Q1 2017 Earnings Call

Company Participants

- Flavia Oliveira, IR Manager
- Leonardo Moretzsohn, CFO
- Pedro Thompson, CEO & IR Officer

Other Participants

- Marcelo Santos, Analyst
- Ricardo Rezende, Analyst

Presentation

Operator

Good morning, ladies and gentlemen. Thank you for standing by and welcome to Estacio's conference call to discuss the First Quarter of 2017 results. 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/ir and Engage-X platform together with that respective presentation and the earnings release.

(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 call over to Mr. Pedro Thompson, CEO and Investor Relations Officer. Mr. Thompson, the floor is yours, sir.

Pedro Thompson {BIO 19803506 <GO>}

Thank you. Good morning, everyone. Welcome to our conference call to discuss our results for the First Quarter of 2017. With me here today are Leonardo Moretzsohn, our CFO. And Flavia Oliveira, Head of our IR Department. Just to remind you all that there will be a Q&A session as soon as the presentation is over.

Let us go straight to slide two where I would like to emphasize also again the Company's strategic guidelines as of the second 2016 regarding transparency. Transparency is not just a guideline, to the (inaudible) where all of our processes (and traditions sit). As of Second Quarter of 2016 we have been disclosing information based on high governance standards, student base and ticket recovery.

Since the last semester we adopted measures to attract a more sustainable student base, taking the best advantage for the net present value per student in order to increase average ticket ensuring student (continuity).

Control of costs -- a series of measures adopted as of the end of 2016 enabled the Company to dilute costs particularly related to personal marketing and general and administrative expenses.

Cash generation -- the (full revision) of the Company's collection improved Estacio's EBITDA to cash conversion ratio, also enabling a gradual reaction in the average receivable dates. Therefore I can say that Estacio entered 2017 focused exclusively on execution.

And the first results can be noticed on slide three of our presentation. In spite of the economic downturn that affected the student enrollments and reduced (inaudible) revenue, our net operation revenue increased by 3.8% to BRL819 million in First Quarter of 2017 compared by EBITDA growth of 9% over the First Quarter of last year to BRL214.8 million.

It is clear on this table that, in addition to the impact of the First Quarter of 2017 revenue, EBITDA was also influenced by the improved management of (Second Quarter) which fulfill initiatives implemented in the First Quarter of this year fell by 5.8% over the First Quarter of last year leading to a margin gain of 3.8percentage points.

Excluding the effects of 2% retention of net revenue for (inaudible) (quarter) (inaudible) decreased 7.1 and (inaudible) and the nonrecurring effects for expenses with (inaudible) M&A transactions. First-quarter comparable EBITDA (totaled) BRL223.4 million, 13.3% (up) on the First Quarter of last year.

Therefore the comparable EBITDA margin came to 27.3% in the First Quarter of this year, 2.3% percentage points (inaudible) the First Quarter of last year, despite the increase -- the fall in the creation of provisions for the installment payments program (inaudible).

I will now turn the floor over to our IR to present with more detail the performance of our student base and tickets.

Flavia Oliveira {BIO 20130905 <GO>}

Good morning, everyone. I will now present slide 4. At the end of the First Quarter we had a total of 561,000 students, 5.3% less than last year. Essentially due to the 10.5% decrease in the on-campus student base, which was partially offset by the 8.2% increase in the distance learning student base.

Of the 383,000 on-campus base, (305 1,000) are undergraduate students, 10.6% less than last year, due to the 26.6% increase in the number of graduates and the 21.4% reduction in the number of new students due to the adoption of a new (intake) strategy which reduced discounts and (inaudible) focusing on the increase of average ticket per student.

Additionally, the renewal rate also decreased by 6.7percentage points essentially due to more restrictive (inaudible) enrollment discount criteria in that renegotiation. It is worth noting that both the reduction in the number of new students and the decline in the renewal rate were influenced by the decrease in the (inaudible) student base, which fell by 19.7%. Nevertheless, the net revenue growth emphasized our strategies and advantages in growing without depending on (inaudible).

In the distance learning segment the 8.2% increase to 177,000 students referred to the (upturn) of 1.8% in the undergraduate student base and 34.2% in the graduate student base largely due to partnerships in the student intake process.

(inaudible) this slide I will talk a bit more about enrollment, which fell by 13.2% in this quarter compared to last year, essentially due to the 21.4% decrease in the number of new on-campus students due to the change in the intake strategy focusing mainly on the ticket growth and students who comply with their payment obligation.

It is worth noting, however, that in addition to the higher average ticket, the dropout of students enrolled in this quarter is lower than in previous quarters when enrollment was strongly influenced by (Discount King campaign). Therefore our estimates regarding students enrolled in the last intake cycle showed that (inaudible) net present value is distinctly higher than that of students enrolled in previous cycles.

We are already reaping some benefits from this strategy. For example, the dropout of freshmen students until April up to this moment has decreased by 23.7% when compared to the same period last year. We remain focusing our new strategy on the intake restructuring process to our sales force increasing the number of sales advisors and implementing a more aggressive variable compensation program to foster the attainment of the sales goals, which are now based on the average ticket rather than just student intake.

Simplifying and streamlining the grading of (inaudible) discounts in order to increase the average ticket, we have fixed a significant reduction in discount campaigns establishing a minimum payment of BRL59 to conclude the enrollment process. The regionalization of campaigns and reduced institutional (appeal), besides the new installment payment program.

We now move to slide number 5 and we focus on Estacio's offer -- the new installment payment program (called) parcelamento Estacio which begins on the First Quarter this year. Of the (92,000) students newly enrolled in on-campus courses 6,800 students have enrolled using our installment payment program, which make it possible for the students to pay half of their tuition while studying and the other half after graduating.

The amount of installments is progressive. Starting with the payments of 30% of the tuition in the first two semesters, 40% in the third, 50% in the fourth and 60% as of the fifth semesters. The gross revenue received in cash from students (with par) amounted to BRL5.4 million in the First Quarter while the total amount to be paid in installments was BRL15.1 million. The efforts to offer the product were focused on the (vision) and on the courses with the greater (inaudible) demand, excluding ticket premium quarters.

On the next slide we talk about distance learning and on-campus average ticket. Beginning with the on-campus segment tickets increased by 17.2% over the same period last year. Analyzing the on-campus undergraduate segments only we see an increase of 16.8% resulting line with the Company's new focus which now prioritize days quality rather than just growth, creating a new pricing strategy.

The on-campus graduate segment increased by 8.9%, in line with inflation. The distance learning average ticket increased 13.6% over the same period last year also due to the changes mainly with regard to the relationship with partner centers and the management of (technical difficulty).

Average ticket increased by 13.8% and 13.9% in the undergraduate and graduate segments respectively. Estacio is already reaping some benefits from this strategy. One I can mention for example is the intake average ticket which increased by 30% this quarter when compared to last year, directly affecting the net operating revenue of the period.

Thus our estimates concerning the students on this last cycle of intake indicates that the net present value of these students moved forward being significantly higher than the previous cycle. From this better quality base we assure higher net revenue from intake as well as more sustainable dropout (inaudible) indicators for the upcoming period.

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

Leonardo Moretzsohn {BIO 15216920 <GO>}

Thank you very much, Flavia. Good morning, everyone. On slide seven we represent net revenue figures. As you can see, the bridge presented First Quarter net revenue came to BRL819 million, 3.8% up compared to Q1 last year. Especially due to the BRL152.5 million created in ex-US revenue from monthly tuitions which represented an increase of (60.1%) over Q1 2016 due to the rising ticket this period.

The BRL48.4 million reduction (inaudible) revenue from monthly tuitions 1% less than in Q1 last year due to the (inaudible)-based reduction. The BRL5.5 million reduction (inaudible) revenue due to the graduation of the last students in this segment.

The BRL7.5 million reduction with the other revenue, chiefly due to the end of the (inaudible) 2016 project referring to the training offered by Estacio to the (inaudible) years of the Rio 2016 Olympic Games, which generated quarterly revenue of approximately BRL8.3 million in Q1 2016.

It's worth noting that there was a corresponding entry under expenses with institutional events so that the effect in terms of operating results EBITDA was (inaudible) impacting the period's margin only. This BRL46.4 million increase in the scholarship (inaudible) line due to other change in the Company's pricing strategy.

The (2% retention) of net revenue from FIES contracts (inaudible) (741) as of the second semester of 2016, which has an impact of approximately 6.8 million in Q1 this year. It is also worth noting that in the First Quarter approximately BRL7 million was raised on the (course) revenue reduction due to the adjustment to present value of receivables from Estacio installment payment programs product.

Moving to slide 8, I will talk a little bit about operating profit. Cash cost represented 48.8% of net operating revenue this quarter, a 3.8percentage point margin gain compared with 82.6% in 2016. Essentially with the personal line which shows the first results of Estacio's restructuring of faculty cost management.

In this sense I can highlight the following measures (inaudible) to use the maximum possible number of modules online up to the allowed limit of 20% of the on-campus cost. We increased the number of (inaudible) distance learning classes using resources such as live webcasts in specific modules. We now offer direct study classes in the distance learning segment. We also offer online term paper modules and we offer earlier class (inaudible) which reduced by 50% the additional nightshift premium.

With regard to textbooks materials, Estacio now produces its own content and has reduced printing costs by offering the material online. These simple measures brought significant results to the Company's Q1 2017 in the hope this trend continues in the coming results.

Jumping to slide nine we present operating expenses. Selling expenses accounted for a reduction of 2.5percentage points in the margin, essentially due to the increase of 2.3percentage points in (PVA) over Q1 last year and the beginning of our installment payment programs for provisioning. First-quarter PVA performance was due to the increased default in second half of last year.

Marketing expenses accounted for a reduction of 0.3percentage points in the margin over Q1 last year. Last quarter general and administrative expenses represented 12.2% of net operating revenue, a 0.4percentage points decrease over Q1 last year chiefly due to the 0.5 (percentage) point margin decline in the personnel expenses line as a result of higher bonus provisioning this quarter compared to the same period last year.

On slide 10 we see the First Quarter net income totaled BRL121.8 million, 4.8percentage down compared to the last year primarily due to the increase in the financial results by BRL3.9 million and higher depreciation in the amortization BRL4.4 million, partially offset by the BRL17.7 million increase in EBITDA.

The financial results recorded negative impact in the following line mainly, (inaudible) revenue from the restatement of FIES accounts receivable which fell by BRL8.4 million due to the decrease in FIES accounts receivable from 2015 following the payment of the first installment in the middle of last year.

Second, investment income, which dropped by BRL7.2 million due to the BRL95.8 million decrease in cash and cash equivalents over the same period last year.

And third, interest and financial charge expenses which climbed by BRL8.7 million mainly due to BRL127.8 million increase in (loans) and financial over Q1 2016.

Now on slide 11 we present average receivables days. We continue to focus on improving our collection campaign and distribute debt renegotiation policies, the results of which have already become apparent in the performance of average loan FIES receivable days which improved by (two days) in comparison with the same period last year. First-quarter accounts receivable for (inaudible) year due to the downturn on FIES accounts receivables and in the student monthly tuition.

Slide 12, in the first table we see the information of all our capitalization and cash. Cash and cash equivalents totaled BRL458.1 million on March 31 (inaudible) conservatively we invested in six income instruments (inaudible) CDI interbank rate, government bonds and certificates of deposits with top-tier regional banks.

The net debt of around BRL1 billion corresponds mainly to: one, the corporate debentures the (debt) issues, second series of BRL300 million, third series of BRL187 million. And fourth series of BRL100 million. Second, the loan from the IFC first (debt) installments of BRL48.5 million and second of around BRL200 million. Third, the issue of Company promissory notes totaling BRL300 million. And fourth, the capitalization of equipment lease expansions in compliance with (inaudible) (11,638).

The BRL227.8 million increase in the (inaudible) and financed in line with Q1 last year refer mainly to the issue of BRL300 million in promissory notes November last year and BRL1,100 million in debentures (before issue) in December. The objective of these operations was to recover the cash earned on the settlement of the first debenture issue totaling approximately BRL214 million and the payment of the extraordinary dividend in November and December last year totaling BRL420 million.

Including the commitment for future payments related to acquisitions made which totaled BRL115.3 million, as well as (inaudible) installments totaling BRL15.2 million, Estacio's gross debt came to BRL1.171 billion at the end of last quarter resulting in net debt of BRL713.5 million.

Also on this slide we show First Quarter CapEx, capital expenditures, (we invested) BRL26.3 million, 20.3percentage down to the same period last year chiefly due to the scheduling of maintenance investments which totaled BRL13 million, BRL3.4 million less than Q1 last year when the Company anticipated investments mainly allocated to integrated systems, equipment, libraries and laboratories as a unit. Additionally, what were new investment integration projects last quarter given that there were no acquisitions in the past 12 months.

On the next slide, 13, we present our cash flow. Our operating cash flow was (inaudible) BRL62.3 million, a substantial improvement over the same period last year, especially when analyzing EBITDA to operating cash flow conversion rate ratio, which stood at 34.1% in Q1 this year.

I will now turn the floor back over to our CEO, Pedro Thompson, for his closing remarks. Thank you.

Pedro Thompson {BIO 19803506 <GO>}

Thank you, Moretzsohn. Concluding our presentation moving to slide 14, I would like to go over (inaudible) and our scheduled focus 100% of (performances). Personal and sustainable base of students as a result from (inaudible) turnover (inaudible) and non payments. Second was focus on cost and expenses especially the cost within faculty and marketing. Third, generating cash is also the main goal of the key objective of the Company. Fourth, bringing our work with a high level of governance. And the last finally always preserving our academic excellence that we have achieved with outstanding outcomes.

To conclude I highlight some photos from our last leadership meeting held on April 18 and 19. The organizational environment is an invaluable treasure that we have, one we will never relinquish. We can move to the Q&A session now. Thank you, all.

Questions And Answers

Operator

(Operator Instructions) Marcelo Santos, JPMorgan.

Q - Marcelo Santos {BIO 20444938 <GO>}

I just wanted to see if you could provide a regulatory update. So what are the most recent development you have been seeing in FIES and your expectations for that? And also for distance learning?

A - Pedro Thompson {BIO 19803506 <GO>}

Hi, Marcelo, thank you for your question. We don't have any further updates of -- any updates of FIES.0 or any regulatory issue until now. We -- due to the full schedule that we campaigned in political environment in Brazil I do not expect anything in short-term about this.

Q - Marcelo Santos {BIO 20444938 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) Ricardo Rezende, HSBC.

Q - Ricardo Rezende {BIO 16469276 <GO>}

I just want to have some more color on the (inaudible) cycle with your own financing program, your strategy to attract students, if it was more the (inaudible) strategy or if you had (inaudible) students for such financing. Thank you.

A - Pedro Thompson {BIO 19803506 <GO>}

Can you repeat, please, your question?

Q - Ricardo Rezende {BIO 16469276 <GO>}

Sure. So can I just get come more color on (inaudible) and on the financing program on this intake cycle -- on your strategy to market this product to students. If it was more a bold strategy from you or students were actively looking for this financing program?

A - Pedro Thompson {BIO 19803506 <GO>}

We are very proactive to offer this. But we are very concerned about (inaudible) to cannibalize the premium student with this product. But we are very proactive in (showing) this to our students.

Q - Ricardo Rezende {BIO 16469276 <GO>}

Okay. Great. Thank you.

Operator

(Operator Instructions) I would now like to turn the floor back over to Mr. Petro Thompson for his final remarks. Sir?

A - Pedro Thompson {BIO 19803506 <GO>}

I would like to thank all of your for taking part in our results conference call. Our Investor Relations Department is always at your disposal to help you with any questions you may have. IR contact information is available on our website. We hope to see you again at our conference call next quarter. Also again, thank you very much and have a great day.

Operator

And thank you, sir, to yourself and to the rest of the management team for your time also today. This concludes Estacio's conference call. At this time you may disconnect your lines. Thank you, again, everyone. And have a great day.