Q2 2017 Earnings Call

Company Participants

- Flavia Oliveira, Unknown
- Leonardo Moretzsohn de Andrade, CFO and Member of Board of Executive Officers
- Pedro Thompson Landeira de Oliveira, CEO, IR Officer and Member of Board of Executive Officers

Other Participants

- Marcelo Santos, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, thank you for standing by and welcome to Estacio's conference call to discuss the Second 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 the MCIQ platform, www.MCIQ.com together with the respective presentation and the earnings release.

We would like to inform you that during the company's presentation, all participants will 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. Pedro Thompson CEO and Investor Relations Officer. Please, Mr. Thomson, you may proceed.

Pedro Thompson Landeira de Oliveira {BIO 19803506 <GO>}

Thank you. Good morning, everyone. Welcome to our conference call to discuss the results for the Second Quarter of 2017. Leonardo Moretzsohn, our CFO and Flavia Oliveira, head of our IR team are with me.

Just to remind you all that there will be a question-and-answer session as soon as the presentation is over.

Let us begin with Slide 2. As you all know, we had important challenges over the last year. It was a period of great change and transformation in the company. However, we kept three major commitments in mind at all times. First, I should point out that our main goals were to maintain operational performance and (inaudible) at a time of transition. We had a deal that was being analyzed by the Brazilian Antitrust Authority and we were committed to meeting the wishes of our shareholders in closing the deal without affecting the company's performance during this period. We have worked together with (inaudible) to prepare an integration process. I can assure you that we have devoted our team's time and (inaudible) to sure that this process was as smooth as possible, always in compliance with the antitrust legislation.

And last but not least, we were also committed to being transparent to our shareholders. We have strict governance and implementation of the compliance future. Although the CADE did not approve the deal, I can say that's our care and concerns improved the company's performance while the antitrust agents was analyzing our requests has produced significant results. Over the last two quarters and especially this quarter, our results proved that (inaudible) able to improve its performance.

Moving on to Slide 3. We can see the results highlights for the Second Quarter of 2017. Our net revenue moved by 9.3% or BRL 78.1 million over the same period in 2016, totaling BRL 913.4 million, while EBITDA came through BRL 264 million and the EBITDA margin stood at 27.8%, an increase of BRL 210.4 million and 22.6percentage points respectively over the Second Quarter of the last year. However, for comparison purpose, it's necessary to exclude the effects of one-off interest totaling BRL 105.7 million recorded in the Second Quarter of 2015. The BRL 6.6 million related to the fees of 2% of net revenue from FIES contract in the Third Quarter of 2016. And recurring M&A expenses of BRL 0.7 million, giving a comparable EBITDA of BRL 261.3 million and a comparable EBITDA margin of 28.6%. And up-turn of 74.9% and 10.7percentage points respectively of the same period of 2016.

This performance was a consequence of our initiatives to increase operational efficiency improvement, the management of the company's cost and expenses. I believe we have been able to show that it is possible to increase profitability in a challenged scenario. It is still impacted by the lower volume of FIES contracts, while making changes to important processes such as student intake and pricing was the results we will discuss in further detail now.

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 begin by talking about our operational performance on Slide #4. In the graph on the left, we can see that our student base grew by 0.9% year-over-year, totaling 5,39,000 students, mostly due to the 10.3% increase in distance-learning student base, thanks to the initiatives including the performance based (inaudible) in order to better align with (inaudible) end results.

The distance learning growth offset the 3% decline in the on-campus student base. The base decrease reflected the reduction in the First Quarter intake cycle due to the change in the strategies to attract new students designed to create a more solid students base with compliance with their payment obligation.

It is worth noting that the on-campus students (inaudible) rates improved by 7percentage points to 93.6% at the end of the period, one of the first time of the college of our students base. We would also like to draw your attention to the fact that the decrease in the number of on-campus students this semester was much lower than the decline in the FIES students base, which fell by 15.6% compared with the Second Quarter of 2016.

Next, revenue growth and the adoption of the instalment payment program for a more solid students base. (inaudible) Estacio's strategies and differential advances to maintain its sustainable growth.

Moving on to Slide 5, I will now talk about our average ticket, which reflected the pricing strategy we began adjusting this semester in order to ensure a sustainable students base that combines compliance with payments obligation with the dropout rate. The on-campus average ticket moved up 11.7% to BRL 751.6 while the on-campus undergrad average ticket climbed 10.9% to BRL 784.6, thanks to the new pipeline strategy adopted by Estacio in the First Quarter intake cycle and the 7,000 students, who also positively impacted the average ticket, as there are no discount or scholarships under this program. The on-campus graduate average ticket increased by 6.7% over Second Quarter of 2016 due to the decrease of approximately 40% in the deductions line, generating a gain of 9.1percentage points in relation to grad revenue. In the Second Quarter of 2017, the distance learning average ticket grew up by 27.8 % over the same period last year to BRL 239 with an increase of 23.3% to BRL 247.9 in the undergraduate segment. And a net turn of 80% to BRL 175.4 in the graduate segment compared to the 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, Flavia. Good morning, everyone. Moving to Slide 6, I will begin with our net revenue in Q2 2017. As we can see, Second Quarter net revenue came to BRL 913.4 million, 9.3% up compared that Q2 2016, essentially due to the BRL 219.7 million increase in revenue from monthly tuitions, 18.3% up on Q2 '16, due to higher average tickets in most (inaudible) student base. The BRL 3.5 million decrease in Pronatec revenue as reported in the last few quarters due to the graduation of the last students in this segment.

The BRL 4.6 million reduction on other revenue due to end of the Rio 2016 project under which we provided training to the volunteers of Olympic Games. The BRL 109.9 million increase in scholarships and discounts due to the change in company's pricing strategy for new students. The BRL 8.1 million (inaudible) taxes in line with revenue growth.

The 2% retention of the net revenue from FIES projects, who's (inaudible) decreased BRL 741 million. As of the second semester of 2016 it had an impact of around BRL 6.5 million -- BRL 6.6 million this quarter. What is also worth noting that close to BRL 9 million was recorded on the gross revenue deduction in the Second Quarter 2017 due to the adjustment to the present value of PAR receivables.

Moving to the Slide 7, I will talk a little bit about our operation costs. Our cash flows represented 48.1% of net operating revenue in the Second Quarter versus 56.8% in the same for the last year, representing 8.7percentage point margin gain. It was concentrated in the personnel line, underlying the results of Estacio's restructuring of faculty across management.

Some of the initiatives implemented at the beginning of the year include the offer of 20% on-campus online content, if they increase and the number of students in distance learning classes, all of which were part of the process of restructuring the management, office staff with faculty. In addition to the decrease in personnel cost this quarter, the tax book (inaudible) also played a role in the 8.7percentage point gain when comparing the total cash flow to revenue relation over the Second Quarter last year. We intensified our production of books that's offered this to our libraries for students. The result of these efficiency efforts, mainly in the distance-learning segment, combined with revenue growth this quarter led to a 30.5% year-on-year increase in the company's gross profit to BRL 445 million. Excluding the period depreciation and amortization, the gross margin claimed 8.7percentage points from 43.2% in Q2 2016 to 51.9%.

On Slide 8, we present our operating expense. The Second Quarter of this year, selling expenses represented 12.7% of net operating revenue, with a 9.4percentage point margin gain, impacted by one-off entries in Second Quarter of 2016.

Excluding the effect of (inaudible) the selling expense margin gain came to 4.3percentage points, even including the impact of PAR. The allowance for doubtful accounts lines was adversely affected in Q2 last year as Estacio conservatively provisioned (inaudible) to comply with obligations related to the FIES. However, after an in-depth analysis with our internal and external legal advisors, we have concluded that we have not breached the rules on academic performance and reversed entirely the accrued amount in the last quarter of 2016, generating a new net effect in the full year.

I wanted to mention these adjustments in order to allow a fair comparison between Q2 2016 and Q2 2017. We excluded the BRL 43 million recorded in the same period last year as we see a 1.7percentage point margin gain in the allowance for doubtful accounts line due to a stricter collection process in students' retention efforts, which offset the negative 0.4percentage point impact when we began approving provision for the PAR.

We have 3percentage point gains in the advertising expense margin in the same period, it was also impacted by the non-recurring effect of the end of contracts and institutional campaigns, which led to a one-off BRL 15.5 million increase in advertising expenses in the Second Quarter 2016. Excluding this effect, we had a 1.1percentage point margin gain compared to Second Quarter last year. I would like to remind you that since the beginning of this year, the campaigns have been focusing more regional cluster driven strategies and less on the institution itself using more efficient lower cost channels.

Second quarter general and administrative expense represented a 11.3% of net operating revenue, a 3.2percentage point margin gain over the same period last year, impacted by one-off interest in Q2 '16. The company booked a non-recurring contingency item totaling BRL 28 million in Q2 2016 due to the revision of the company's base, taking into account the market nature of these assumptions. Excluding the effect of these entries, the general and administrative expenses margin would have remained intact.

Jumping to Slide 9, we can see the net income totaled BRL 166.3 million this quarter, resulting in a 20.5 year-on-year percentage point increase in the company's net margin, mainly due to the BRL 210.4 million up-turn in EBITDA in the period.

The Slide 10 shows Estacio's average receivables period. I can assure you, we remain focused on improving our collection in students' debt renegotiation campaign. It was more (inaudible) BRL 5.3 million year-on-year reduction of the monthly tuition fees line of account receivables. As a result, actually our average receivables days improved by nine days from 82 days in Q2 '16 to 74 days this quarter.

On Slide 11, in the first table we can see the information on our capitalization cost in cash. Cash and cash equivalents closed BRL 542.3 million on June 30, 2017, conservatively invested in fixed-income instruments pegged to the CDI interbank rate, government bonds and certificates of deposit with top-Tier Brazilian bank.

Our bank debt close to BRL 1 billion was recorded mainly to (inaudible) issues, the loans from IFC, the issue of promissory notes in the capitalization of equipment and leasing expense in compliance with (inaudible) 11,638.

The BRL 237.7 million increase in the loans and financing line over June 2016 refers mainly to the issue of BRL 300 million in promissory notes in November 2016. And over BRL 100 million in debentures, the fourth issue in December last year. The objective of this operation was to recover the cash spent on the settlement of the first debenture issue, totaling close to BRL 214.1 million. And the payment of extraordinary dividends in November and December 2016, amounting to BRL 420 million.

Including the commitments for future payments related to past acquisitions totaling BRL 109.5 million and taxes paid in installments amounting BRL 14.6, Estacio gross debt came to BRL 1.63 billion at the end of Q2 '17, resulting in net debt of BRL 615.5 million.

Also with this regard, we show our Second Quarter CapEx, we invested BRL 31.5 million, 10.7% less than the same period last year, mainly the (inaudible) in acquisition in the last 12 months that required integration CapEx.

Jumping to Slide 12, we present our cash flow. Operating cash flow was bolstered by BRL 117.1 million in Q2 '17, an improvement of BRL 23.9 million over the same period last year.

Let me remind you that we expect to receive the amount related to second installment of 2015 receivables accrued due to (inaudible) at the beginning of next month of August.

So (inaudible) I would like to turn the floor back to our CEO, Mr. Pedro Thompson for his closing remarks. Thank you.

Pedro Thompson Landeira de Oliveira {BIO 19803506 <GO>}

Thank you, Moretzsohn. Now we will move on to the last part of our presentation. On the Slide 13, what I want to show how much efficiency, we were able to obtain during one of the most important transformations in Estacio history, comparing the results for the 12-month periods between the second half of 2015 and the first half 2016. And between the second half of 2015 and the first half of 2017, we can see a futures gain of over BRL 217.7 million. This result was obtained, thanks to the initiatives implemented over the last year, including measures to attract a more sustainable student base. And much rise the present value per student proof are healthier average tickets and longer student retention.

In addition to increasing our topline leading to better cost dilution, we also improved our cost structure, especially in regard to personnel advertising and general and administrative expenses. We also begun rebuilding the company's collection policies. And have already observed an improvement in the EBITDA to cash conversion ratio and as well as a gradual reduction in the average receivables days as our CFO mentioned earlier.

We recorded an 8percentage points margin gain. It is worth noting that there was no room for major strategic moves in 2017. We remain focused on execution, which led to a gradual and consistent improvement in the results of the last few quarters. In the coming quarters, we plan to implement over 100 initiatives in order to continue obtaining efficiency gains. These initiatives have already been made and we have begun implementing them this semester.

In addition to these short-term initiatives, which are practically low-hanging fruits, we are developing a new long-term strategic plan and maintains to present use on this front before the end of this year at our Investor Day, which should take place in mid-November. As soon as we set the date, we will widely publicize these events. We want to share a reason for the future of Estacio and we'll do it as soon as possible.

On Slide 14, I would like to finish this presentation by talking about our growth drivers. The first is the launch of new distance-learning centers. We currently have three institutions accredited to provide distance learning education. (inaudible) with (inaudible).

Given these grades, the new regulation allows us to launch 250 new distance-learning centers. (inaudible) these new centers, we will launch 76 new centers in the Third Quarter intake process and already have 55 prospective partners and in all process of formalizing the partnership and organizing the necessary infrastructure. As a result, at least 131 new centers will be added to start the current network of 238 centers during the second half of 2017. And we'll be able to operate in the first intake cycle of 2018.

Another growth driver is the allowance of four new medicine campuses through the Mais Medicos program at the beginning of 2018. Thanks to this program, we are authorized to offer another 225 medicine places per year at the new (inaudible) units. Please bear in mind that (inaudible) operates medicines courses in four campuses, totaling 3,000 students. It's also worth noting our expertise in the health area, with 17 courses and over 100,000 students in this field.

Another important growth driver was inorganic growth through good M&A opportunities. We have a robust cash position, certainly a more efficient operational structure. So we are analyzing opportunities for consolidation of the educational sector.

Our Board of Directors authorized the prospecting of financial advisers (inaudible) in the identification of potential assets for acquisition. Our organic growth pipeline is another growth driver that we have been working on steadily. We have 10 applications for new campuses already approved by the Ministry of Education, which will be launched in a phased manner over the next 24 months.

To wrap up, I would like to say we have began a new phase of our history. But we are doing this supported by solid results achieved during an extremely challenged year in which we were fully focused on execution. We currently have a more efficient management structure and continue improving our academic quality indicators. I believe we have found fundamentals to continue our growth trajectory, creating value for our stakeholders, now with a long-term strategic and sustainable reasons.

We can move on to the Q&A session. Thank you.

Questions And Answers

Operator

Thank you, Mr. Thompson. Ladies and gentlemen, we will now begin the Q&A session. (Operator Instructions) And your first question will come from Marcelo Santos of JPMorgan.

Q - Marcelo Santos {BIO 20444938 <GO>}

The first, I just wanted to understand a little bit better the gains on the distance learning. So you put more students per class. I just wanted understand the class concept that you use on the fully online course. I mean I would imagine if you're putting like more students per tutor or something like this, does this mean that the tutors were being underutilize before? Just wanted to understand a little bit better the logic of gains in line.

And the second question is regarding FIES. You still have roughly 1/3 of your revenues coming from FIES and FIES has a higher ticket, at least it looks like a higher ticket on average than your average ticket. What do you think should be the impact on the margins in the next year since a lot of FIES students are going to graduate by the end of this year, do you expect a negative impact on your margins due to that? These are the two questions.

A - Pedro Thompson Landeira de Oliveira {BIO 19803506 <GO>}

Thank you, Marcelo. The first question regarding the distance learning efficiency, we changed our education methodology with a correlation about students per tutors with more students per tutors when we compare to the last year.

A - Flavia Oliveira {BIO 20130905 <GO>}

Yes. Marcelo, this is Flavia speaking. In fact, now have some system helping our tutors. So we are able to answer the doubts of our students to have a better relation with our students in last time when we had in the past. So we maintain the quality of answers to our students with less tutors because we are better equipped in terms of systems.

Q - Marcelo Santos {BIO 20444938 <GO>}

The second question?

A - Pedro Thompson Landeira de Oliveira {BIO 19803506 <GO>}

Yes. The second question regarding FIES. We are not allowed to give guidance, okay. But it affects the whole sector that the change of average ticket regarding lower FIES penetration will be a concern to all players for sure.

Operator

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

A - Pedro Thompson Landeira de Oliveira {BIO 19803506 <GO>}

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

Operator

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