving now to slide number 14 and analyzing the gross margin reconciliation. Let's take a look at some general aspects which affected the margin as a whole. Reported figure in First Quarter of 2011 was 35.5%, the variance compared with the 26.7% figure reported in the First Quarter of 2012 can be explained as follow.

First, non recurring adjustment in net debt provision policy have adversely impacted the gross margin by 200 base points. The change in allocation criteria for viable pay related to operations which was already mentioned in the previous slide adversely impacted gross margin by 130 base points.

Labs D'Or strategy which was re-entered towards a higher dispersion of imaging PSCs and as a consequence lower cost efficiency which was compensated by lower SG&A adversely impacted gross margin by 150 base points.

If you are following the chart you will notice that the exclusion of these three factors would bring gross margin back to 31.5%. If we now add back the already mentioned cost of growth related to the depreciation, general expenses. And increasing remuneration level, gross margin would achieve 35% and this number can be compared to the 35.5% reported in the First Quarter of 2011.

Based on these reconciliation, we can now try to anticipate what the group expects to be the recurring margin level which would be achieved as soon as we reach two important landmarks. The first one, to finalize Labs D'Or integration which is expected to happen until the end of 2012 generating synergies as a result of the closer relationship between our branch in Rio de Janeiro.

The second landmark would be to achieve a more mature stage for the new PSCs and also the recently launched services which were able to increase our participation from imaging and high complex staff in the group's portfolio.

Our approach to calculate this hypothetical margin is to add back 480 base points to this quarter's reported margin and this 480 base points can split as follow. We need to return 200 base points from non-recurring cancellations, we need to return 130 base points from the dilution of depreciation and general expenses, we need to return 100 base points from the increase expected in labor productivity and we need to return 50 base points from the increase in cost efficiency in the a+ patient services sectors.

Summarizing, if we exclude non-recurring effects and anticipate expected cost efficiency increases the group's gross margin should return to sort [ph] of 31.5%. Then, product portfolio improvement and price negotiations should contribute to bring these margins to even higher levels.

Moving now to the next slide line number 15 about operating expenses. We will quickly analyze what happened with them during the First Quarter. Over all there is not too much to say this quarter. Operational expenses have achieved BRL39 million or 11.1% of net revenue. Of course, this was influence by the transference of viable pay expense and from G&A to the cost of services provided.

And also there is a reversal of provisions of around BRL2 million related also to viable pay expenses. But overall, as a general rule, our expectation for operating expenses is always to stay below 13% of net revenue.

Moving now I will ask to jump to slide number 16, I will return to that later and move to slide number 17. And let's now speak about EBITDA. EBITDA has achieved BRL77 million in this quarter which represents a 22% margin of net revenue. If we exclude the non-recurring cancellation provisions, the recurring EBITDA would have achieved more than 24%.

Although the group chose not to disclose information by grant, we believe it's important to highlight some important contributions made by each of them during this quarter. Fleury brand continues to outperform both in terms of growth rate as well as return on investments. Since it's unique positioning continues to attract undisputed positive reactions from both patients as well as physicians.

The recently launched brand a+ has already proven that it has the ability to grow in all macroeconomic regions where it is present. Speaking specifically about Sao Paulo, where it has just absorbed (inaudible) brand, it grows at almost the same pace that Fleury.

Slyman [ph] and Diagnoson have also accelerated growth due to this quarter as the continue to believing and reference brands both in Rio Grande do Sul and by (inaudible) respectively.

Finally, Labs D'Or is being integrated according to plan. Although it hasn't yet delivered EBITDA margins higher than group's average, maybe due to the fact that complete integration will happen from the Second Quarter of 2012 onward. We firmly believe that the gains arising from the combination with a+ in Rio de Janeiro, we will be sure a sustainable market advantage in the midterm and long term.

Even considering the already mentioned higher inflationary pressure on some P&L contracts, the Company continues to believe that can keep its commitment to stay within the 23% to 24% range for recurring EBITDA. Even considering the implementation of fundamental strategic initiatives as Rede reconciliation, expansion of patient services centers, Labs D'Or integration, physicians' retention, continuous work for training and technological innovation.

Let's now move to slide number 18. And speaking a little bit about EBIT. So moving to this next slide, the operating profits or EBIT has achieved BRL55 million in the quarter which represent a 15.5% margin and a recurring BRL65 million or 17.9% margin on that revenue.

If you take a look at this slide, you'll notice that the recurring end of the margin is at the same level as reported in the First Quarter of 2011 which was the quarter immediately before the acceleration of the expansion plan and also before Lab D'Or acquisition. The reason why we are mentioning this is to reinforce the group's permanent commitment to expand its business scope and market share without hurting profitability levels.

A balancing act between the already mentioned cost of growth and the efficiency improvement in the application of increasingly more expensive resources as labor, technology, equipment and facilities. Although this does not represent any sort of guidance we also dedicate our best efforts to keep recurring EBIT margins stable between 17.5% and 18% over the next few periods.

Let's now move back to slide number 16. Just to speak about the net income and the net income has reached BRL32 million or 9% of net revenue. Just to reinforce this quarter's borderline has been negatively affected by the already mentioned non recurring cancellations, BRL10 million and also by the one off payment of BRL4 million of interest which is related to Labs D'Or acquisition, the second installment.

Effective tax rate at 0.6% reflects that the group has already started to amortize the fiscal -- physically amortize in the Labs D'Or (inaudible) which represents BRL160 million per year. If we add this up with other acquisitions, goodwill and amortization and other available fiscal benefits, the effective tax rate is expect to be closed to zero in 2012.

Let's now move to slide number 19. And speak a little bit about investments. CapEx which has accelerated over the past four quarters achieved BRL62 million, more than 50% of this total has been dedicated to the purchase of imaging equipment amongst which six MRIs and seven CT scans, reinforcing our historic approach to the one stop shop concept developed by the group more than a decade ago. For 2012 we continue to estimate a CapEx of BRL120 million.

Moving to slide number 20, talking about the debt. Total debt and BRL735 million is under control. BRL9.2 million [ph] will be due over the next 12 months as our (inaudible) cash position of more than BRL250 million is more than enough to ensure liquidity.

Just to remember, during the Fourth Quarter of 2011, the group has issued BRL450 million of net in order to reestablish our financial flexibility, improve the balance sheet efficiency, ensure the ability of funds for future investment activities, either organically or strategic acquisitions.

At the time, true [ph] confidence were offered as a safe word to investor, net debt to EBITDA which is equal or less than 3 times and interest coverage equal or higher than 1.5 times. And their ratios are both under control.

Moving to slide number 21, speaking about receivables. It has been mentioned during last year the Company has established a thorough process to evaluate the quality of its receivables and to negotiate and collect old debts. Also, we started to adopt a more comprehensive set of perimeters during negotiations in order to mitigate credit risks and uncertainty of both collection in the future.

Based on this new commercial approach. And improved controls related to accounts receivables, company's management decided to redefine the bad debt provision policy and implement it as from January 1st as mentioned in this slide. Therefore just to reinforce discretionary provisions we will only be recorded if the resulting coverage remains above the new range described by the policy, 15%, 50% and 85% according to age.

Second, Labs D'Or operations have already been proven in the group's provision policy ensuring consistency across the Company. The impact of this decision was BRL10 million as previous mentioned.

Moving to the final slide, slide number 22, we show some public information about our shares performance in the red line compared to the Brazilian Stock Exchange Index in the green until the end of 2012. Overall -- until March of 2012. Overall, the stock has performed well in a period of intense volatility. Since the IPO share price has increased by 51% while Ibovespa has decreased by 6%.

Thanks for your patience, I would like now to open the session of questions and answers.

Questions And Answers

Operator

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

Q - Andrea Teixeira {BIO 1941397 <GO>}

Hi. Good morning every one, congratulations on the results. Omar and Fabio, I'd like to responsible if you can understand more on the work that you've done on the synergies and I appreciate that you put on the presentation page 14 the impacts on the gross margin which was on 30 basis point as I can you know positive impact on the synergies.

But if you can and you mention in your prepared remarks that you received not only an improvement potentially on the cost but also on the productivity which obviously you have been suffering the productivity given that you're expanding your floor space very fast and you have a natural 18 months operation of that space

So can you kind of explain more on what you expect I would love to see the same kind of diagram on the SG&A side and I know there are moving parts because you had to transfer some of the costs into the gross margin so it should then kind of like that's my first question on kind of reconciling your synergies against what you have planned and what you see in future.

The other second question would be regarding the working capital. If you can comment on what do you think do you have a very impressive improvement already in the First Quarter and what do you expect that to be recurrent or and if you can explain more also on the provision because I know you had announced the BRL10 million back in the Fourth Quarter apparently is and if you really don't see any further oppositions in the years to come. Thank you, very much.

A - Fabio Marchiori {BIO 16680005 <GO>}

Hi Andrea, it's Fabio. Thanks for the questions, the first one is a little bit comprehensive. So, I'll probably reinforce some aspects that I have already said and then if you need to -- something is not clear, then you complement your question please.

Speaking about what we expect in terms of synergies as we said, we have as you see in chart number 14 showed that there is something related to the cost of growth which involves of course Fleury and Labs D'Or. And we expect to dilute [ph] these over time. Also, we expect to increase the productivity of labs PSCs and another element that we didn't mention specifically. But we are studying is how will be the synergy between the technical areas in Rio de Janeiro.

All of that is being studied by the integration group. We don't want to do any bold movement because we want to understand very well how we can move this things without hurting quality for customers. We need this not to be perceived by them or if perceived that they perceive that there is an improvement in quality and services.

But to what we expect as we said in terms of gross margin is to return this only based on this synergies and only based on this improvements to circle [ph] off 31.5% without including in this number any improvement in product portfolio and we don't include in this number any advance that we have in price negotiations in the Second Quarter.

When is the specifically mentioned if you would like to see equivalent chart in G&A. In G&A their approach is a little bit more simple. In G&A the level is stable, we don't want to increase G&A based on this volume growth because we believe that we have the structure already set to receive more volume growth.

What you going to see in the next quarters in G&A, is again, in this quarter it didn't happen, the regular investment in marketing expenses and this is not above the current budget or what we have done in the previous years. Is just regular expenditures so what you going to see, is an increase on that because of this marketing expense because as you know, Henrick [ph] has a very extensive plan for marketing efforts for this year as well.

But again, everything according to what we have done in the past. So, as I have mentioned we intend to keep the G&A expenses below 13% of net revenue. So, summarizing all what I mentioned is that there is a potential upside for both gross margin and G&A expenses reduction based on dilution of fixed cut as we grow, based on improvement in product portfolio and hopefully based also on pricing negotiations and improvement of portfolio of our customers.

So, that what I would have to say about this now. I will allow now Omar to answer your second question. Then if you need to reinforce some aspect we can talk.

A - Omar Hauache {BIO 16579589 <GO>}

Well it's just to put some more color Andre, on what you asked about synergies and you still giving the example of Rio de Janeiro, the recent acquisition of Lab D'Or. Now if you take a look on slide nine, where we illustrated the PSCs assets efficiency, you get to see that our PSCs gross revenue per square meter fell down to BRL3,300 per square meter in the last quarters. And this is mainly due to the expansion plans that we undertook this last year. You know we delivered a lot of new square meters but also because of Labs D'Or acquisition.

The major part of this 57 PSCs that came all together with Labs D'Or acquisition they are not as efficient, talking about revenue per square meter as for Rio (inaudible). So, we foresee a very good opportunity to increase these by exploring this assets efficiency. One other example that Fabio mentioned is the technical facilities we have in Rio. The plants we have in Rio to perform clinical analysis tests.

We still have two plants in Rio and makes no sense to keep on having two plants. So we already analyzed how to integrate into one single facility. We have already calculated some synergies that we are going to get from this integration and this are good examples that are still to come, Okay? So, we have plenty of synergies to explore in Rio de Janeiro with Lab D'Or.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Now, I appreciate it. Just to reconcile what also Fabio had mentioned and I saw the cost of growth quote, unquote, right. In that chart -- and I appreciated when you said 31.5% and also the prepared remarks. But I was just like trying to see -- we obviously want you to grow. So part of that you know impact is a good problem to have, right.

There's a 200 basis points if I understand like the increase in depreciation and general expenses. But there was part of it is also inflation on some of those costs, when do you expect -- you know to -- the growth to normalize? In other words, the rate of growth should be normalized actually in 2012, right, because you grew a lot or you expect -- when you expect in other words and I know you still working on the CapEx for 2013. But when you expect you growth to be kind of more normalized so that these impact of 200 basis points will be actually not as strong.

I mean probably by 2013?

A - Fabio Marchiori {BIO 16680005 <GO>}

Okay, Andrea, yes, you made two questions that are very interesting. First when we hope to stabilize the growth, it depends on what you call stabilize as we've mentioned and we pretend to keep this pace of growth above 15% for organic growth for at least two years and maybe three years at least, it would depend of course on market conditions.

But we believe that we have all the tools here, all the capabilities to keep this growing coming and then this will generate new expenditures and new expanses. But of course this set that you are seeing right now we expect to dilute as from the end of this year on so I would expect this cost of growth, this is specifically cost of growth that you are seeing right now to be diluted by the end of year. Why, because this will be the average -- the medium term of six to 20 months for the maturity of new services. So it's 12 months and we expect to see that.

So, let's say that we stop growing. This is not a hypothesis that we take in consideration here, then this numbers will be diluted by the end of this year, begin to dilute by the end of this year. But as you know we intend to continue to grow at this fast pace probably will need to apply new resources and maybe this will compress the margins to this level that I have just told you, 31.5% for gross margin, 23% to 24% recurring level for EBITDA margin, 17.5% to 18% EBIT, the recurring margin.

In terms of CapEx yes, we are already reviewing the phasing of delivery of new services because that we appreciate a lot of the balancing act to grow and to stabilize the previous growth so that's why we're reviewing the phasing. But if I could guess, I would say that for this year, this is for sure, we're going to expand that BRL120 million and probably for 2013 something around BRL100 million to BRL120 million again because we firmly believe that we'll continue to grow.

So again, I have no specific answer to give to you about how much will be the stable level because we'll continue this pace of amortizing the previous investment while doing new investments. But we give this references in terms of gross margin EBITDA and EBIT to help the modeling for anyone that wants to analyze the value of the Company.

Q - Andrea Teixeira {BIO 1941397 <GO>}

I appreciate that. And also if the pace is regularly stable, it would -- the dilution would come naturally, you would expect right, because you're also investing a lot of new machinery which not necessarily which the curve of maturation is even longer than the diagnostic services, right, is this your way to say --?

A - Fabio Marchiori {BIO 16680005 <GO>}

Yes, that's correct.

Q - Andrea Teixeira {BIO 1941397 <GO>}

The last question on the working capital, on the working capital can you kind of like help us kind of navigate for the quarters because that's going to be a I guess a moving target, right. And I appreciate that you had a lot of changes on the contracts and you're being more selective on the figures. So if you can just update us on that fluctuate [ph].

A - Fabio Marchiori {BIO 16680005 <GO>}

Sure, I'll just give a quickly answer, in terms of working capital or more specifically accounts receivable, I would say that we need to be conservative. So continue to project that the growth in revenue will effectively flat in growth of accounts receivable. Of course we are putting more effort in this collection and we are getting success of that by recovering the old debt.

But of course new debts are coming up because we are still growing very fast. So to be conservative, do not include any efficiency in working capital. We prefer to surprise the market positively by improving the negotiations rather than just announcing this without having any specific thing to comment at this point.

What I can assure you that we're putting all the efforts and we are very, very positive about the fact that this non recurring adjustment are added. Maybe what will happen is that the cancellations now will become more transparent to the market because we included there between gross revenue and net revenue and this is aligned with Omar's initial speech saying that we want to disclose net revenue to show that we are reducing the gap between growth and net revenue.

But at this point I will say that this adjustment that we did it's enough to ensure that now we have the correct level of provisions unless the market change radically what we don't believe as well.

Q - Andrea Teixeira {BIO 1941397 <GO>}

Perfect, thank you so much for both of you for the explanation.

A - Fabio Marchiori {BIO 16680005 <GO>}

Okay, (inaudible).

Operator

Excuse me, our next question comes from Mr. Rafael Frade with Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Good morning all, my first question is just follow up on the last question regarding cancellation effect, your comment Fabio, in fact excluding this high provision that you did, the remaining provision were still significantly higher from what you had in the past. IN some previous call comments that probably this provision should be something between 1% and 2% it came like almost 3%. So if you could talk a little bit about that.

The second question would be regarding the EBITDA margin, you mentioned that you are working to have EBITDA margin between 23% and 24% for 2012 but in -- also in the past you mentioned that this 23% to 24% should be probably impacted by some expenses relate to pre-operational expenses from the expansion that you did.

But considering the number that you are delivering the First Quarter should be more reasonable to work with 23% to 24% including this other expense or in other words, really 23% -- between 23% and 24% and not 22% and 23% for example.

And the last question is if I'm not wrong, you should terminate your contract with (inaudible) in the Second Quarter, if you have some estimate of what could be the impact of that would be a helpful.

A - Fabio Marchiori {BIO 16680005 <GO>}

Thanks Rafael, this is Fabio. So let us start with your cancellations questions. Yes, what you have seen is an increase in cancellations compared to previous quarter and there are two elements to explain this increase. The first element is the fact I'm sorry to say that that in the past this accrual of provision would happen in cancellations and inside SG&A. In between that other provisions, other costs in SG&A on the revenues.

Now we are stopping that so, to be honest with you it has not increased, it's just has transferred from SG&A to cancellations. So in group Fleury, what we see is the same level, the same need for provisions as in the past. But now you're going to see 99% of this in the cancellations because in fact there is no structural problem with the market. There is not a lot of companies that are going bankrupt in HMO/MCO space.

What is happening is that we still have this discussions regarding the clauses [ph] and right now with the improved contracts that we are put in place and improve the control process, this number it tends to reduce but as I said to Andrea, do not put this in our forecast. Let's be conservative because this is a long discussion that we have with HMOs and MCOs. So, is part of our explanation, transfers from SG&A to cancellations?

The second part, the movement that we had -- that put increase is the fact that Labs D'Or needs more provisions related to the gross revenue when compared to the group Fleury we now have to establish the same kind of controls in Lab D'Or that we have here and we have had to put the same way reinforcement in contacts that we have here to reduce the level of provisions that we have to put over there.

So that's the explanation, the mix between Group Fleury and Labs D'Or that has increased a little bit the level of provisions because of this mixed effect. So this would be my answer to cancellations if you need further clarification then you complement.

About EBITDA margins, yes we reinforce even consider all the growth and all the one off expense and non recurring and pre-operation, what we are reinforce is that 23% to 24% is the EBITDA recurring level and the reported level would stay between 21% and 22%.

I was positively surprised this quarter with this 22% EBITDA [ph] because as you know, this quarter is little bit weaker than the other quarters so it was a good result for us. We have good cost control here mainly in our operations which also is favorable to our result and we would expect the margin, the reported margin for the year to stabilize between 21% to 22%.

So I'm reinforcing that this is the standard we are looking for and I'll give you another information we expect that recurring EBIT margin to stay between 17.5% and 18%. So, about the EBITDA margin we have no change.

Now I move to Omar to --.

A - Omar Hauache {BIO 16579589 <GO>}

So your third question, Rafael was about (inaudible), right?

Q - Rafael Frade {BIO 16621076 <GO>}

Right.

A - Omar Hauache {BIO 16579589 <GO>}

So what I can add about that Rafael is -- exactly what I said when I was talking about the slide 10, about hospitals, diagnostic operations in hospitals. As I said, we are looking for healthy margins, right, businesses that we know together healthy margins. So when we entered -- when we started our operation in (inaudible) one year ago, we were really happy with the perspective a high volume and especially with high competitive test that could -- came all together.

What happened only after one year being there is that we didn't reach other commercial agreement with the hospital. They wanted a lower price, we didn't agree. So we decided not -- both sides decided not to keep up -- to keep on going with the contracts. As simple as that. We need to make sure that margins coming from this business line should remain healthy, right.

So, what they are doing right now, this will impact the volume of -- related to this business line and not being there will improve the margins of this business line, of this specific business line, this is automatic. But what we're looking for is to further increase this business line by having new contracts as long as this new contracts bring healthy margins. This is mandatory for this kind of business line for us.

Q - Rafael Frade {BIO 16621076 <GO>}

All right, Omar, just a follow up on the EBITDA margin question, considering excluding this high provisioning in this quarter, the EBITDA margin was something like 24%. Looking for the coming quarter, what would be the pressure to do the reported margin, be more like 22% to 21%, 22 higher? Where you come this higher expenses?

A - Unidentified Speaker

Okay, again, it's pre operational expenses as we will continue to grow. And the fact that the BRL10 million affected the whole year that's why we're telling about the year staying between 21%, 22%. But the difference between the 23% and 24% to 21%, 22%, mainly is pre-operational expenses.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay, thank you, thank you very much.

A - Unidentified Speaker

Thank you.

Operator

Our next question comes from Flavio Barcala, with UBS

Q - Flavio Barcala {BIO 7505480 <GO>}

Hi. Good morning everyone. So my question is regarding growth. So it was a partially answered. But I would like to have just a little more color. So if we look at previous net income, it is already presenting growth easing up even after just one year after the expansion plan was initiated and also the Company's leverage position is under control.

So based on this scenario, does management believe that it is now time to push further for growth so to try to accelerate even further the Company's expansion. And if that is true, what should be more feasible for us to expect so the Company opens more PSCs and the square meter -- the area to increase by more than the 10.500 that the Company has previously guided. Where should we see new acquisitions going forward. So this is next question, thank you.

A - Omar Hauache {BIO 16579589 <GO>}

Okay, Flavio, thanks for your question. Well I think it's reasonable for us to keep them growing organically speaking more than 15%. I think it's wise not to promise a more aggressive role. What's happened this quarter like 18.7% of organic growth that will be very strong, we are obviously very happy about this growth.

We feel -- we see opportunity, the market is favorable for us to keep on going more than 15% every quarter and I think this is aggressive enough. But anyway, doesn't mean that we are comfortable only accepting the gross -- just higher than 15%, of course if the opportunity -- more opportunities are to come, we are going to explore this opportunities.

This is why last year, we expanded so aggressively and we still didn't capture of the effects coming from this aggressive expansion plan. This new facilities, this new PSCs, still didn't reach maturation. It takes some time for them to mature. So, there is still more to come, coming from this recent aggressive expansion plan we undertook here at Fleury.

Not only that, you know the big acquisition we performed in Rio as I mentioned still have plans of synergies for us to explore. And you ask about acquisitions. Again, we are still negotiated with some few companies. I always mention that we are very selective now, we are even more selective, right. We are -- we should be even more selective right now.

No big acquisitions ahead of us, when compared to Labs D'Or, nothing that big of course. But again, following our criteria of selectivity there are still some companies that may be of our interest. So, there are many opportunities for us to keep on growing organically as well as we have been growing. If possible we will accelerate but we need to be more cautious about that.

We cannot grow without quality. We should keep in mind that every single percentage of growth should come with quality. This is our major differentiation features that we have -- our major differentiation features that we have here at Fleury and this is so important to us. Okay?

Q - Flavio Barcala {BIO 7505480 <GO>}

Thank you, Omar. So, we could expect for this year -- we should continue to expect at least for now the 10,500 new square meters, distance?

A - Omar Hauache {BIO 16579589 <GO>}

Regarding square footage, as I told you, we are we reviewing the spacing of square footage for this year. For 2012 and 2013 we plan to deliver 14 or over 14,000 new square meters, right. So, we are focusing even more, I'm going to repeat this. And we're focus even more in productivity. As I mentioned, as Fabio mentioned there are several opportunities for us to increase productivity.

In the new PSCs coming from Labs D'Or and the new PSCs that we launched last year. So, things can go together. They're going to -- we're going to pursue these together. But we need to value every single penny with us as I told you during the presentation.

Q - Flavio Barcala {BIO 7505480 <GO>}

Great, thanks and congratulations on the numbers again.

A - Omar Hauache {BIO 16579589 <GO>}

Thank you.

Operator

Our next question comes from Mr. JC Santoswith BTG Pactual.

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

Good morning, everybody thanks for taking the question. The first ones sorry to insist on this theme. But it seems that the margin that you guys are guiding for the year is very much based on the operating leverage that you'll get from growth, right and the fact, given the fact that you're insisting on 15% more let's say conservative approach for growth. I was just trying to understand if there was anything specifically in the First Quarter that you think that should not be translated throughout the year in terms of reaching this 18%, 19% growth.

As a matter of fact, if you could also explain for us a little bit technically what's the difference between your same store sales growth and your organic growth because the numbers were -- interestingly enough they were quite the same in spite of this square footage expansion in the quarter, an impact here from Sao Luis [ph] hospital.

I just trying to understand why isn't this 19% sustainable for the year as a whole and as well on margins regarding the change from provisioning for doubtful accounts from deductions to cancelings. There's also sort of an accounting impact here in terms of margin expansion, right.

So, wouldn't it be reasonable for us to assume at least, all else equal to have like 1%, 1.5 percentage point higher margin for the year because of these accounting change here on provisioning, thanks.

A - Omar Hauache {BIO 16579589 <GO>}

Regarding -- hi Joao. Regarding growth, again, we are being cautious, just cautious, nothing special happening the First Quarter. We have a very strong March which is usual, this usually happens March is traditionally a very strong month on our business. And this really happens very strongly this year. But still January and February were good months here for the Fleury Group.

What we predict, what we expect for the next month is still a strong growth. We can -- we are able -- probably we are able to hit high teens again. Why not? We are looking for that, we are planning all the structures, all the facilities and all the personnel we have to be prepared for this growth.

But what makes me more cautious is that I don't want to deliver a gross over 20% for instance putting in risk our quality, it's just that if I'm sure that quality can be assured and we are -- we always grow with quality then we can go even more. But, you see what I mean. We can't (inaudible)

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

For sure.

A - Omar Hauache {BIO 16579589 <GO>}

And the first thing that we should think about when we talk about Grupo Fleury.

A - Fabio Marchiori {BIO 16680005 <GO>}

In terms of margins, you were right in your assessment Joao Carlos that there is a potential for increase in margin based on operational leverage. But then, this is what we continue to say all the time. First we consider that there is opportunities for operational leverage but we see some inflationary pressure mainly on salaries and remuneration. So we have to balance that and also please do not forget that we always take in consideration is opportunities.

Of course we don't disclose the information but if you get our pipeline in terms of innovation, in terms of development, in terms of marketing opportunities, in terms of research. We have several opportunities that we continue to explore and we increase the base of exploration according to this operational leverage.

So, use this operational leverage to create the future invest, future growth for the Company so that's why we keep saying, no we don't want to raise margins based on operational leverage because if possible we will reinvest this in the creation of intangibles for the future because the pipeline for innovation, for research and development and margin efforts here and even training of our own personnel and training and development of the physicians that send patients to us is also very large. So that's why we take every single opportunity to explore these possibilities.

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

Thank you, very much, Fabio, this is very helpful, this information. But in fact there is impact here on an accounting perspective, right, regarding the provisioning for doubtful accounts coming from deductions to canceling, you're reducing the net revenue and not having the same. It's just from an accounting thing, you could have like 1 percentage point or 1.5 percentage point increase just by the accounting metrics right.

A - Unidentified Speaker

Yes, we could have put in SG&S and moved this number, you are right. But again what I try to do here is to put the accounting in a way that it reflects the business,

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

Oh sure.

A - Unidentified Speaker

So, okay, no. So you are right. This is the correct approach.

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

Okay. So and the last thing here guys. We have seen from the numbers that you published on the ITR but you sort of republished it the Fourth Quarter balance sheets as well. And out of that republishing we have seen some reduction in working -- in accounts receivable coming from Labs D'Or if I'm not mistaken talking about BRL28 million. I was just wondering the rational view, why was this like changed in Fourth Quarter instead of having like the write off in the First Quarter as well.

And points number two, important to hear about this is that by changing the numbers in the Fourth Quarter, the receivable days as a matter of fact it increased quarter over quarter, in four days of revenues, right. I was just trying to understand -- because I know you're growing a lot so you're deploying cash as working capital as you grow.

As you said perfectly enough. But in terms of revenues days it's sort of increases a little quarter over quarter so what is the trend here, is that anything to do with the growth in the a+ brand or anything like that? How should we -- should look into this number going forward for the year? Thanks.

A - Fabio Marchiori {BIO 16680005 <GO>}

Thanks, well, I say in terms of the adjustment in the Fourth Quarter results these were just adjustment in the balance sheet. As you know, we have entered operations of D'Or really after integration and on January 1st and then we of course checked everything again. And what we notice is that there is some confusion between D'Or reports and Rede D'Or reports.

So there are some problems with the way that we have accounted for accounts receivable. Part of this accounts receivable belong to Rede D'Or but as you know when we have operations inside hospitals, it's just one bill. So sometimes there was some process that were accounted for in the Labs D'Or but in fact belong to Rede D'Or and there were some also problems with some payments that they haven't received and that they have not written off in the balance sheets.

So these were prior to the acquisition, this was not post acquisition, these were elements that were checked by PWC [ph] that happened before the acquisition on August 1st so that's why we did that adjustment in the opening balance sheet. So that's why this doesn't affect the results of the Fleury Group as a whole. And that does not represent cancellations of bad debtors after August 1st.

This is just an adjustment in the opening balance sheet. We had 360 days to do that but we believe that we have finalized these by now because in less than two months we are able to check everything again, in January and February. So this was your first question, sorry your second question was?

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

Yes, thanks, that's for the first one perfectly. The second point is regarding the dynamics for working capital. With that adjustment in the Fourth Quarter you increase is four days, quarter over quarters still trying to understand here why the additional days.

A - Fabio Marchiori {BIO 16680005 <GO>}

No, there is nothing happening. What happens is also because of the transfer of the operations from hospital Rede D'Or, we are still analyzing the payment systems with them. So that's why most of the cash that would come from our new operations in Rede D'Or hospitals has not yet enter in our accounts. But this will be sorted out now in April and May.

So. And this represented if I remember correctly a little bit more than BRL20 million that we have that with Rede D'Or but this is -- as I can tell in 50 [ph] so we're going to sort this out in terms of transactions systems with the people from the platform, the operation that serves the Rede D'Or hospitals and then we get this cash and this will reduce again.

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

Excellent. So we should assume our BRL20 million reduction in your receivable out of this specific item in the Second Quarter and then get like more of a normalized level of days of receivable in the (inaudible).

A - Fabio Marchiori {BIO 16680005 <GO>}

Exactly. This is just what we have to do and we are sorting this out. But as you know we prefer to move the business quickly because we want to take control of the operation then we sorted out this transaction systems issues. Because as you know the contracts were inside Rede D'Or hospital so we have to renew the contracts, we have to do a series of adaptations in our systems.

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

All right, Fabio, thank you very much for the answers, sorry for taking so long, thanks.

A - Fabio Marchiori {BIO 16680005 <GO>}

Thank you.

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 Hauache {BIO 16579589 <GO>}

Okay, I would like to thank you all for your attention and interest in our company. We are always available to clarify any remaining doubts you may have and have a good day, thank you very much.

Operator

That does conclude the Grupo Fleury audio conference for today. Thank you, very much for your participation and have a good day.