Q1 2019 Earnings Call

Company Participants

- Adriano Pistore, Vice President of Presence Operations
- Alexandre Aguieiras, Vice President of Distance Learning
- Eduardo Parente Menezes, Chief Executive Officer
- Gustavo Artur Ciocca Zeno, Chief Financial Officer and Director Investor Relations
- Jose Aroldo Alves, Vice President, Marketing
- Rogerio Tostes, Director, Investor Relation

Other Participants

- Guilherme Palhares, Analyst
- Javier Martinez, Analyst
- Leandro Bastos, Analyst
- Luiz Garcia, Analyst
- Susana Salaru, Analyst
- Thiago Bortoluci, Analyst

Presentation

Rogerio Tostes {BIO 6148759 <GO>}

(Starts Abruptly)

and by the CFO that is hearing us, we have also the entire Board of Directors, and we inform you that we are available for Q&A. These slides are being transmitted in our website of www.estacioparticipacoes.com.br/ir. Before I give the word to Eduardo, we start the teleconference that is being simultaneously transmitted into English that's why we are keeping the best governance and avoiding losing any information for our stakeholders.

All other participants that will only listen to the presentation and thereafter, we will start the Q&A. You will receive more instructions thereafter. (Operator Instructions)

This audio conference might have predictions about future events that are subjected to risks and uncertainty and maybe they are not going to be fulfilled in terms of expectations. These predictions and that the unique opinion are based on data and we are not obliged to update them should we have any new information.

Please, Eduardo, the floor is yours.

Eduardo Parente Menezes {BIO 16707188 <GO>}

Well, good morning, everyone. It's a pleasure to have you here. Thank you for participating in this teleconference. Well, I think that throughout the presentation, we have a few highlights, which is the predictability that we can keep in our operations. You can see all of that in the following slides and the result of the actions that we've implemented since last year are very strong efforts that results in loyalty pricing supplies. And you have clearly true results in the best capturing the history of Estacio and the stability of results that even though we are living a very hard, very difficult part of the economy.

Here on page 3, we can see here, the predictability of the report. In the top of the slide, you can see the direction, the guidance that has been confirmed in the last quarter where we had 80% of the capture concluded, and we are within our predictions, somewhat better than others. Second issue, also in regards to predictability. We talked about the granularity and the actions that we have in the pricing and the sales process as well. We have, in the bottom, the 187,000 students total was that we captured this quarter, which is the highest number of captured by Estacio in its history. And the most important thing that we commented with you, the EAD, or the distance learning, which is capturing growth. And you can see the results, almost 100,000 students captured this semester, a growth of 29% versus the first quarter -- the first semester of last year in comparison to last -- the first semester of last year. While we have here the Flex, it's double than last year.

Well, let's go to slide number 4. Let's talk about the highlights of the quarter. Well, once more, predictability is key in our operation. Well, the total base of students is growing in spite of the decrease in the financing of FIES. Everybody knows that FIES is less than 10% of our base of students and a great result for us for growing in the FIES base. We are compensating for this loss.

In the top part of the slide once more, you can remember that in the last quarter, we had a few projects and the complete result would only be seen this year, of course. Now, we couldn't expect for better results. We said no, the result of this project will be actually to compensate the effects that we know that will happen, which is FIES and the increase of PDD.

Now in the bottom slide, we can see a change. Regardless of the change of mix, we have the distance-learning growing. With a smaller ticket, we can maintain the revenue stable. In the middle of this slide, you can see the gross margin growing as a result of our efforts, 59% to 60.4%, leading to the greatest margin that we ever had over 60%. And our great achievement to keep this EBITDA and this margin of 35% also with the great result of our great effort that we've done with pride and we are keeping on in 2019.

Page 5. We break down the numbers in the previous slide. Three main highlights. Total base of students in, well, the on-campus, except the FIES. In the middle, our retention rate. We can see that it's stable. And once again, the distance-learning on the right. In the bottom and over the left, we have the biggest achievement maybe and that's the increase of average ticket with capturing that was very strong, very strong as you can see, very solid. And here, there's no secret in what we're doing. Re-education of veterans, I mean, the courses that we introduced and the average ticket through this evolution of our average and this has led to the 4% almost in the on-campus and the distance-learning. And on the right, we can see the evolution, of course, of the distance-learning, EAD, growing in this operation. Well, we can see the total net revenue, 19% growing. We are very proud of these numbers.

We see people in the markets that we respect a lot. They have difficulties, some giving up, some are stagnant, but we managed to grow. If you remember, the left -- what we can see a growth of almost 40% in the last two years.

Slide number 6. For those of you that are just with us, please take a look at the last three weeks where we talk about the comparison of our quality with the rest of the market. Now what we can highlight here is the evolution. We have an evolution that is very solid, but we want to continue to evolve. So 53% of our courses are Grade 4 or 5 at the Ministry of Education, MEC. It's an evolution, 48% in comparison to 2017. And last year, 84% of the evaluated courses here at Estacio received a Grade 4 or 5.

At the bottom of the page, we can see a focus in the distance-learning. Well, given that our -- one of our guidance of growth, strong growth, is -- I think that this is due to not just the regulator or the Ministry of Education and the market and the students, everybody recognizes our quality that is superior, and that allows us to have accelerated growth and we can grow -- we can charge for a premium in regards to the rest of the market.

Well, I can -- we can give you later more details in the finance part of our presentation.

Gustavo Artur Ciocca Zeno {BIO 19036323 <GO>}

Thank you, Eduardo. Before we start -- before I start, I wanted to highlight that in this quarter, we didn't have any items that is nonrecurrent.

Let's start with the first slide, page 7. As a backdrop, we can see the reduction of the FIES financed students in a macro scenario that is still not favorable. We have the net revenue stable, practically stable in regards to the first quarter of 2018. The capturing of 2019 also helped to keep the stability in the first quarter.

Now going through the net revenue. We had an economy and the costs 3.8%, with the highlight for staff and subcontracted services. And we guarantee a growth in 2% of the gross profits and the gross margin. We went beyond the 60% margin, 60.4%. We have to highlight that at the end of 2018, we had to promote a restructuring of staffing, of personnel, the management and corporate centers. So this is important to preserve our infrastructure being cost-efficient, so we can have a long-term operation.

Let's keep on looking at the results, slide number 8, operational expenses. Definitely from the cost components that we've seen in the previous slide, the operational expenses, they have a larger weight in the results, specifically the commercial side due to a growth of the provisions that comes from the programs that are maturing within the portfolio of the company. Our provisioning went from 4.6% in the first quarter of 2018, to 6.8% as a mix of the DIS and PAR services.

As you can see in the graph at the right at the top of the slide, I highlight that this was expected by the company and compensated by the benefit for the growth of the base of students and consequently, the revenue and the EBITDA.

Now in regards to the general expenses and management expenses, we had a reduction in subcontracted services after we finished the work with a consulting company throughout 2018. And also, a reduction of contingencies due to initiatives in the labor front.

Well, let's look at EBITDA and net revenue. We -- and generation of cash flow. Well, comparison of the EBITDA in the FY, we can see that even though there is an increase here for expenses in publicity, the expenses of G&A did a stability of the EBITDA and the margin. I believe that this maintenance of the EBITDA and margins are important, independent and show independence and resilience of the business. Now we had an increase of 25% in the net revenue. It's important to highlight that a great deal of this increment comes from probably from the first quarter of 2018. There is the increase of taxes but it was compensated in the next quarter.

Now let's talk about the operational cash flow. We maintain a good conversion rate, 44.2%. Now the decrease in the nominal value to BRL146 million, is still the biggest incident in the accounts receivable, so there is a deadline. There's, an increase in the receivables deadline.

Well, now I give the word to Eduardo Parente. He can talk about our investments.

Eduardo Parente Menezes {BIO 16707188 <GO>}

Thank you. I'm on page 10, and you can see here, our CapEx has increased from BRL37 million to BRL50 million in the first quarter, an increase of 34.2%. As we can see here, we have a year where we have on the -- at the right, we can see that there is the CapEx, the two lines, the nonrecurrent. Well, we have the expansion and transformational parts on the expansion. There is investments that generate revenue in the short, medium and long term. For example, the lab of odontology, we are -- had the Mais Medicos program in the medicine course. And also the nonrecurrent, we have regulatory, transformation, digitalization of documents and updates that we have to do with our campuses to improve on the experience for the students that are on the on-campus segment.

What do we expect for this range? It's another, well, over 30% in comparison to -- the delta is over 30% in comparison to last year and the expansion and transformational, we don't expect that they are going to be so strong. Next year, the expansion, of course, should there be an opportunity, we are going to discuss them, but the investments might or not take place, transformational or point investment at this point.

Now, page 11. To close, I believe that taking a look at this quarter, we are very satisfied with the results. We are in the right path. We can see the biggest capturing of students in the history of the company. And here at the bottom, we see in the on-campus and the distance learning an important growth for -- so in the future the financial result, even though we can see all the difficulties in the market and the economy, PDD, FIES, financing, decrease in debt. The result of the work that has been since 2018 shows the resilience of the business. We are not just sitting and crying over spilled milk, no.

We -- and FIES is negative impact, but for us to reduce this to less than 10% is important of the total base. It's also a relief. It shows the new reality of the company, and we still have a result of 35% of EBITDA. It is very solid. Let's take a look at the future. We see stability. Finance stability, operational stability, following up on the results that we've been having with this new reality. And we are optimistic in regards to the capture of the students, not only do we have solid tools that are -- we can apply to capture new students, they are very good, but we also learn and we're going to do this better in the second quarter of '19.

Well, looking at the future, repeating what we are saying. These are three areas with growth. The healthcare area, we have one of the best schools of medicine in Brazil, and we might get to 5,000 students in three or four years. At the distance learning, we are still more courses. Flex is a reality in and of itself consolidated and the M&A. Of course, I cannot get into the details here, but the mergers and acquisitions, taking a look at caution and optimistic -- optimism towards the opportunities that we can see in the future.

Well, up ahead, we have the payment of dividends, BRL153 million and dividends that represent a dividend that is over 50% if you compare it to the period of last year.

Well, now I give it back to Tostes.

Rogerio Tostes {BIO 6148759 <GO>}

Well, thank you, Eduardo. Well now, we can do the Q&A session, please.

Questions And Answers

Operator

Ladies and gentlemen we will start the Q&A session. (Operator Instructions) Well, here is the first question from Bradesco.

Q - Luiz Garcia {BIO 17432519 <GO>}

Good morning. Two questions. First of all, retention of the students. That is the number that was expected due to the FIES financing and the distance learning. Well, looking at the future, how do you keep this rate of keeping the students enrolled, the enrollment rate? What is your expectations? And well, we've seen that there's a lot of publicity marketing, so this might be in the future keeping you more competitive.

And the second question, also connected to this issue, is the -- we see the capturing and we -- how do you see the strategic capturing of the students up in the future?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Luiz, thank you. It's good to hear from you. I'm going to give you our expert, Aroldo. He will answer the questions.

A - Jose Aroldo Alves {BIO 20655783 <GO>}

Luiz, first of all, let me ask you -- let me -- well, the retention is key. As you see we have the FIES decrease, but we are getting into stability period but we have a very young distance learning base. We have the relationship process under control with what we predicted with the project. Now the second point that you raised was the expenses, the commercial expenses, marketing expenses, we prioritize issues of preservation of ticket, average ticket and also we increased the portfolio in the amount of whole different sites. Well, it was predicted the gain of revenue and our prediction -- annual prediction is still the same, which is to keep the standards that we have been practicing, that we've been working with. Nothing outside of what was planned.

Last but not least, in the PAR capturing, this was for students that would come exclusively from the FIES financing and they would need help. So if we can capture the paying student without the use of the PAR, that would be our priority. So if we can -- this was planned and this is nothing different from what we've done in the capturing and it's within our strategy.

Q - Luiz Garcia {BIO 17432519 <GO>}

Thank you, Aroldo. So the idea -- so the marketing expenses is always looking at the scenarios and this is connected to the strategy of ticket. So you're being more aggressive in tickets and the idea is to dose that?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Exactly, yes. We counter balance with the ticket.

Q - Luiz Garcia {BIO 17432519 <GO>}

Thank you.

Operator

Our next question comes from Leandro from Citibank.

Q - Leandro Bastos {BIO 21416405 <GO>}

Good morning. Two questions. The dynamic of gross margin. We were impressed with your cost dilution delivered in the quarter. We see a gain in the staffing. Is that the standard that is recurrent, that is normalized, that we can expect for the next quarters? Or was there an effect of replenishment of teachers throughout this first quarter, making this cost structure still not representing 100% of your new structure? That would be my first question.

Second question. This increase in the PMR, the former FIES, if you -- we see a decrease in your finance cost. So if you can share a little bit of that, what is the strategy of the company with the renegotiation with the students? Thank you.

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Some opportunities to work this line better, increase the productivity of this line. It's difficult to say when and where, but this is something that we're working with. Focusing in PMR, which is your question. We are being more successful in our negotiations with the -- well, we gave the discount we did more agreements with less discounts and that was very successful. And if we stratify the PMR for the monthly basis, we had a lower effect. But looking at PMR conjugated with the finances, the accounts receivable was really affected, especially in the long-term. It's about BRL110 million going to BRL210 million. And this counterpoints the improvement and elongating the PMR. Now up ahead this PMR, we hope that it's not too extended. The cash conversion should improve this intention and this is the way that we should do things.

Q - Leandro Bastos {BIO 21416405 <GO>}

Well, thank you for the answers.

Operator

Well, the next question is from Guilherme Palhares, BTG Pactual.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Thank you. There are two questions in regards to distance learning. Can you tell us a little bit about the capturing of the different courses, more portfolio of products? Within the structure, I wanted to understand what is the time, the duration of these courses and what is the horizon for graduation for these students? What is the timeline? What can we see in terms of these graduation rates due to the change of the mix? And the company really focused in the distance learning last year and we had some news from class entities that are doing something that was given as a certainty, but I wanted to know more about this class entity issue, class action issue, if you can explain a little bit better?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Well, I'm going to give the first question to Alexandre, our Distance Learning Director to answer. And the second one, I can answer.

A - Alexandre Aguieiras {BIO 20961306 <GO>}

Hi, Guilherme. Well, just to make it clear. This evolution of the portfolio, it doesn't change our course time. We're getting longer courses that shouldn't have any impact in this timeline.

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Right now, we don't have any pressure about the -- well, about the class entity. We talked to the associations, the (inaudible), and we understand that there is no legal base for this contestation, this association. Well, we are very -- we are trusting in our legal peers and the lawyers that we've involved in this class action suit. So this is not a relevant concern.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Thank you. Just one more question. The consulting fees. Now given the time that has passed since the service that was provided, now you have a plan to work with the company up ahead or do you -- will you still need some contracted support for the future, just so we can take a look at the future while looking at the important reduction in the expenses that you've just had?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Well, I think that we've reached at a standard that we wanted. Consulting was -- fees were very important. Last year, it was in our current expenses but now, it's -- we will keep on. We might have a few sporadic help, but we're not going to get a big punch as we got last year.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Well, thank you.

Operator

Our next question comes from Susana Salaru from Itau.

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Good morning.

Q - Susana Salaru {BIO 16170633 <GO>}

Good morning. Thank you. I have two questions. First, could you comment a little bit about the dynamic for the competition in the distance learning and also on the on-campus? Is it aligned with what you expected and do you expect that for 2020, the competitiveness will be the same as today or it will improve or will be worse?

And the second question. Can you tell us how the medical school opening is impacting the Mais Medicos program?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Hi, Susana. Thank you for your questions. Well, competition is fierce. I don't think that is worse or better than the last year, and I think that we were more prepared to -- better prepared to face -- well, with these pricing and marketing projects that we've done, they gave us the granularity to compete where we have to compete, and getting a little bit more leverage where we actually going to need. Well, up to 2020, I think it's very difficult for things to get worse, even though we know that the worse has no limits, but I think that it's very unlikely. We have a very difficult scenario and any improvement in the economic scenario has a positive impact in the industry as a whole.

Now if that improvement will arrive, yes, I depend on you actually because you have a lot more deftness and you're following up on the economy closer than we are. Competition is strong but not worse, I think it's a strong competition. But once again, nothing that is a reason for despair. And I think that any improvement in the economy, it tends to be better for everyone. About in Mais Medicos program, more physicians program, he can talk about it later.

Q - Susana Salaru {BIO 16170633 <GO>}

Well, if you allow me in the follow-up and to your answer, you mentioned that the pricing really helped in the granularity, the pricing model. Do you understand that the application of the pricing model was done 100%? Or can you optimize this instrument for the next capturing cycle?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

I think that we can optimize it more, because it was the first time that we used it full. So it's a lot of things that we did with Excel, with the system. We learned a lot about how to get the information from the different cities, the different places that we have our operations. And we are learning -- there's a learning curve, but we have started full throttle and I have good expectations for the future.

A - Adriano Pistore {BIO 20655758 <GO>}

Susan, here is Adriano. In regards to your question, it's important to highlight that the Mais Medicos is very similar to the previous Mais Medicos program. Well, there was a contestation about the results as well as it was in Mais Medicos 1, the first iteration. Now, we want to start that operation as soon as we can.

Q - Susana Salaru {BIO 16170633 <GO>}

I'm sorry, you're talking really fast and I couldn't understand. So you did a contestation in the four campuses and you can reverse this in the next months?

A - Adriano Pistore {BIO 20655758 <GO>}

Well, this is very normal. So since this is very competitive, it's normal that the non-winner will contest the results and they are being analyzed. And we hope that this will be solved in the next month as we -- so we can start again. You're questioning the gains of other -- you're disputing the gains of other companies. Well, this is normal. The dispute is normal in the Mais Medicos process.

Q - Susana Salaru {BIO 16170633 <GO>}

And how many places are you trying to reverse the loss?

A - Adriano Pistore {BIO 20655758 <GO>}

It's another two, an additional two.

Operator

And the next question comes from Thiago Bortoluci, Goldman Sachs. You can continue.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Well, good morning everyone. Thank you for your question. We wanted to talk a little bit more about margins. In the on-campus, you have a drop in the base of the students and the average tickets, going a little bit below the inflation. In that context, is it possible to keep the operational margins of the segment? And what are the leverages for the future?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Thiago, Adriano will answer.

A - Adriano Pistore {BIO 20655758 <GO>}

I think that one of the levers that we've used that is very efficient, they are the gains and efficiencies. We have more people to work here. Another point which Aroldo already commented is our capacity to work with better pricing. And in issues of capturing, we are subjected to the variables but -- the market variables, but we can keep the margins at the centers that we are working with. I think it's important that if you take a look at the presentation of the last quarter, we have the scorecards here that's shown the projects, their values and how much have we implemented. So we chose that there is a lot of the things were at the inception and some were in mid-way, so there is still gains in the lines of cost that are very relevant. That again will not produce a bigger margin because they try to offset. I don't know if that would exist in Portuguese but anyway, they offset the eventual losses that we have of FIES and the disclaimer issues that we have. Well, are we going to increase the margin? No. Our expectation is to be aligned with what we've done with the last quarters regardless of the disputes and everything.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Well, you are really mentioning pricing. If you could open the drivers of growth and the pricing and the average price in the on-campus, is there any way to tell us how much was that on-campus or how much it was mix?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Well, it's very important that we don't open that because this is what our competition would like to know. But the pricing has a part that it's pricing that is a market-oriented pricing. The objective of pricing is to keep the largest ticket that we can, of course, but we also have to be competitive and be granular where we have to be. We see the industry in the past with the whole market and this is what we managed not to do this semester and we had a lot of deficiencies.

Now I'm going to give this question -- I'm not going to answer fully this question because this is what the competition wants. So it's fair to say that the mix improved, the mix of average costs improved this first year. Well, yes, certainly. The introduction of healthcare courses, engineering courses. And once again, it's important to highlight the presentation of last year, the big increase in cost and the presentation that we had, bringing us to a more current reality, current to the work market. And here, we can leverage our structural distance learning, including the on-campus. We have a lot of updates in the content because it's been borne completely digital, the context, so the mix has an important role in this.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Well, thank you.

Operator

Next question comes from Mr. Javier Martinez from Morgan Stanley. You can continue.

Q - Javier Martinez {BIO 15226046 <GO>}

Good morning. I wanted to ask you, about the PAR, and here, the quantitative data that you have, it's not very clear. You have provisioning, the receivables, then you have a difference in the profile of capturing that is very aligned with what we see, with the reduction of the finance of the FIES and increase of the mix of cost. But the question is qualitative, now that we have a quarter more of information of behavior of the student. Well, what have you been learning from that? Is it still reasonable, the accounting? Are you completely sure of the provisioning levels?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Hi, Javier. I'm going to give you -- I'm going to give the word to Adriano.

A - Adriano Pistore {BIO 20655758 <GO>}

Hi, Javier. Well, let's start. These two products, they've matured at the base. As you can see, there is a capturing that is even better than last year. The rate to retention of both products are very much aligned with our expectations. You can see here our numbers. You can run those numbers and if you compare the distance learning and on-campus, we have retention rates that are lower, but they were expected for these two products.

Now looking at provisions. The company keeps on following up on the provision levels. You can see in the earnings, page 19, I'm not talking in the presentation but the earnings, here we have the coverage level of PDD, and we see it's very satisfactory for the period for the PAR. Now, there is no changes in the provision rules.

Q - Javier Martinez {BIO 15226046 <GO>}

Thank you very much.

Operator

Next question comes from Mr. Guilherme Palhares from BTG Pactual.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Thank you for this additional question. Just complementing the issue of capital structure. You have a cash flow, you announced dividends in the second semester of the company. It was very emphatic in the buyback. I wanted to know how is that working with your capital structure and where should it converge in the future?

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Guilherme, thank you. If you have cash flow, you will have opportunities. Last year, we did a distribution that was extraordinary during the buyback, and this is still in our radar. Do you want to add anything else?

A - Gustavo Artur Ciocca Zeno {BIO 19036323 <GO>}

No. I would just like to say, well, the company today has cash, a very balanced capital structure and this cash flow is going to be directed towards investments for the shareholders. The access to maximize the revenues, we have the buybacks. We've done that in the past and if it's justified this year and makes sense, we will do it again.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Thank you.

Operator

As there is no more questions, I would like to give the word to Mr. Eduardo Parente for their last words to finish the presentation.

A - Eduardo Parente Menezes {BIO 16707188 <GO>}

Well, ladies and gentlemen, thank you very much. I hope to hear you -- hear from you in three months. I think that as I've told you before, predictability and results is a long-term work that we've been doing and it's paying itself. Thank you very much for your trust. Thank you, and have a wonderful day.

Operator

The teleconference of Estacio Participacoes has closed. Thank you for your participation. Have a wonderful day.