Y 2012 Earnings Call

Company Participants

- Rogerio Melzi, Chief Executive Officer
- Virgilio Gibbon, Chief Financial Officer

Other Participants

- Juan Haltartegaray, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, thank you for standing by and welcome to Estacio's Conference Call to discuss the Fourth Quarter and Year of 2012 Results. This event is also being broadcast simultaneously on the internet, via webcast, which can be accessed on the companies' IR website www.estacioparticipacoes.com.br/ir, together with the respective presentation and the earnings release. We would like to inform 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, when 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 will now turn the conference over to Mr. Rogerio Melzi, CEO. Please, Mr. Rogerio, you may proceed, sir.

Rogerio Melzi {BIO 16212298 <GO>}

Well, thank you very much and good morning everyone. Welcome to our conference call to discuss the results of the fourth quarter and full year of 2012. With me here today are our CFO, Virgilio Gibbon, who will be helping me with the presentation, and our IR team. Just to remind you that we will have a question and answer session just as soon as the presentation is over.

Going straight to slide number 2 of the presentation, which is available on our website. 2012 will be remembered as an excellent year for Estacio. After years of planting seeds and practicing a culture based on the pursuit of sustainable results in the long term, we began to harvest the first fruits of our work. We remain committed to the implementation of our Academic Model, taking this major competitive advantage to all our units in Brazil at an appropriate pace, without disrupting students and faculty, while improving our content, creating new extra-class activities, increasing our question bank for national exams, and developing internal benchmarking on a daily basis.

We also maintained a healthy pace of innovation, another of our model's powerful success drivers, with the launch of the Didatic@ social network and the delivery of 12,000 tablets in 2012. Once again we received highly satisfactory grades in the visits to our campuses organized by the MEC Education in order to give its seal of approval to our programs, and at the same time the results of the 2011 National Student Performance Exam, the ENADE, published at the end of the year, showed a clear shift of our scores to the right side of the bell curve.

Following the design of our management model and the development of our organizational culture, in 2012 we implemented the Management Excellence Program, which we call PEG (inaudible), another step towards ensuring excellence in all our activities.

Our degree of student satisfaction, measured by an independent firm through acclaimed publicly recognized methodology, moved up yet again in 2012, showing that we are managing to combine student base growth with a good service level. Our organizational climate survey, also measured by an independent company, repeated the excellent results achieved in 2011, demonstrating ongoing operational stability despite our accelerating growth.

Finally, we concluded five highly successful acquisitions, adding 8,700 students to our base, and marking our entry into three new states in Brazil, Maranhao, Paraiba and Rio Grande do Sul. As a consequence of all this, our student base moved up substantially, as Virgilio will show you, allowing us to grow our revenue and, consequently, our results.

The table at the bottom of the slide shows the year's main financial highlights. Net revenue totaled R$1.4 billion, 20.5% up on 2011. This growth came as a result of the student base growth and the average ticket increase, which is only possible due to the better perception of quality by our students, as well as due to our improvements in infrastructure and the continuous efforts to improve student service levels.

This revenue increase, together with our management model, our growing capacity to control faculty costs and improve classroom occupation, and the increasing penetration of our academic model in the student base, led our EBITDA to climb to R$209.9 [ph] million, reaching a margin of 15.2%, 450 basis points up on the year before, already using our about in full compliance with the new EBITDA calculation methodology suggested by CVM Rule 527.

Under the previous calculation method prior to the CVM ruling, EBITDA would have been R$216.7 million, with a margin of 15.7%, 350 basis points higher than in 2011, very much in line with our expectations and underlining our capacity to deliver this year results in a sustainable manner, with no ups and downs, thanks to the management model we have been implementing over the last four years.

Net income totaled R$109.7 million, 56% more than in 2011, chiefly due to the more than 70% upturn in EBITDA, which was enough to absorb higher expenses from the interest on our debt. As a result, earnings per share came to R$1.33, 56% above last year, reflecting our capacity to generate healthy returns for our shareholders.

As you can see from the table on slide three, our main operating indicators closed the quarter with strong results and margin evolution. Net revenue totaled R$361.7 million, 22.9% up on fourth quarter '11, while EBITDA climbed by 115% to R$48.3 million. In the meantime, we concluded our strategic plan, which defined our 2020 vision, in order to analyze the variables impacting our business in the years ahead. I will talk a little bit more about this at the end of the presentation, during my concluding remarks.

However, it is worth noting that, as a result of this plan, we created two new executive departments in November, within the context of a new growth and expansion phase. The new executive departments are, Distance Learning Operations, created to increase the focus on this important segment of our business and prepare the Company for expected growth in this area. The new Department is under the responsibility of Marcos de Oliveira Lemos.

Continuing Education, created in order to organize growth in Academia do Concurso operations, short-duration non-regulated programs, and lato sensu graduate programs, in addition to developing and implementing new business opportunities in areas of interest to Estacio. This new Department is headed by Marcos Noll Barboza. We also created new areas to handle topics such as Innovation, Sustainability and Social Responsibility, Relationship with Alumni, and Employability, reflecting the recommendations of our strategic plan and our concerns for the future.

I will now hand over to Virgilio, who will comment on our results in more detail.

Virgilio Gibbon {BIO 16679141 <GO>}

Thanks, Melzi. Good morning everyone. I would like to draw your attention to slide four, where we show how we changed our EBITDA calculation in accordance with CVM Rule 527. In line with our policy of dropping the concept of adjusted EBITDA, we decided to exclude the Operating financial result, which refers to revenue from fines and interest on tuitions, from the calculation.

Also following the guidance of the CVM, we included the Result from discontinued activities, impacting negatively the 2011 EBITDA calculation. The table presents the reconciliation of the two calculation methods, showing that this year's margin gain of 450 basis points would have come to 350 basis points under the previous method. In other words, at the upper limit of the guidance we revised for the market in 2Q12.

Now let's move to slide five, which deals with our operating performance. As you can see in the first chart, which gives our student base figures, we closed the year with 271,500 students, 13.1% over 2011, with the same-shop student base growing by 9.5%. Our on-campus base ended 2012 with 222,600 students, including acquired (inaudible) during the year. In the same-shop concept on-campus base grew by 6.6%, underlining the trend of sustainable organic growth of the student base following five record high enrollment cycles in a row.

Our distance learning base ended the year with 48,900 students, 24.1% more than 2011, reflecting the higher growth of the Distance Learning segment, launched in mid-2009 and now with almost 50,000 students. As you can see from the chart at the side, annual net operating revenue increased by 20.5% over 2011 to R$1.4 billion, while fourth-quarter revenue moved up by 22.9% year-on-year to R$361.7 million, due to expansion of the student base and the increase in the average ticket.

The average on-campus ticket increased by 10.2% in the fourth quarter and recorded average annual growth of 9.1%, consolidating our capacity to increase prices in a sustainable manner throughout the year, which is only possible when students have a higher perception of our quality. The average Distance Learning ticket increased by 7.2% in the quarter and 7.4% in the year, in line with the on-campus trend.

Moving now to slide six, here you can see the vertical analysis of our cash cost, which recorded an efficiency gain of 4.0 percentage points, with significant gains in four lines, 2.7 percentage points in personnel, reflecting the more efficient faculty cost control, as well as the increasing penetration of the academic model in the student base, 0.8 percentage points in the INSS labor tax line, resulting from the end of the INSS step-up in 2011.

0.4 percentage points in rentals, due to our increasing rigor in negotiations over contractual increases and the more efficient occupation of our buildings with the growth of the student base, and 0.3 percentage points in third-party services, reflecting increased discipline in the control of third-party contracts and the use of techniques such as matrix-based cost and expense controls.

In the fourth quarter of 2012, the ratio of cash cost to net revenue registered a margin gain of 1.0 percentage point over fourth quarter 2011, due to gains of, 0.5 percentage points in personnel, a smaller gain than in previous quarters chiefly due to a higher variable compensation provision for our professors in 2012, as well as part of the union agreement from October onwards, 0.2 percentage points in the INSS line, following the 2012 trend, and another 0.2 percentage points in textbook materials.

On slide seven, we provide a breakdown of our selling, general and administrative expenses. In 2012, G&A expenses represented 13.1% of net revenue, with a margin gain of 1.7 percentage points, mainly due to our improved budget controls. In the quarter, G&A represented 13.9% of net revenue, a 4.3 percentage point improvement over fourth quarter 2011 chiefly due to the 1.4 percentage point gain in the personnel line, due to the provision for the variable compensation programs, which was built throughout the year in 2012, differently from 2011, when the entire impact occurred in the fourth quarter.

Other gains came from third-party services, with 1.1 percentage points, mainly due to the change in the accounting criteria in the fines and interest line and, as a counter entry, the compensation of collection agents, reducing the level of third-party services related to collections as of third quarter 2012. And a 0.8 percentage point gain in provisions for contingencies.

Selling expenses represented 11.4% of annual net revenue, with a margin reduction of 1.5 percentage points over 2011, due to the 1.1 percentage point increase in the PDA net revenue ratio, chiefly due to the deterioration in PDA in the first half of 2012, even though it improved in the second half as we expected. In fourth quarter 2012, selling expenses represented 10.5% of net revenue, 0.1 percentage points over the same period in 2011, as a result of the 2.4 percentage point gain in the PDA, offsetting the 0.8 percentage point loss in marketing and the impact of the 1.5 percentage point reduction in the Provision for FIES line.

It is worth noting that the Provision for FIES refers to the provision for FIES students, most of which had already been recognized, remembering that now we are booking the contribution to the Guarantee Fund as a deduction from net revenue. More details on the Provision for FIES can be found in our earnings release.

Moving on to slide eight now, we present our accounts receivable. Our net days receivables, excluding PDA and FIES receivables, averaged 58 days in fourth quarter 2012, two days less than in third quarter 2012 and seven less than in fourth quarter 2011. The 12-month reduction was the direct result of improved receivables management and the efforts to combat delinquency in our units.

As observed throughout 2012, with the normalization of FIES contract amendments and the effects of the company's increased focus on the control of non-FIES receivables, the average gross days receivables, shown in the last line of the table, including both FIES accounts receivable and gross accounts receivable, without discounting PDA, showed evolution.

Once again there was a reduction in the average gross days receivables, by two days over third quarter 2012, and seven days over fourth quarter 2011. It is worth emphasizing that we achieved this reduction at the same time as our student base increased 13.1%, while new enrollments increased by 25%. Such an improvement came from reduction of delinquency and improvement of FIES internal processes, directly improving our operating cash generation.

As you can see on slide nine, FIES carry-forward credits fell by R$9.8 million in the quarter, reversing the third quarter 2012 upturn caused by the delay in transfers from the FNDE in September, as anticipated at that time, so that we converted cash of R$91.2 million from FIES certificates to pay taxes and to take part in repurchase auctions. Since these transfers were normalized in fourth quarter 2012 (inaudible), the FIES days receivables averaged 75 days.

Given this scenario and the strict process of FIES contracting and contract amendment here at Estacio, we reinforce that the level of our FIES accounts receivables, around R$56 million, less than twice the FIES average monthly net revenue, is appropriated for the sustainable expansion of the FIES base in our operation., which already accounts for 20% of our on-campus undergraduate base.

Slide ten shows the aging of our receivables. As shown throughout the year, this breakdown demonstrates that we remain firm in regard to our credit policy, refusing to allow an expansion of the student base at the cost of credit negotiations that are unfavorable to the Company, thereby risking the future solvency of these receivables. Thanks to our adoption of rigorous debt renegotiation policies, in the fourth quarter of 2012 only 5% of total receivables came from renegotiations with students, 3 percentage points lower than in fourth quarter 2011.

In addition, the percentage of receivables from renegotiations overdue by more than 60 days accounted for 46% of total agreements, or 2.5% of total accounts receivable. As we mentioned in the release, a good part of our dropout happened due to the increased rigor in our credit policy. In on the one hand we had more dropouts, on the other hand we remained firm in our strategy of fighting delinquency, pursuing cash flow and at the same time doing a better job to educate our students to their future lives.

Slide 11 shows our fourth quarter cash flow. In the small chart on the right, you can see that the variation in working capital was a negative R$29.6 million, due to pressure from personnel expenses in fourth quarter related to vacation pay and Christmas bonus in November and December, which, together with the R$37.4 million increase in CapEx consumed more than the R$48.3 million EBITDA, generating negative operational cash flow of R$18.7 million. In fourth quarter 2012, the negative operational cash flow, the negative R$12.0 [ph] million financial result and the variation in loans were the main reasons for additional cash consumption. At the end of the quarter, our cash position stood at R$140.5 million.

Slide 12 shows our annual cash flow. EBITDA of R$209.9 million was only partially consumed by the R$111.9 million variation in CapEx excluding acquisitions and the R$32.8 million negative variation in working capital, generating positive operational cash flow of R$65.0 million in the period. As a result, operational cash flow before CapEx came to R$175.1 [ph] million in 2012. The positive operational cash flow was consumed by the negative financial result, investments in acquisitions and dividends paid-out, partially offset by the positive variation in loans R$25.3 million and others.

On slide 13, we have one of the most important information of all, which is the evolution of our cash flow along the year. We recorded operational cash flow of R$65.2 million in 2012, compared to a negative almost R$99.9 million in 2011, a massive improvement of R$165 million. In the fourth quarter of 2012, operational cash flow moved up by R$37.9 million over fourth quarter 2011. This improvement was the direct result of our efforts to control working capital, our strong combat against delinquency, and the more effective management of FIES processes in 2012, which in turn evidences the maturity of our management model.

This new level of cash flow has allowed us to honor our obligations, to invest in expansion and to finance at least part of our acquisitions, further reinforcing our growth strategy and ensuring the best ROIC in the sector.

I will now hand this conference back to Melzi for his conclusions and final remarks.

Rogerio Melzi {BIO 16212298 <GO>}

Thank you, Virgilio. On slide 14, I will comment on some important points regarding 2012 which will also influence future cycles. We know that the great results we achieved in 2012 also bring great responsibilities. In the short term, we are aware that as our student base continues to record strong growth levels, we need to focus more and more on the quality of our student services, investing in infrastructure, training our staff and aggressively eliminating service bottlenecks.

At the same time, we have to make a strong effort to further improve our teaching standards, so that the value of our student to their future employers and our campuses' positive impact on our surrounding communities may be recognized by the MEC education and society alike. We also need to consider our responsibility to our shareholders and financial partners who are also seeking a fair return on their investment, which in turn allows us to continue investing in Estacio.

Reflecting on all this responsibility, and in line with our long-term view, in 2012 we organized a complete strategic planning in order to analyze the variables impacting our business in the years ahead and then to come up with a strategy capable not only of overcoming threats, but also of leveraging the opportunities that invariably emerge from challenging scenarios, such as the current one.

As a result, in the recent months we have implemented a series of changes and organizational projects. So we are top such as Innovation, Applied Research, Relations with Employers, Technology, Sustainability and Social Responsibility, Institutional Representation, Corporate University and New Businesses Development can become an integral part of Estacio's day-to-day business, built on top of the foundations we have already laid and preparing for our coming growth cycles.

At the end of this process, when we realized that we are exceptionally well organized for growth, we decided to accelerate projects that may give us a greater presence in the on-campus and distance learning segments, as well as in new segments of our business, thereby taking quality education to every corner of Brazil. In order to finance this growth potential, we successfully organized and concluded a public share offering at the beginning of 2013, which provided us with the financial capacity to implement our plan and to begin shaping Estacio for the future from now on.

Well, speaking of 2013, although the enrollment cycle is still under way, we can comment on the intake trend we see at the moment. On-campus undergraduate enrollment is showing a same-shops growth rate between 15% to 20% over last year, already discounting students, who are not able to enroll in any class, the so-called financial-academic gap. It's still in our on-campus operations, our renewal rate should improve around 3 percentage points over the past year, already reflecting our internal improvement and the increase of FIES students in our base. That said, we estimate that our on-campus student base, under the same-shops concept, should grow between 10% and 12% over the first half of 2012.

At the same time, distance learning undergraduate enrollments points to a 25% to 30% growth over 2012, while our renewal rate for the segment indicates 5 percentage points increase over last year. So, our distance learning student base should grow something between 20% to 25% on 2012. That said, our undergraduate student base, not considering the grad segment, which has its intake and renewal processes still under way, should present a 12% to 15% growth compared to last year.

Another important topic at the beginning of this year has to do with increasing the coverage of our distance learning operation. Following the regular process of new distance learning centers accreditation, two of our regional problems received at first recognition of visits and both received, a still preliminary grade of four out of a maximum of five, for both the concept and curriculum and the distance learning centers, a total of 11 visits all of them (inaudible). We are now awaiting confirmation and publication by the Minister of Education, but we are highly optimistic in relation to the process, especially in the view of such an excellent evaluation by the MEC or the Minister of Education's auditors.

Finally, at this month of March we are filing requests for the creation of 15, potentially getting to 19, new campuses in Brazil, in line with our greenfield expansion strategy. These processes have a long maturation period, but as of 2014-2015 essentially they could generate quality growth, with excellent returns for our shareholders.

That brings us to the end of our presentation, so now let's go to the question-and-answer session. Thank you.

Questions And Answers

Operator

Thank you, sir. Ladies and gentlemen, we will now begin the Q&A session. (Operator Instructions) We have a question from Juan Haltartegaray of Lariantial. Please go ahead.

Q - Juan Haltartegaray

Yes. First of all, congratulations for the great year. I wanted to know about the financial expenses, you have an item where there is a third financial discount. I want to know what this is about, and why is the growth so big in this event?

A - Rogerio Melzi {BIO 16212298 <GO>}

Hi, Juan. Thanks for the congratulations. We are also very happy and enthusiastic about our results and our perspective for 2013. Financial discount usually account for discounts we give to some students who come back to study with us, but whenever they come back to study with us when they recall this they reopen before they get that to study first, usually there is something in exchange.

So, we do that only, for example, if they sign for FIES or if they have other commitment with us. So, sometimes it varies up and down quarter-after-quarter, it does not have a trend. There is a lot of campaigns they are going to be launching over time. But again, whenever we provide this kind of discount, there is something back in exchange, so as to prevent students from taking advantage of this kind of situations. Okay.

Q - Juan Haltartegaray

Okay. Thank you very much.

A - Rogerio Melzi {BIO 16212298 <GO>}

Welcome.

Operator

(Operator Instructions) Since there seems to be no further questions, I would now like to turn the floor over to Mr. Rogerio Melzi for his final remarks. Sir?

A - Rogerio Melzi {BIO 16212298 <GO>}

Well, thank you all for participating in this quarter's conference call. As you have seen, we are experiencing our best time ever in terms of fundamentals, results, and also future prospects. Our IR team is always at your disposal to help you with any questions you may have. Our Company information is available on our website. We hope to see you again at our conference call next quarter. Once again, thank you very much. And have a good day.

Operator

And we thank you, sir, and to the rest of management for your time. This concludes Estacio's conference call. You may disconnect your lines at this time. Thank you again, and have a great day.