

Q4 2013 Earnings Call

Company Participants

- Rogerio Frota Melzi, Chief Executive Officer
- Virgilio Deloy Capobianco Gibbon, Chief Financial and Investor Relations Officer

Other Participants

- Bruno Giardino, Analyst
- Felipe Cruz, Analyst
- Marcelo Peev Santos, Analyst
- Pierre Safa, Analyst
- Ruben Couto, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by. And welcome to Estacio's conference call to discuss fourth quarter and year of 2013 results. This event is also being broadcast simultaneously on the Internet via webcast, which can be accessed on the Company's IR website, together with the respective presentation and earnings release.

We would like to inform you that during the Company's presentation, all participants will only be able to listen to the call. We will then begin the Q&A session, where further instructions will be given. (Operator Instructions)

This conference call contains forward-looking statements that are subject to risks and uncertainties that could cause the Company's actual results to differ materially from those in the forward-looking statements. Such statements speak only as of the date they are made and the Company is under no obligation to update them in light of new information.

I would now like to turn the conference over to Mr. Rogerio Melzi, CEO. Please Mr. Rogerio, you may proceed.

Rogerio Frota Melzi {BIO 16212298 <GO>}

Well, thank you very much and good morning everyone. Welcome to our conference call to discuss our results for the fourth quarter and full year of 2013. Virgilio Gibbon, our CFO is with me here today and he will be helping me with the presentation, as well as our IR

team. I'll just remind you that we are going to have a question-and-answer session at the end of the presentation.

So let's go straight to slide number two of our presentation, which is also available on our website. In every single lecture given our campuses from our Brazil and believe me, there are many in order to spread our organizational culture, we always use the picture of a scale to illustrate our constant portrait for Equilibrium, a vital characteristic for companies' elected to the realities of the 21st century. In general, we say that we have to pursue our balance between financial management and academic quality, financial results and non-financial results and short-term results and long-term results.

Such perception comes from serving successful cases from companies both in Brazil and in the rest of the world and also from our firm belief that companies must constantly work on their fundamentals, if they were to survive in the long run. For this reason, we always seek to measure, monitor, control and then disclose data that go beyond financial information about our Company, because we believe this information help us not only to understand our good financial performance but also to create a culture oriented to long-term results.

Now let's go to slide number three, where we deal with the two sides of the scale. When you look at our operating and financial results for 2013, we see that we have been very successful in achieving this balance. With regards to our financial results, which Virgilio will deal with in more detail later on. It is particularly worth highlighting the 25% increase in our annual net revenue, which together with our cost control initiatives led to substantial EBITDA growth of 52.6%.

The EBITDA margin came to 18.5%, 3.3 percentage points up on 2012, underlining our healthy and consistent growth trajectory. As a result, our 2013 net income increased by 123% closing the year at R\$244.7 million generating an earnings per share of R\$0.83, 89% higher than 2012.

I'd like to mention that we once again delivered substantial results without any large size acquisition and without any meaningful structural change to our company. In other words, we once again grew basically in an organic way with building on top of our solid foundation we have been working on for few years, which requires a lot of efforts and managerial capacity.

On the non-financial side, we obtained relevant results in the latest round of the Minster of Education MEC evaluations in 2012 published at the end of 2013 with the focused on the Law, Communications and Management programs, which accounts for around 53% of our student base. Our grades showed great improvement in comparison to the 2009 results, in the last year in which this group of courses was evaluated, which demonstrates that our academic model puts us in the right path when it comes to gains in teaching quality.

Further, a reportable proof of the evolution of our academic quality came from the transformation of Colleges into University Centers, which is subject to very rigid appraisal

standards by the Ministry of Education. The National Education Council approved the transformation of Faculdade Estacio de Belo Horizonte and FACITEC in Brasilia into University Centers. And now, we are only awaiting publication of the respective ordinances in the Official Gazette. In addition, the Sao Paulo and Salvador University Centers recovered the academic economy [ph], thanks to their good grades in the Enade and CPCs, I just mentioned.

At Estacio, we also seek balance between our financial and non-financial operating indicators. We therefore, keep a very close eye on the satisfaction level of our students and employees measured in a systemic, regular and concrete manner. Our student satisfaction index has improved substantially, climbing from 58% in 2008, when we began measuring these indicators to 68% in 2013, according to a survey by Copernicus and Ipsos Pesquisa de Mercado. In the same period, our employee satisfaction index increased from 56% to 68%, according to an organizational climate survey conducted by the Hay Group.

We also put our efforts in the development of Applied Research, including the equation of an agency develop scientific activities at Estacio. And we remain firm with our social responsibility initiatives. The latest highlight was the sponsoring of Solar Meninos de Luz, responsible for almost 500 helpless children into majors in the city of Rio de Janeiro.

Finally, when we think of the balance between short-term and long-term results, we are aware that the excellent results Estacio has been obtaining recently are the fruit of seeds planted years ago. And we are equally aware that if we want to carry this sustainable growth into the years ahead, we need to plant new seeds. With this in mind, we are moving ahead with our expansion projects, both through geographical organic growth and strategic acquisitions. We opened three new greenfield units, two in Rio de Janeiro in Angra dos Reis and Teresopolis and also our third campus in Fortaleza. We also entered Brasilia through the acquisition of FACITEC and expanded our operations in Santa Catarina with the acquisition of ASSESC. We also announced our biggest ever acquisition UniSEB an excellent [ph] asset located in Ribeirao Preto in the countryside of Sao Paulo state with an extensive nationwide network of distance learning centers.

In the new business front, we began to record the first results of our Continuing Education area, we entered at the end of 2012. The Graduate segment exceeded 20,000 students mark, fueled by our partnership with the Grupo Phorte. And the short-term -- short duration course area reached 1 million accesses through the Voce Aprende Mais You Learn More website.

So moving onto slide number four, here you can see the recommendations of our strategic plans, which we disclosed to the market at the beginning of 2013. We now have a structured innovation area and just opened our Corporate University has began building our Branding project, I mean Estacio's brand have reinforced our institutional positioning, and thinking about our future academic model, have consolidated the EVA culture throughout the company, and investing now alumni relationship projects and are strengthening our Applied Research area.

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At the same time, the term [ph] will further improve our student satisfaction levels, we successfully implemented an extensive Quality System Student Complaint Control and Central Ombudsman allowing us to monitor our students' complaints and deal with problems as soon as they arise.

To sum up, this year, we could see the results of our work on several fronts, at the same time, that we achieved the data's I mentioned in the introduction and prepare the ground for achieving the goals of our 2020 vision, which means generating the best returns for students, employees and investors in our segments.

I now hand you over to Virgilio, who will go through more details concerning our results for the fourth quarter and 2013.

Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Thanks Melzi. Good morning everyone. To begin, I'd like to call your attention to slide five, which deals with our operating results. The first chart shows the student base at the close of 2013 and we have 315,700 students, 16.3% more at the end of 2012. In the same-shop terms, growth came to 14.6%, it's worth remembering that we consolidated that position of ASSESC in Florianopolis adding around 900 students to our base.

Our on-campus student base totaled 250,500 students at year-end already including the 4,500 students acquired in the last 12 months. In the same-shop terms, growth came to 12.5% including graduate students reinforcing the sustainable organic student base growth trend following seven consecutive record high intake cycles. It's worth highlighting some important points concerned the on-campus undergrad student base and the dropout rate, which can be explained by the following factors.

One, a much younger student base in the fourth quarter 2013, which had 62.3% of its students enrolled in the first three semesters vis-a-vis 57.5% in fourth quarter 2012. Two, the dropout of FIES students who were not able to renew their contracts, mainly due to insufficient academic performance, totaling around 3,000 students. And three, a one-off base cleaning of 3,000 students who did not request the withdrawal of their classes or did not attended classes or took exams. It's worth highlighting that this procedure was conservatively changed in fourth quarter 2013, as we observed the behavior of this type of student in the previous quarters, which ended up not returning to classes after the renewal period.

We believe this change; although it has a negative impact on fourth quarter 2013's net revenue, will bring positive effects in our 2014 first semester renewal rates and will help us to reduce our level of civil litigations related to undue charges.

Our distance learning base grew by 24.1% over fourth quarter 2012 to 60,700 students. As you can see on the graph at the side, the net operating revenue increased by 20.5% over the same period in the previous year, reaching R\$436 million, thanks to the expansion of the student base and the increase in the average ticket.

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In relation to fourth quarter 2013 revenue, it's important to mention three points. Number one, higher dropout, the higher dropout level was caused by the increase in the dropouts from FIES student and the student base growth since the first three quarters of the year given the sequential record high intake cycles.

Base cleaning, Estacio's fourth quarter 2013 net operating revenue was impacted in approximately R\$12 million due to a base cleaning we decided to do in a very conservative approach, as previously explained. Out of this amount, around R\$9 million refer to on-campus revenues and R\$3 million to distance learning revenues.

Provision for FIES Guarantee Fund FGEDUC, as of fourth quarter 2012, we have changed the provisioning methodology for students contracting loans through the FIES Guarantee Fund. Over the revenues of these students, we must make a contribution in order to constitute the Fund. The number of FIES students using this Fund increased significantly in the second half 2013, reaching 81% of the FIES student base. This difference increased the amount of revenue deductions related to the Fund to R\$10.9 million, an increase of R\$6.9 million or 172.5% in relation to fourth quarter same period 2012. Excluding the one-time effects mentioned above, fourth quarter 2013 net revenue would have been approximately R\$19 million higher, totaling R\$455 million, a 25% growth in comparison to fourth quarter 2012.

The average on-campus ticket grew by 5.9% in the fourth quarter, in line with period inflation and by 5.0% in the full year, slightly below inflation, mainly due to the impact of the FGEDUC revenue deductions. If these are excluding both 2012 and 2013, the average ticket would move up by 6.4% year-on-year, above inflation for the period. The cancellations previously mentioned also had a negative one-off impact on the average ticket increase.

The average distance learning ticket fell by 6.6% in the fourth quarter 2013, due to the cancellations of undue charges, corresponding to R\$3 million, referring to students without proven academic record, so this affected the average ticket this time. In the full year, however, it moved up by 4.1%, exceptionally below inflation for the same reason as in fourth quarter 2013, plus the launch of EAD Mais, an option which dilutes the course curriculum and consequently its value over a further two semesters, which also impacted the quarter.

Now let's move onto slide number six, where you can see a vertical analysis of our operating cost and expenses. In the fourth quarter 2013, our cash cost improved by 2.5 percentage points over fourth quarter last year, as a result of the following gains; 1.2 percentage points in the personnel line for the same reason as the gains in the previous quarters; and 0.8 percentage points in third-party services confirming the dilution in this line and improved management of third-party contracts throughout the year.

The 2013 cash cost was once again an important source of efficiency gains, improving by 3.2 percentage points due to the following gains; 1.3 percentage points in the personnel line demonstrating another year of increasingly efficient management of faculty costs with higher occupation rates and increased penetration of the academic model in the student

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base; 0.8 percentage points in the INSS line, reflecting the gains in prior quarters; 0.5 percentage points in rentals, thanks to improved contract management and gains of scale from the increase in the student base. And 0.7 percentage points in third-party services confirming the scale we have been obtaining in this line.

In fourth quarter, selling expenses recorded a gain of 0.4 percentage points, although the PDA/net revenue ratio posted a one-off deterioration of 0.5 percentage point, this was more than offset by 0.9 percentage point gain in the marketing line. It's worth mentioning that in fourth quarter 2012, we had the adjustment of PDA related to the booking of the contribution of FGEDUC, which began to consider as a revenue deduction, meaning a R\$4 million reverse in the PDA that quarter.

Let's remember that this year's contract from February 2014 onwards, we will have the non-covered risk booked in the same way of FGEDUC, even from new contracts with our guarantor is a proportion between government and institutions already known, while we will do the 5.63% contribution for all new contracts.

We highlighted as of July 2013, we have been receiving an analytical report on the real distribution of FIES students with guarantor and with FGEDUC from the National Education Development Fund, FNDE.

Based on the difference between our own estimates and the figures in this quarter, we began to effect this retroactive adjustment given that the percentage of FIES students with FGEDUC was higher than we originally estimated.

In second half 2013, distribution of FIES students was 81% with FGEDUC and 19% with a guarantor. Selling expenses in 2013 represented 10.6% of net revenues, generating a margin gain of 0.8 percentage points, chiefly due to a 0.7 percentage point increase in the PDA/net revenue ratio, demonstrating the organic improvement in our PDA in 2013, as a whole and the growing penetration of FIES student in our student base.

In the fourth quarter 2013, general and administrative expenses represented 15.2% of net revenue, 1.3 percentage points down on fourth quarter 2012. The 0.4 percentage point gain from personnel was more than offset by losses of 1.3 percentage points in other operating revenue, which did not benefit from the one-off gain in fourth quarter 2012 from the sale of properties, totaling R\$4.0 million. Two, 0.4 percentage points in orders impacted by R\$3.3 million loss in civil agreements and convictions as a result of the strategy adopted this year to decrease liabilities from civil lawsuits at the same time reducing the number of new lawsuits.

It's worth noting that we gained efficiency in the personnel line, despite having provision of 3.3 million of bonuses in fourth quarter 2013, then in fourth quarter 2012, reflecting 2013 positive results.

The full-year G&A expenses represented 13.8% of net revenue, 0.7 percentage point deterioration over the year before, chiefly due to margin losses in the following lines. 0.3 percentage points in provision for contingencies, which benefits from reversals in 2012,

0.4 percentage points in other operating revenues and 0.3 percentage points in others impacted by the negative variation civil agreements and convictions as in recent quarters.

It's also worth remembering that, as we have been mentioning since the second quarter 2013, the personnel line was impacted by around R\$4 million from the increase in the headcount, corresponding to investments in new areas that will generate significant revenue for the company, such as Continuing Education.

Moving to slide seven, we can see the EBITDA growth posted in the quarter and the year in 2013.

EBITDA came to R\$320.3 million, a 52.6% increase over 2012, capping a year of excellent results, with an EBITDA margin of 18.5%, up by 3.3 percentage points, unquestionably reflecting our capacity to attract students and our efforts to manage and control costs and expenses, which are becoming more and more efficient.

It's also worth noting that the gradual and constant pace at which we have been growing our EBITDA and the consistent and smooth improvement in the margin in the last three years, a direct result of our management model and our focus on the long run.

In the fourth quarter 2013, EBITDA totaled R\$65.8 million, 36.2% higher than the fourth quarter 2012, with an EBITDA margin of 15%, up by 1.7 percentage points. The margin expansion slowdown observed in the fourth quarter 2013, in comparison to the previous quarters, can be explained by, the R\$4 million asset sale concluded in fourth quarter 2012, loss of 1.1 percentage point and the higher amount of provisions for bonus, due to the superior result and the achievement of our internal goals, loss of 0.7 percentage point.

Excluding the effect of these two events, the margin expansion would have come to 3.5 percentage point. In this context, our margin gains in 2013 was of 3.3 percentage points within our expectation for the year.

Now let's go to slide eight, where we present our accounts receivables. The number of net student receivable days average 70 days in fourth quarter, seven less than in third quarter 2013 and three less than in fourth quarter 2012. Excluding FIES net revenue and receivables, the average receivables period came to 81 days, one day more in third quarter of 2013 and four less than second quarter 2013.

As you can see on slide nine, our FIES accounts receivable fell by R\$21.3 million over the previous quarter, showing the normalization of the certificate transfer process following the greater volume of FIES contract amendments in third quarter 2013. These amendments are concentrated in the opening months of the academic semester. In fourth quarter, FIES transfers totaled R\$180.9 million, R\$45.6 million more than the previous three months.

FIES carry-forward credits increased by R\$44 million in the fourth quarter, due to a one-off delay in the FNDE buyback auctions in December, which was postponed until January,

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thereby impacting quarterly cash flow by this amount. However, cash flow was normalized when the buyback auction took place in the first week of January. The average FIES days receivables therefore increased over third quarter 2013, due to postponement of this auction. If the auction had taken place on time, the average FIES days receivables would have fall in to 48 days, its lowest level since the beginning of the program reflecting the major improvement in the FIES contract management process.

The slide 10 shows our quarterly cash flow. We recorded a negative working capital variation of R\$54.9 million, chiefly due to the one-off delay in the buyback auction, which I commented on the previous slide, which reduced our working capital by R\$44 million, while CapEx excluding acquisitions totaled R\$56.0 million. These negative variations more than offset our fourth quarter EBITDA of R\$65.8 million, generating negative adjusted operational cash flow of R\$1.1 million.

On slide 11, you can see that operational cash flow in 2013 was positive R\$78.5 million. If adjust for the delay in the FIES buyback auctions, it would have been positive by R\$122.5 million, R\$33.3 million higher than 2012 representing a clear improvement in our growing cash flow generation capacity.

I will now hand you back to Melzi for his conclusion and final remarks.

Rogério Frota Melzi {BIO 16212298 <GO>}

Thank you, Virgilio. On slide number 12, I will talk a little bit about our prospects for 2014. In 2013, you could see the results of our work on several fronts, at the same time, that we achieved the balance I mentioned in the introduction and set the foundations for our 2020 vision.

One of the side effects of such a good year is that there is an initial effect for the following year, in this case 2014, because there is a positive carryover of several variables that compose our results. One of these variables certainly is the student base. When we look at 2014, it appear to be maintaining our healthy growth pace and everything points out to another record high intake cycle, the 80 [ph] in a row, basically in an organic contest. Although the process is not yet complete, we expect intake to grow approximately by 18% both in the on-campus undergraduate and the distance learning undergraduate segments.

In this contest, our on-campus undergraduate base should grow between 12% and 15%, while the distance learning undergraduate base should grow between 20% and 25%. For our total same-shop undergraduate base growth of roughly 15%, which will certainly allow us to once again expand our results in absolute terms as well as in margins.

It is really important to highlight that all this growth comes in a scenario without relevant acquisitions in the last years. On top of our base, which has been growing steadily for several semesters and had its biggest inefficiencies already nailed [ph]. Not to mention the fact that our distance learning has the same number of distance learning centers since

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the beginning of its operation. In other words, we are talking about organic growth based on our management, which significantly improves our returns over the years.

Parallel to this organic growth, we began the year with excellent news when we owned the Assisted Transfer bids for students from Universidade Gama Filho and UniverCidade, which has been discredited [ph] by the Ministry of Education. We received Gama Filho's medical students and in partnership with Universidade Veiga de Almeida and SENAC, we won the two bids for Gama Filho and UniverCidade all their programs. According to the bid notice around 10,000 students from these institutions may end up transferring to Estacio. In addition to opening new avenues of growth, this process will allow us to extend helping hands to thousands of students whose future was uncertain, in total accordance with our social responsibility principles and initiatives.

In 2014, we also began to explore a new line of business for Estacio, that are vocational courses through Pronatec. And this decision has already began to bear fruits with the result of the bids for the places in the first semester of 2014 held by the Ministry of Education, in which we received approval for a 100% of the places we requested, roughly 24,000 seats. While we made the decision to participate in Pronatec, we put together an excellent team to create and conduct a program with the same standards that we are used to in our regular post-secondary problems, so we feel we are ready to successfully deliver these courses in Rio de Janeiro, in locations where we have demand, penetration and idle capacity to receive these new students.

In the Corporate Solutions area, we entered into our first contract with the Contax Group, and have several order promising contracts in the pipeline, while the Academia do Concurso reinvigorated and ready to launch its courses in the distance learning model in 2014, is fully equipped to begin leveraging its results following a period of intense restructuring.

On the expansion process, we are awaiting authorization from CADE, Brazil's antitrust authority to conclude the acquisition of UniSEB, but we are very excited about the growth prospects for our distance learning segment and the integration of all the operational academic value that UniSEB can offer.

It is also worth remembering that we have five requests with (inaudible) to open new units and we expect to receive authorization to operate 11 new campuses. We currently being so successful with the re-take process for 2014 and because we have all these not yet placed evidence for growth, our team is absolutely confident that we are in great shape to deliver outstanding results in fiscal year 2014.

However, thinking about the future, we have also included several projects in the targets of our receptive offers related to the company's strategic plan and therefore long-term by nature including the branding project, the hospitality project, the EVA in the management system and the alumni project.

Here to start, we keep the reaping the flow three two years ago, But in parallel, we also keep lending usage for the years to come with more files on Estacio's long-term goals.

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That brings us to the end of our presentation. So now let's go to the Q&A session. Thank you.

Questions And Answers

Operator

(Operator Instructions) And our first question comes from Felipe Cruz of Itau. Please go ahead.

Q - Felipe Cruz {BIO 17343069 <GO>}

So my first question relates to just to make sure that this client base, student base clearly that you're doing relates to revenues coming only from the fourth quarter or it also relates to revenues coming from the any impacting your third quarter results, so that's my first question.

And also if you could provide because in the Portuguese conference call, you said that EBITDA in the first quarter of 2014 shouldn't be impacted a lot by the screening, but second quarter results should already see significant reduction as you clean fourth quarter students in this result. So I just wanted to have a better sense of the breakdown of how much of this R\$12 million come from the fourth quarter and how much comes from the third quarter? And how do you expect that to impact your results going forward?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

All right. This is Melzi, Felipe. Thank you for your question. Let me clarify this a little bit and have Virgilio helps me with this more technical conformation. I just want to talk a little bit on our decision to make it very clear that we are not changing anything related to the past. This is a change in the way or this is a change in our process to charge these students.

Let me explain this better. As you all remember, three years ago, 2011 and 2012, we solved this spike in our delinquency here in Estacio and decide [ph] to be much stronger in terms of improving our collection with all these students and we did that by how do we extend our systems and making sure that all these students were getting charged at the proper time. And this is proving to be very helpful to us because we are watching our FGEDUC, our delinquency is coming down over the last semester or so.

However, we also saw and I think it's very clear in our release, we also saw an increase in our civil lawsuits and this started happening roughly in July or August this year. So the moment we saw that, we went to analyze what was going on and it became clear to us that there is a cluster of students. The students that were signing with us at the beginning of each semester. We force every student to sign a contract with us. A contract that will allow us in the future to try to charge the student with better chance of success. They were signing with us, but they were dropping out very early in the semester. And they were not even coming to take their first exam, which is very important for us in terms of being successful with this charging attempt.

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We were -- until this semester or this quarter, we were keeping invoice in these students because we thought we had a good chance to charge them based on the contract they had signed. However, these are students were suing us, not only to protect them against the charges, but also to try to charge us because we are -- it's kind of a more of -- I don't know how to say that in English, more hazard or stuff like that, something that we were trying to do in a fair way. And they were being successful in that.

So, in each case, we get this kind of loss. We end up being around R\$10,000 to R\$12,000 for these students. So, not only we are not receiving from these students, we are not collecting anything, but now we have to pay them because of this more of hazard stuff that they are suing us for. When we saw that, we decide to take a process here. So now, when we see that these students haven't come or didn't come, didn't show to pick their first exam, and we are not showing, and they could be just a sort of insurance if they are not accessing the website, we can monitor that.

So we are now -- we have now decided to stop invoicing the students. However. when we see that in the middle of the fourth quarter, yes, we had already advised them partially in the third quarter and also in the fourth quarter.

So, this is what we are calling a cleanup, it is not something that had been sitting therefore three or four years, this is something we didn't know that happen this semester, and because we learned with our own mistakes, we decide to change that.

This is the reason we should have said in the Portuguese call that there's not a lot to build or to recover in the first quarter, because the vast majority of this invoices happen in the fourth quarter given our the way we get the student enjoy student certain base.

So we are going to see something coming back, and why this comes back in -- because, of course, if the students were getting watched, if they were not coming back because they were not drop out anyway at some point, we will need to recognize this is a PGA right. We need book for this provision. This is near to our standpoint, but it's not so near to anymore, at this moment this kind of money back on us.

So this is reason the we decided to stop, so chances are in the first quarter of 2014, we are going to see a slight reduction coming from this situation. And I expect to see a further reduction in the second quarter of 2014.

I also think that in the medium term, we will see a reduction in this CBO, lots of -- we are suffering, because if we start with this biggest driver for these lawsuits, I would expect us to have some recall in the medium term.

So let's just make it very clear, we're not talking about anything old, this is something happened, it has been happening over the past semesters, the moment we saw that we decided to change because we think it's reasonable for the company in the medium term.

Q - Unidentified Participant

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Okay, thank you. And also going forward, how we should look at dropout rates and how we should look at -- how you actually account for or not account for these kinds of students. So, should we continue to see kind of more seasonal result where you account for these students in the first half of this semester, and then in the second half as you as you learn that this student is one of those that falls into this category of guys that sign with you, but eventually drop out and won't receive an invoice anymore. So, how we should model now your results quarterly? And how we should look at dropouts for the company going forward?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Well, obviously -- I can give you more details when it comes to modeling, but let me give you an overview. First, let's remember that, we have two kind of dropouts here as we speak, as we call in Estacio, the first one, we call the renewal rates and that happens at the end of each semester, right. So every student who finished the semester has to make a decision to come back at large [ph], right, this is what we call renewal rates and that happens every end of the semester.

Because we changed this process, I expect these renewal rates should be better now in 2014, first quarter of 2014 for the simple fact that, these students were not going to come back anyway. So if we have already got rid of them, in terms of our student base, chances are that the renewal rates in percentage terms will be better now in this first quarter.

The other dropout situation we have, we call evasion [ph] or dropout, that happens during a semester. So if student fight [ph] with us, say in January-February or so, and that's where whatever reason they dropouts doing that, current semester, they we call dropouts or evasion here in Estacio. That won't to be so affected by that decision. I think there maybe sometime it may become a little bit smoother in terms of that some of these students may end up not being recognized in the first quarter. If we see that, on time, so they don't show up as evasion in the second quarter.

But the problem is that, our first exam usually happens right at the end of the first quarter, sometimes it begins in the second quarter or the even quarter. And we are going to wait until this moment to make sure that recapture these students in a proper way. And then we stop invoicing them.

So, I'm not so sure, we see any kind of change in this dynamics between odd and even quarters when it comes to this evasion or this dropouts. But I am confident that we are going to see a better renewal rates at the odd semesters and also in the medium term we are going to see a reduction our civil lawsuits. And again, this is that -- you need to reassume [ph], we made the decision to reduce our civil lawsuits, okay.

Q - Unidentified Participant

Okay. Well, thank you very much.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

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Welcome. Thank you.

Operator

Our next question comes from Pierre Safa of Tree Capital. Please go ahead.

Q - Pierre Safa {BIO 18632234 <GO>}

Yes, hi. Thank you very much for taking my question. So, I had two questions. The first one was just to understand, again what you were just discussing, so the total gain [ph] is R\$12 million and you said R\$9 million, it was just to confirm, I think you mentioned that during the call, R\$9 million was on-campus learning and R\$3 million was distance learning. So I just wanted to confirm that and how many students this affects? So that's the first question.

The second question is, the increased confirm what your guidance is for 2014? Thank you.

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Okay, Pierre, thanks for the question. This R\$12 million, R\$9 million is coming from the on-campus students, if you take into consideration, the 3,000 students that we said about the FIES student base is almost R\$7 million of this total R\$9 million are coming from this canceling from FIES tuition [ph], that the canceling for the tuition from July, August and September.

So you can measure average tuition of R\$700, R\$750, this can go up to R\$6.28 [ph] million and R\$7 million of this on-campus students. The rest is certainly about more 1,000 students is the other part of on-campus student that makes part of all, complete the part of this R\$9 million canceling coming from the on-campus.

The other R\$3 million, almost R\$3 million, R\$2.8 million actually was coming from the distance learning student that we cancel during the second semester. So, as I just told, we are expecting a better renewal rates for the second semester, and also a reduction and good trend to reuse the new entrance of the PDA for the first half of 2014.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

And Pierre for your second question. This is Melzi, again, thank you. We have this policy here not giving guidance, it is something we like and we intend to continue. What I can tell you, and I think I did at the end of my presentation is that, with everything in our hands right now with the numbers, with this intakes and with renewal rates, we are watching in Estacio and plus our capacity to generate results based on this gross net revenues. I think we have everything in our hands to deliver an outstanding year in 2014. By outstanding, I mean, a number that we will please, every single investors could believe in us.

But we also have some things that are not absolutely considered by investors so far. And we mentioned some of them. Pronatec or the UniSEB, the students coming from Gama Filho and UniverCidade, they can get just 7,000, 8,000 students eventually, plus this

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corporate solutions area, we have in our hands, watching a good pipeline of bids coming along.

When we consider all these other, what we call here [ph] avenues for growth. I think that we have a wonderful year ahead of us. Again, if everything goes wrong in terms of this additional possibilities, we still, I think we are in great shape to deliver outstanding results. If at least part of the thing that are happening, I think we're going to have an unforgettable year in 2014.

Q - Pierre Safa {BIO 18632234 <GO>}

Excellent. Thank you very much.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Thank you.

Operator

Our next question comes from Bruno Giardino of Santander. Go ahead please.

Q - Bruno Giardino {BIO 15974970 <GO>}

Hi, good afternoon everyone. First question, I would just like to confirm the numbers that Virgilio just said about the revenue impacts on FIES student cancellation, was it R\$7 million right, Virgilio?

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Yes, Bruno. It's R\$6.8 million actually. Okay.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay. So the remaining 3 million would be from students -- from revenue that you canceled off non-paying students regarding to the third quarter, right?

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Yes, the third and fourth part on-campus student and the other R\$3 million is the part coming from distance learning students.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay. Thank you very much. So my second question would be, actually there are two additional questions. The second one would be, how many from (inaudible) seats do you expect to fulfill in this first semester? And secondly, if the inspector say that if projected a similar net revenue expansion for next year. The company would be able to deliver another similar margin expansion as this following in 2013. I mean, my question is, if you still see a lot of potential from margin expansion from the turnaround of the operation you did recently. That's it from my side.

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Well, Bruno. Thanks for the question. As for the contracts, it's unclear for us because it's the first time we are doing that. Well, I can tell you is that we had a kind of -- we got a website where students could declare the -- we can just to take this problem with -- in Estacio. The numbers were huge, by huge, I mean like eight or nine times the number of seats we have, obviously this is just an intention. And now they have to confirm this in the Ministry of Education website. So the process is different.

I believe that we have a very strong demand. I think our team here is trying to push as hard as we can in terms of advertising making sure the students get the proper semester. So it's hard to tell, because it's going to be the first time, but I am very enthusiastic about the possibility that we're going to have a lot of students in this first trial with Pronatec.

Also Bruno, the way we do things in Estacio is step by step and remember that there is a learning curve. So this semester we decided to learn about Pronatec or in Rio de Janeiro. With the number of this seats we got again, these numbers we got only in the state of Rio de Janeiro 24,000 seats. But now in the second semester, as we are learning more about this and if we feel confidence on our own capacity to deliver these products in the same way we deliver everything else in Estacio. Obviously, there is a chance we're going to expand that to other states, because we are present in 21 states, physically present, in 21 states in Brazil.

So I think Pronatec, if the government keeps going with the Pronatec in the same pace as they did in the last two semesters, I think there is room for a lot of growth in Estacio. Just remember it that again we do think step by step here in a very gradual way.

As for the margins, if we get the same kind of revenue growth we saw in the first -- sorry, we saw in last year compared to 2012, eventually we should see a kind of similar margin expansion, obviously you've got to give me some kind of tolerance what I have done because there are a lot of details, you still have to wait for, for example, what's going to happen with our teaching costs, we are now defining how this cost will behave for the remaining of the year. We are not very clear on that, not to mention G&A and everything else.

But I think there is a part of this -- our entire cost structure, expenses structure, that is by nature fixed. So, chances are that there is room for to go a little bit further what we did in 2013 versus 2012, assuming that everything else will be equal, because again there will be further dilution. Okay.

Let's also remember that we're not seeing anything coming from UniSEB yet. It's early to tell. We need to wait for a card [ph]. But let's remember that UniSEB is almost a pure distance learning operation, so the moment we can bring it in and add everything we can in terms of management, capability and so forth, obviously there will be potential to increase our margins because they are pretty much a pure distance learning player. So, I think this can be a good surprise for everyone at the end of the year as well.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay. Excellent. Very clear. Thank you very much. Melzi, thank you very much. Virgilio have a nice day.

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Thank you, Bruno. Same for you.

Operator

Our next question comes from Marcelo Santos of JP Morgan. Please go ahead.

Q - Marcelo Peev Santos {BIO 20444938 <GO>}

Good afternoon to you. Thanks for the question. I have two questions actually. The first is, I like to -- if you could give a sense of how much of the PDA in the fourth quarter is related to students that in the first semester have not shown academic performance. And therefore under the new procedure you adopted, these students wouldn't actually have been burden [ph] so they wouldn't go to the PDA. Can you give an idea how much -- what improvement we could be seeing for the next semester? That will be my first question.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

That's such a great question. I don't have the answer for that right now. It's a great point, I mean, we don't have this analysis. I think it's easy to do, we can try to go (inaudible) with anyone who has -- who is curious about that. I would assume it is equivalent in terms of magnitude, because the process was pretty much the same. There may be some changes, but I would assume it is equivalent to what we saw now in terms of number of students. Okay. But again, we can run these numbers here, Virgilio (inaudible).

Q - Marcelo Peev Santos {BIO 20444938 <GO>}

Okay, that should be great that. And that second question about the 3,000 students that lost their FIES scholarships on academic performance or the lack of academic performance. I just wanted to understand better, is this something has happened it's like there was a semester, the semester was higher or just happened this semester? And also do you have students who dropped out because they lost FIES, are there students that could lose FIES and stay in the company. I just wanted to on that a little bit better the dynamics of moving FIES on performance?

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Hi, Marcelo, it's Virgilio. These numbers are higher in this year because of that the higher numbers of FIES intake that we have seen in our student base. Last year, this number was less than a 1,000 students that didn't have the right performance. So in this year, we have 3,000 students that been lost that the possibility to meet their amendments by the end of the first semester. And we invoiced the student to renew this quarter in July or August and September, but they didn't appear, they didn't take the exams in September, October. So we decided not invoice the October, November, December and canceled this revenue from July from September. That's the dynamics what happened.

And the number is very higher or much more higher right now, because to lose the FIES they have to pay you in two semester in a row having less than 75% of performance in the credits that they are enrolled for the semester. So the numbers are higher, and this will be another some kind of trend that we have, we have higher numbers coming from FIES and we will see more students failing semester-over-semester. Okay.

Q - Marcelo Peev Santos {BIO 20444938 <GO>}

Okay. Thank you very much for the answers.

Operator

(Operator Instructions) Our next question comes from Ruben Couto of Brasil Plural. Please go ahead.

Q - Ruben Couto {BIO 19172367 <GO>}

Good morning everyone. Thank you for taking my question. Actually, most of them are already answered. But sorry to insist on this, but could you just provide more color on the quarter-over-quarter spike that you're having in delinquency rates in this fourth quarter? I'm not talking about what would be the impact in the coming quarters, but I understand that were so much facts that would reduce your net revenue base, but even by adjusting this fact, I think it was still pretty much above the level for the amendments of the year. Is it entirely related to the second half intake cycle, I mean, your intake cycle was pretty above average as well. So this is also impacting -- already impacting the delinquency rates in the fourth quarter. Thank you.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

I'm not sure, this is Melzi. I'm not sure, I follow your question. But I mentioning in spite the delinquency, this is three years ago and I mentioned that because it isn't [ph] causing a change in Estacio, and the way we were charging or we were trying to collect the fees from our students, we became much more aggressive around three years or year and a half ago in that direction.

Now, and again, I think we were very efficient when we decide to do that. But I think, now we start to a price, because you know in Brazil the rules are such that, if you do that, and not charging students in a not a fair way, by definition, the students can come back and eventually sue us and that they are doing that.

We are losing these lawsuits. So this is what I was trying to illustrate, I was showing that because this -- there was change three years ago, we decide to become much more aggressive and now we had to review that some of the process, we decided to abort [ph], because we want to bring these numbers down. As far as I know, there is no signs of increase in terms of delinquency in this last five -- Virgilio can talk more about that. But I think the markets as a whole, not only the education segment, but in the bank system itself, I think the delinquency has been coming down in Brazil, which is great news for everyone.

So, eventually this is going to help us to bring it down next semester by itself. But on top of that, because we did this change in our process, there may be some additional improvements to our PDA. And there is no impacts to our PDA in this semester, because the way we recognize our PDA as such to wait for 180 days. So we are pretty much doing something now, then we would have to grow anyway 180 days ahead from now. And again, what we are doing, I'm not sure if I answered you, but rather we're doing pretty --

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Q - Ruben Couto {BIO 19172367 <GO>}

Yeah. I understand. Thank you for that. Just to wrap this up. I mean talking about year-end '14. Could we expect that the level would be seem unlikely [ph] pretty much what we had in 2013 as well, even considering your new approach to these issues?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

You mean, what would be the same in 2014 or -- I lost you.

Q - Ruben Couto {BIO 19172367 <GO>}

The level of the delinquency rates. Sorry about that. In terms of net revenues?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

I think, it won't change, delinquencies -- well, I think PDA is only thing, right. PDA is the result of the delinquency. If delinquency goes really up, we have a lot of things to do between -- before this delinquency ends up, becoming provision, right.

Q - Ruben Couto {BIO 19172367 <GO>}

Yes. (inaudible) and PDAs, sorry about that.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Okay. Okay. Because obviously they are correlated, right. If you have a higher delinquency, then the PDA will go high. So, for delinquency, I see no signs of change, whatsoever think, as far as in 2014 it will be pretty much the same as '13. Yeah, eventually with some time to do [ph] those. As for PDA, Virgilio.

A - Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Yes, just to add some points here, Ruben, just remember, in 2012 in the fourth quarter, we did adjustment for the accounts for the PDA. So in the fourth quarter, we have around -- something around R\$4 million that benefit the PDA levels, because the FGEDUC at the fourth quarter little retroactive in the net revenues discounts for the entire year of the 2012. We didn't have this movement in 2013. So when we compare the PDA level, the first quarter of 2013 against 2012, 2012 had this benefit, this (inaudible) benefit at that time.

Another point is for what we are doing for delinquency for the 2014? We're just implementing in this third quarter a new area under (inaudible) here in Estacio, trying to retrofit all the collecting process, implementing our BI strategy, how to improve our collection and reduce delinquency in consequently the PDA levels in the long-term. So it's

a very new project that we have and we are expecting a very good results in the PDA for 2014 as a consequence of this new area. Okay.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

And by the way on top of that before I forget, we are moving towards an EVA culture in Estacio. So this year for the first time, not only EBITDA will finally be the trigger for our entire bonus but operational cash flow will be part of this equation as well.

And my first -- and my personal first goal is the EVA for 2014. So you will see it, we are pretty much teaching our company to think more in terms of cash flow and value generation. So, I think we are aligning the entire organization towards this constrain. Okay.

Q - Ruben Couto {BIO 19172367 <GO>}

I see. Sorry about insisting that, but thank you. That was very helpful. And just talking about a different subject, you mentioned that you are now starting your Branding project, but when we look at marketing expenses it was pretty much -- talking about year-end '13 as a whole, it was pretty much flat in terms of net revenues compared to the last year. So, these are things that which this new Branding project, do you expect to invest a little bit more in terms of marketing or do you expect it to remain flat in terms of net revenues? Thank you.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Thank you for the question. That's a good question. Branding is a long-term thing here. So, what we did last year was pretty much in the back half, so we brought here being an expert, we have in Brazil. The same company, the same team that actually built our (inaudible) brand a years ago and then the (inaudible) brand some years after that, so we are talking about highly expert people. So we spend entire year last year thinking about how we are going to build this brand, what is the kind of perception we want to cause in that population, so there was something really incurred.

At the end of the year, you may have seen we did some kind of institutional marketing, talking more of our students and our contribution to the society. And this is also very important, not only because it will eventually in the future help us to boost our sales, but also because it helps us to somehow protect our image against people who don't like very much education for profits and so forth. So, we're working on that direction as well.

In the future, obviously, we are going to do or to dedicate part of our marketing expenses to build these brands. And this is going to be more institutional than something as merchandising and so forth. But we intend to keep our 5% in terms of revenues for marketing expenses. These numbers are strategic for us. So the goal is to increase the revenues. If we increase the revenues, we still have much more money in absolute figures in order to invest not only in our current traditional marketing stuff, but also to build these brands in the medium term. This is really, really important to our strategy in the future. Having a national brand that demands a lot of respect from everyone is absolutely key to our future in Estacio. So, great question, thank you for that.

Q - Ruben Couto {BIO 19172367 <GO>}

Thank you.

Operator

(Operator Instructions) Our next question comes from George Rick [ph] of Harvard Rich [ph]. Please go ahead.

Q - Unidentified Participant

Hi guys, this is (inaudible). So, couple of questions from me. Just to sort of circle back on is that issue already one more time. So, just to understand in terms of what really changed -- you really just decided to be a little bit more proactive and to avoid lawsuits, you basically bringing some of the -- and canceling some of the students that you would cancel either way but just later. So in that sense you just being proactive, nothing else really changed there, right? So that's one question. Is that the correct understanding?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

(inaudible) yes, you are absolutely right. Think about that. Invoice a student, right, and then I have pass the message to try to collect that. If I have not -- the direction, at some point I will have to recognize this as a PDA, Provision for Doubtful Accounts. So, it is neutral, except for this time difference, it is neutral --

Q - Unidentified Participant

Yeah. So that's my point. It's neutral, really it doesn't do anything. I mean if anything it improves the operations, right, remove some of the issues down the road, right. So as we think about the year and if I forget the timing differences on Q1, Q2 then there should be no real impact from that point of view?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Yes and no, because remember I told you, it was neutral until the moment we start getting sued by these students, because we are trying to charge them in a fair way. So it became negative. So what motivated us to change this strategy or this process, was these lawsuits. So nothing to do with revenues or PDA, because they are neutral, except for this time difference, right. But we were losing money, because we are getting sued, so instead of waiting for the situation, we decided to change now that's it.

Q - Unidentified Participant

That's good, in my mind that's good, that's not an issue. I just wanted to understand from delinquency point of view and all that other stuff right, this policy doesn't really impact the numbers, the lawsuits there is sort of -- in my mind, once you stop this, then you can treat them as a one-off, the way I think about it, but maybe I'm wrong.

Okay. And then my other question is, the results were, if you make these adjustments, results were okay, the results were in line with sort of expectations. But some of your

peers, they had a blowout results, right. So they are a little bit more aggressive in terms of how they drive growth. I'm just wondering, is there a reason for you being more conservative or you just kind of, it's the learning curve -- how would you think about that? I mean outside the product mix, I know the mix is different, so they have more deal than you do. But still this is different from the growth rates, and I'm just curious to hear your view?

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A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Well, (inaudible) yes, they also had great results, but they were obvious reasons (inaudible) with results, right.

Q - Unidentified Participant

Sure. But I am only comparing you with the (inaudible) you're good, right?

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

But I think that's the differences there, right, if you compare to (inaudible) who actually showed an outstanding results and obviously, I am happy for them because we're talking about the industry, right.

A short-term, think about short-term, they are coming from a sequence of a large acquisition. So they have a lot of room to improve when it comes to delivering better results and margins because they have a lot of inefficiencies to work with, and I think they are being and totally capable to do that. They are showing great capacity to quickly work on these inefficiencies within the acquired companies.

We are in a different path, because we haven't had any kind of large acquisition except for UniSEB, which we are waiting for authorization from the Ministry of Education. So, we don't have all these rooms to work and this is why I kept repeating during our presentation, that we are doing everything we are doing here, for the third year in a row margin 50% EBITDA growth and all this margin expansion we are doing pretty much on organically and that requires a lot from us.

The beauty about that and this is a little bit from long-term now is that, we also have all those opportunities to do no more organic stuff, right and to boost our margins and to do something here at some point. Let's see what is going to happen with UniSEB, right. The moment we're able to integrate UniSEB. And then I think that about that as an option, we have in our hands, right. We can do whatever we can keep doing what we're doing in terms of keeping expanding our operation with what we already have in our hands. But then we have all this evidence for growth I mentioned in the (inaudible) any other moves that I cannot comment at this moment in time, but that is obviously we can actually go through as well. And then we can add on all this capacity we have in our hands.

So, I think we are in a situation here, where we have the best of the two words. We are able to generate a lot of value just based on what we have in our hands, plus we have everything that others also have. So that's it, I look long-term, I think we are going to deliver outstanding results for all of you. Okay.

Q - Unidentified Participant

Okay. Thank you.

Operator

Since there seems to be no further questions, I would like to turn the floor back over to Mr. Rogerio Melzi for his final comments.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Well, just to thank you all for staying with us and for all these questions. It was quite an interesting call this time. I just want to point out that this last quarter and the entire 2013 for us again was great, outstanding results, financial and non-financial results, but 2013 is gone now. It is past for us, we celebrated a lot and that's it. We are now looking ahead and now wondering how beautiful 2014 can be with all these things we have in our hands.

So I hope you'll stay with us, and join us in the next quarter results with great news. Hope to see you all. Thank you. Bye-bye.

Operator

This concludes Estacio's conference call. You may now disconnect and have a good day.

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