

Q3 2017 Earnings Call

Company Participants

- Flavia Oliveira, Head of Investor Relation
- Leonardo Moretzsohn de Andrade, Chief Financial Officer
- Pedro Thompson Landeira de Oliveiraon, Chief Executive Officer and Investor Relations Officer

Other Participants

- Susana Salaru, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by and welcome to Estacios Conference Call to Discuss the Results for the Third Quarter of 2017. This event is also being broadcast simultaneously on the internet via webcast, which can be accessed on the company's IR website, www.estacioparticipacoes.com.br/ri.

We would like to inform you that all participants will only be able to listen to the call during the presentation. We will then begin the Q&A session, when further instructions will be given. (Operator Instructions) Please note this event is being recorded.

The conference call may contain 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. Pedro Thompson, the company's CEO. Please, Mr. Thompson, you may proceed.

Pedro Thompson Landeira de Oliveiraon

Welcome to our conference call to discuss the results for the third quarter of 2017. Leonardo Moretzsohn, our CFO, and Flavia Oliveira, Head of our IR team are here with me. Just to remind you all that will be a Q&A session as soon as the presentation is over.

Let us begin with slide number 3, where we can see the results highlights for the third quarter of 2017. Our net revenue moved by -- up by 5.9% of 45 million over the same period in 2016, totaling 808.1 million, while EBITDA came to 223.6 million and the EBITDA

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margin stood at 27.7%, an increase of 15% and 2.2 percentage points respectively over the third quarter last year.

However, for comparison purpose, it is necessary to exclude the effects of the internal risk structuring presented in the third quarter of 2016, of 3.8 million and the M&A expenses of 4.9 million last year, and 0.9 million in 2017. Accordingly comparable EBITDA came to 224.5 billion and comparable EBITDA margins some 27.8%, and up 10.5% and 1.2 percentage points respectively over the same periods of last year. Estacio remains focused on the initiatives to increase operational efficient and improve their management of costs and expenses, bringing positive gains to their results.

We believe that it's possible to increase profitability in a challenging scenario, while making changes in important processes, such as student intake and pricing, whose results we will discuss in further detail now.

Turning now to slide number three, I want to present another important highlight of our results this quarter. Our operational cash flow was positive by 360.4 million in the third quarter of this year, a significant improvement of 101.3% over the same period of last year, which was an increase of 181.4 million, when compared to the same period of the last year. In addition to the EBITDA increase the following effect has contributed to this improvement in our cash generation. Also the increase of 97.5 million in collection of non-FIES revenues, due to our healthcare student base.

Second one, increase of 48.2 million related to FIES, due to the second quarter of this year transfers, that were dammed with the cash effect only in this quarter due to some problems with Estacio's negative debit certificates which had already been settled and monetary correction of this PN 23 receivables, the old FIES receivables. In the third quarter, the EBITDA to cash flow ratio came to 151.2%, once again highlighting the initiatives implemented to improve our performance indicators.

I now give the floor to our Head of IR, Flavia Oliveira.

Flavia Oliveira {BIO 20130905 <GO>}

Thank you Pedro. Good morning, everyone. I will talk about our operational performance on slide number four. In the graph, we can see that our student base grew by 0.7% year-over-year, totaling 531,000 students, mostly fueled by 15% increase in the distance learning student base, thanks to the initiatives, including the performance based clusterization of partner centers in order to better align incentives and results.

The distance learning growth also offset the 5.3% decline in the on-campus student base, which was under the effect of the 23.8% decrease in the FIES student base, this quarter. Excluding the effect from the decrease of FIES student base, non-FIES student base increased by 6.1% as a result of the changes implemented in their intake strategies, aiming at a more sustainable student base.

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It is worth noting that the objective of fostering a more sustainable student base, reducing discounts and scholarships are ensuring students' financial commitment in order to conclude the enrollment process, reduced our dropout rates by 42.6% this quarter.

Moving on to slide number 5, I will now talk about our average ticket, which continues reflecting the current pricing strategy. The on-campus average ticket moved up by 10.2% to BRL688, while the on-campus undergraduate average ticket climbed 8.9% to BRL760. Thanks to the new pricing strategy adopted by Estacio during the 2017 intake cycle, and then 12,000 are students who also positively impacted the average ticket, as there are no discounts or scholarship under this program. The on-campus graduate average ticket increased by 42.9% over the same period last year. The decrease in deductions contributed to these results, generating gains of 9.6 percentage points in gross revenue.

In the third quarter of 2017, the distance learning average ticket moved up by 12.1% over the same period last year to BRL212. Therefore it was possible to see the results of the changes in the strategy, which aims to leverage the operating revenue given that third quarter distance learning net revenue increased by 29.6% over the same period in 2016. In the distance learning undergraduate segment, average tickets increased by 6.7% to BRL115 and over 85% to BRL191 in the graduate segments compared to the same period last year.

I will now turn the floor over to our CFO, Leonardo Moretzsohn, who will talk about our financial performance.

Leonardo Moretzsohn de Andrade {BIO 15216920 <GO>}

Thank you very much, Flavia. Good morning, everyone. Moving on to slide six, I'll begin with our net revenue in Q3, '17. As we can see third quarter net revenue came up to BRL808.1 million, 5.9% up compared to the same period last year, essentially due to one, the BRL170.8 million increase in the revenue from Monthly Tuitions, an increase of 14.8% over Q3, '16 due to higher average ticket and a more sustainable student base.

Second, the BRL1.5 million in reduction in Pronatec revenue due to the graduation of the last students in this segment. Third, the BRL1.5 million reduction on the other revenue, chiefly due to the end of the Rio 2016 project, referring to training offered by Estacio to the volunteers of the Olympic games, which still generated residual revenue in Q3, 2016.

Fourth, the BRL119.6 million increase in discounts and scholarship, as a result of the company's new pricing strategy for new students. In this strategy the increase in discounts is more than offset by BRL167.8 increase in gross revenue. The BRL4 million upturn in taxes in line with revenue growth, the 2.4 million reduction in FGEDUC due to the smaller FIES student base. It is also worth nothing that in Q3 this year approximately BRL1.6 million under gross revenue deduction, due to the adjustment to the present value of receivables from Estacio's Installment Payment Program PAR.

Jumping to the slide 7, our cash cost represented 47.8% of the net operating revenue in the third quarter versus 48.7% in the same quarter last year,

representing a 0.9 percentage point margin gain, mainly in the textbook material line, which shows Estacio's effort to intensify its production of books and the offering of virtual libraries to students.

It is also worth noting that in the third quarter last year, the personnel line increased by BRL17.5 million, with the early vacation granted to the faculty, and in 15 days in Rio de Janeiro, in view of the 2016 Olympic Games, increasing Q3 last year results over 4Q 2016. Accordingly excluding this effect there was a 1.6 percentage point margin gain in the personnel line, and a 3.2 percentage point increase in the total cash cost observed in the third quarter this year.

Moving to the next slide, slide eight, represent operating expenses. In the third quarter of this year, selling expense represented 12.1% of net operating revenue, with a 2.1 percentage point margin loss over the third quarter last year. This quarter, Estacio decided to intensify investments in the enrollment campaigns in the first months of the second semester, anticipating marketing funds for third quarter. This measure effected the advertising line increase in expense, which accounted for 7.4% of net revenue.

Moreover with the beginning of the provision of PAR, the margin of the allowance for doubtful accounts line fell by 1.3 percentage points in this quarter. It is worth noting that the allowance for doubtful accounts non-PAR and non-FIES over net income ratio improved by 0.9 percentage points over the third quarter last year.

In this quarter, general and administrative expenses represented 13% of net operating revenue, a 3.3 percentage point margin gain over the same period last year, chiefly due to the third party services. In this quarter -- in the third quarter of 2016, we had additional expenses of BRL4.9 million with advisory and audit service referring to the revision process of accounting practice and policies disclosed in the second quarter of 2016, and expenses with advisors and consultants involved in M&A negotiation. Excluding these amount there was a 1.1 percentage point margin gain in the third party services line over the third quarter of last year, underlining the efficiency gains in the management of third party projects.

In slide number 9 we can see the net income of BRL149.3 million, this quarter, up by 10% over the same period of last year, chiefly due to the BRL29.1 million upturn in EBITDA in this period. Third quarter financial results record a negative impact, mainly in the financial discounts line, which increased by BRL9.8 due to campaigns to recover past due debt aiming to increase cash generation. It is worth noting the success of this campaign pulls recovery rates -- reaches more than 50%.

Slides 10 shows Estacio's average receivables figure. This quarter we continued noting the good performance of the average non-FIES receivables period, which came to 69 days, 4 day less than the same period the last year. On the other hand, the FIES average receivable days was 25 days lower than the same period last year, totaling 221 days. I can assure you we remain focused on improving our collection and student's debt renegotiation campaign.

On slide 11, in the first table we can see the information on our capitalization cost. Cash and cash equivalents totaled 709.5 million at the end of the semester, at the end of this quarter, conservatively invested in fixed-income instruments pegged on the CDI interbank rate, government bonds and

certificates of deposit with top-tier Brazilian banks

Our debt, bank debt of 856.4 million corresponded mainly to our debenture issues, the loans from the IFC, the issue of promissory notes and the capitalization of equipment and leasing expenses in compliance with the Law 11,638. The BRL45.2 million increase in the loans and financing line over the same period of last year, refers mainly to the issue of promissory notes and debentures at the end of 2016. The objective of these operations was to recover the cash spent on the settlement of the first debenture issue and the payment of the extraordinary dividends in November and December last year.

In September '17, the company settled the third debenture issue of approximately BRL197, including the commitments for future payments related to past acquisitions totaling BRL93.7 million and tax payable installments amounted to BRL16.3 million. Estacio gross debt came to BRL966.4 million at the end of the third quarter this year. Accordingly Estacio's net debt came to BRL256.9 million at the end of the quarter, 1.1 times our period's EBITDA, versus 1.8 times in the third quarter last year.

Also on this slide we show over third quarter CapEx. We invested approximately BRL44 [ph] million, 10.5% more than the same period last year, especially due to the maintenance investments.

Having said that, I will now turn the floor back to our CEO, Pedro Thompson for his closing remarks.

Pedro Thompson Landeira de Oliveiraon

Thank you. Mauricio. Moving on to slide 12, I would like to emphasize that our plan for continuous efficiency gain is at full blast. Throughout the quarter, we began working on important fronts among which there is the restructuring of the curriculum matrix in the semester in order

to implement the new Educational Model in 2018 , with the objective of improving the management of class creation and faculty cost allocation. This changes comprise increase the sharing of disciplines, mainly in the first periods; offering more hybrid disciplines on-campus and online in the first

period; enabling alternative pathways -- and discipline interchange in the first and second period.

In our online tutoring program we will implement new tools and processes in order to improve the student/tutor ratio, maintaining service quality and student satisfaction levels.

In the first half of 2017 the distance-learning student/tutor ratio nearly doubled with the implementation of some of these tools. Estacio plans to further improve this ratio in the coming cycles.

We are also working on the optimization of the course mix. The initiative among others transferring students from loss-making courses and shifted

to other profitable units, or shifted and limit the offering of courses whose demand is low.

We are carrying out a detailed analysis of our internal benchmark, reassessing the operational performance and business plans in all units, and preparing specific action plans, in order to enhance productivity, considering the possibility of reducing, merging and closing a number of units. This initiative also comprised the evaluation of new opportunities for organic and inorganic growth.

In the last slide of our presentation, slide 13, I would like to reinforce that we continue to work in our growth drivers of which the new distance learning centers at the end of September starts reached 338 active distance learning centers. It is important to highlight that during the quarter we engaged 100 new poles, from the initial expectation announced in the second quarter release. We announced that a 131 new centers will be operating at the beginning of 2018. Including the new operational centers, another 86 new municipalities nationwide will have access to Estacio brand, of which 20% in the Sao Paulo State.

It is worth noting that we have almost 10 years of experience in the segment and expansion area, entirely restructured to comply with the growing number of applications for new partnerships.

The opening of the Medicine Course in Angra dos Reis unit. This quarter we started offering Medicine course in Angra dos Reis unit as authorized by

the Federal Government's Mais Medicos program. The course will begin this semester, with 55 new places [ph]. In addition to the five existing Medicine courses, Estacio will launch three other Medicine courses in the first half of 2018 in Juazeiro, Bahia, Alagoinhas Bahia state and Jaragua do Sul, Santa Catarina state. The significant expansion of the Medicine Courses, reinforce Estacio's position as a reference in the medical area.

High School, we are beginning operations in the high school segment and, in October 2017, we began enrolling students for the first groups of the next year. Firstly, classes will only be offered in seven units in the Rio de Janeiro State; Madureira, Rio Comprido, Ilha do

Governador, Duque de Caxias, Niteroi, Alcantara and Cabo Frio.

In addition to preparing students to join university, Escola Estacio plans to offer technical vocational training to high school students, focused on the labor market. Among the main

differentials of Escola Estacio, we can highlight faculty experience, teachers who have already joined professional development programs at the institution, and the existing infrastructure of the post-secondary education units, such as complete libraries and well-equipped labs.

Finally, I would like to reinforce our commitment to maintain a disciplined capital allocation strategy, focused on increasing profitability, not only by reducing costs and expenses, but also by increasing revenue. Our goal is to continue growing, investing wisely in order to provide the best

return to shareholders and ensure student satisfaction and business sustainability.

We can now move to our Q&A session. Thank you all.

Questions And Answers

Operator

We will now begin the question-and-answer session. (Operator Instructions). The first question today comes from Susana Salaru with Itau. Please go ahead.

Q - Susana Salaru {BIO 16170633 <GO>}

Hi guys, good morning. Congrats on the results. We have two questions here. First, on the efficiency gains you listed four levers. If you could just give us how do you expect them to mature, which ones should mature first, which one are more mid to long-term projects? And also on efficiency gains, which one do you consider the most relevant one from the cost perspective? That would be our first question.

And second, on the advertising expenses, seems to me that was concentrated in the third quarter. If that -- this understanding is correct, I mean we could [ph] understand that, that opens room for a margin expansion in the fourth quarter. That's it guys from our side.

A - Pedro Thompson Landeira de Oliveiraon

Thank you for your questions Susana The first question, the much higher disruptive two initiatives that we have for next year is in terms of efficiency gains regarding to faculty cost. Inside the faculty cost, we are making draw down [ph] of the opportunities of the faculty cost. The first one is, to make like a reframe of our futures basis. Because we have a lot of gaps, a lot of the difference between the average ticket of the labor cost by our professors. We had opportunities to equalize their salaries. We are bringing new people and fired some people and we have -- so making a rebalance of our total future cost base.

So first of all, this is the more disruptive tools that you have in terms of low hanging fruits, margin expansion for the next year. In the second question you want like our guidance for the next semester regarding margins.

Q - Susana Salaru {BIO 16170633 <GO>}

No, I'm just, thinking that if you anticipated marketing expenses for the third quarter, that would implicate that in the fourth quarter we have would expect less marketing efforts, which would contribute to a higher margin or facilitate a higher margin. Just the rationale for the marketing costs, expenses, anticipation.

A - Pedro Thompson Landeira de Oliveiraon

We already anticipate that in terms of margin for the next quarter, I think it's very early to talk about that. But in terms of specifically marketing in expenses, budgets, in fact, we anticipate fourth quarter expenses to the third quarter. You're right.

Q - Susana Salaru {BIO 16170633 <GO>}

Okay. Thank you, very clear.

Operator

(Operator Instructions). As there seems to be no further questions, I would like to turn the floor over to Pedro Thompson for his closing remarks.

A - Pedro Thompson Landeira de Oliveiraon

I would like to thank you all for participating in our results conference call. Our Investor Relations department is always at your disposal to help you with any question you may have. Our contact information is available in our website. We hope to see you again to our conference call next quarter. Once again, thank you very much, and have a great day.

Operator

Estacio Participacoes conference call is now over. Thank you for joining us and have a great day.

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