

Q1 2014 Earnings Call

Company Participants

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

Other Participants

- Unidentified Participant

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 2014 results. This event is also being broadcast simultaneously on the internet, via webcast, which can be accessed on the company's IR website together with the respective presentation and the earnings release.

We would like to inform you 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.

Rogerio Melzi {BIO 16212298 <GO>}

Well, thank you very much. And good morning everyone. Welcome to our conference call to discuss the results for the first quarter of 2014. Virgilio Gibbon, our CFO, is with me here today and he will be helping me with the presentation. Just to remind you all that, we'll have a question and answer session just as soon as the presentation is over.

So let's move straight to slide two for presentation which is also available on our website. Looking at the main indicators for the first quarter, we see that, we had success in sustaining a significant growth base. We announced another record high intake cycle, the eighth in a row. This time, we enrolled 134,000 students in On-campus and distance

learning under graduate courses, increasing our same-shop on campus undergraduate student base by 17.5% and our distance learning undergraduate base by almost 23%, with improved growth of 20.7% over first quarter '13.

Thanks to the excellent performance of the student base, helped by the positive variation on the on-campus average ticket, the first quarter '14 net revenue recorded substantial 30% growth over first quarter '13, reaching R\$538.2 million.

While EBITDA reached R\$129.4 million, which represents the relevant 49% growth year-over-year. EBITDA margin came to 24.1%, a three percentage points gain over 2013. In addition, this quarter we successfully concluded the assisted transfer process of the Gama Filho and Univercidade students, conducted by the Ministry of Education (MEC) following the disaccreditation of these institutions.

By the end of the first semester enrollment process, 6.7 thousand of these students have opted to transfer to Estacio, 1.7 thousand of whom medical students and 5,000 in other courses. It is worth highlighting that Estacio may receive more students from these institutions in the second semester of 2014 through the assisted transfer process. We also concluded Pronatec Program in the Bolsa Formacao modality for the first semester 2014. Estacio won 100% of the requested places almost 30,000 all of which instead of Rio de Janeiro, and enrolled 4.1 thousand students a conversion ratio of 81%.

Around 65% of the enrolled students will take morning courses, 30% afternoon courses, and 5% night time courses. Hence allowing us to occupy either capacity in our units. Following, the guidelines of our strategic events we allowed our corporate universities which is already operating at full strength with on-campus and business running course and training programs to all our people. Also we had another important milestone as we opened it (inaudible) in the same building.

In our facility in the core region of the Rio de Janeiro. NAVE is an innovations space for simulating an experimenting with the university of the future new environments enrollment rooms, classrooms, IT labs and so forth as well also provided for support for start-ups and other Innovation-

related activities. We believe that during this foundation they made a lot of target energy. There is a mid-to-long terms, they will be very important to help us differ our situation from our peers.

At the end of the presentation, I'd get there in to comment on some important facts of our strategy and also on the outlook for 2013. But in short we started the year on a high note keeping an excellent operational phase after concluding another record enrollment cycle which was certainly paved the way for more accurate results throughout the year.

I'll now hand it over to Virgilio, who will go into more details of Estacio results from the first quarter.

Virgilio Gibbon {BIO 16679141 <GO>}

Thanks, Melzi. Good morning everyone to begin with I'd like to call your attention to slide three, which deals with our operating results the first chart shows the students base at the end of the first quarter of 2014. When we have 394.5 thousand students, 20.7% more than at the end of first quarter '13.

The same-shop student base excluding the acquisitions in the last of 12 months FACITEC and ASSESC grew by 19.3% over the same period last year. Our same-shop, on-campus under graduate students based total 316.1 thousand students at the end of March representing 17.5% organic grow and reinforcing the trend of sustainable organic student base grow following eight record in take cycles in a row.

On-campus on the undergraduate intake total 105.7 thousand students, 22.9% more than in the first quarter 2013 already including the 6.7 thousand who transferred from Gama Filho and Univercidade this quarter. These students had already part of their revenues booked in the first quarter, contributed to our revenue. But we will only be booked in second quarter 2014. When we will have a better visibility of the impact of these transfers in our results.

The renewal ratio reached 86.6% in the first quarter 2014, a 0.2 percentage points improvement over the same period last year, primarily due to the procedure change that anticipated student non-renewals in fourth quarter 2013, which offset the higher dropout levels we expected due to the higher number of students in the first and second semesters we currently have, primarily due to the clean-up of the students base in fourth quarter last year, which anticipate first quarter 2014 revenues.

Our distance learning base grew by 27.5%[ph] over last year to 78.4 thousand students, as you can see on the graph at the side, net operating revenue increased by 30.2% year-on-year to R\$538.2 million, thanks to the expansion of student base in the on-campus ticket increase. The table at the bottom shows that average on-campus tickets grew by 10%; this quarter increased was due to our policy of imposing a building solution price hike in specific locations and among our other factors to the choice of more expensive course by FIES students. Notably in the field of engineering and health.

The average distance learning ticket remain flat in the first quarter 2014, edging down by 0.4% due to the higher number of students opt in the distance learning, an option which dilutes the course curriculum and, consequently, its value, over a further two semesters and our policy of these distance learning cost prices adjustment in certain location to better suit local market conditions.

Now let's move on to slide four, where you can see a vertical analysis of our operating cost and expenses.

In first quarter 2014, our cash cost improved by 0.9 percentage point over first quarter '13, as a result of the following gains. Number one, 0.8 percentage point in third-party services, as a result of the insourcing of security and surveillance in our units, which began

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to benefit this line with a counterparty in the personnel, besides the improved management of third-party service contracts. Two, 0.5 percentage points in textbook materials. The fact that the 0.2 percentage points gain in the salaries and payroll charges line was less than in recent quarters was due to the following three factors, number one: The insourcing of security and surveillance in our units mentioned above, which impacted this line due to the hiring of personnel; Initial costs from the hiring of new staff and faculty for the Pronatec vocational courses and to receive the students who transferred from Gama Filho and Univercidade, which had an impact in first quarter 2014 while these students did not have their revenues fully booked in the quarter; and number three, the increase in labor agreements, which climbed from around R\$5 million last year to approximately R\$14 million in this quarter, consuming 1.6 percentage points of margin.

This increase reflects a more proactive approach in solving labor issues, which should extend throughout 2014, and then return to levels more in line with historical average from 2015 onwards, since there is a clear downward trend in convictions related to labor lawsuits.

The higher-than-normal rise in the rentals line can be basically explained by the four factors below. Five new campuses in comparison to first quarter 2013, two acquisitions, FACITEC and ASSESC; and three greenfields, Parangaba, Angra dos Reis and Teresopolis, for an amount of R\$1.3 million; number two, the strategy to change variable contracts pegged to revenues to fixed contracts. In comparison to first quarter last year, nine relevant contracts suffered this alteration, which means an increase of R\$2.8 million. In the medium and long terms, we believe these changes will bring significant margin gains, as we have been working hard to improve campus occupation through distance learning growth, new programs such as Pronatec, and more efficient academic planning;

Number three, Adjustment for period inflation as stipulated in contracts, for an amount of R\$4.0 million. And four, the rental contracts which are pegged to revenues, that end up growing at a pace similar to the 30% growth shown in the net revenue line.

On the same slide, you can see the selling expenses represent 9% of net revenue generating a margin gain of 1.4 percentage points due to the 0.8 percentage points improvement in PDA line, reflecting the organic improvement in this line which also was positively impacted from the student base clean-up in the fourth quarter 2013, and the 0.6 percentage points improvement in the market line.

Still the vertical analysis of operating costs and expenses, you can see that our G&A corresponded 12% of net revenue, 0.6 percentage points improvement over the same period last year, thanks to the gains of 0.2 percentage points in personnel and 0.3 percentage points in third-party services, reflecting the gains of scale in these lines. As we have been mentioning since second quarter 2013. It's worth noting that the personal line has been impacted by the increase in the head count correspondently investment in new areas that will generate significant revenue for the company such as continued education department. So, that this item, maybe more comparable in the next cycles. Besides we move further in the process of linearising bonus provisioning in this account. Nevertheless we still managed to record efficiency gains.

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Moving now to slide five, here you can see EBITDA came to R\$129.4 million in first quarter 2014. So, the special 48.6% more than the first quarter last year. Due to margin gains from both costs, SG&A expense, we are continue to grow our EBITDA and generate a gradual and constant pace, thanks to gains in scale from the expansion of the student base, to our management model, and to our focus on the long term. Net income total R\$125.8 million, 88.9% growth with a margin of 23.4%, a 7.3 percentage points of margin improvement.

Now, let's go to slide six, where we represent our accounts receivable the number of receivable base to aging agreements, including FIES receivable and FIES net revenues averaged 84 days more or less than in the first quarter 2013. Excluding FIES net revenue and receivables the other receivables period was 88 days, four days more than in the last year.

It's worth noting that by the end of March, we still have around 20,000 students in the process of contracting FIES. Moving on to slide seven, here you can see that in first quarter 2014, FIES accounts receivable increased by R\$68.3 million over the previous quarter to R\$147.2 million and that's a result of the concentration of financing costs amendments at the beginning of the semester, as well as the expansion of the FIES student base.

FIES carry forward quietly increased by R\$19.2 million to R\$63.6 million due to a further delay in the buyback auction in March which normalized at the beginning of April. Adjusting for this delay the average FIES days receivable for 78 days, 11 days less than first quarter 2013.

It's worth remembering that in January, we received R\$44 million related to the delay in the buyback auction in December. Besides the regular amount of them all.

Slide number eight, shows the aging of our receivables and agreements, which remain health in the first quarter 2014. Thanks to the continuation of our rigorous debt renegotiation policies, in this quarter only 8% of total receivables came from renegotiations with students. In addition, the percentage of receivables from renegotiations overdue by more than 60 days accounted for 28% of total agreements, or 1.6% of total accounts receivable.

Finally, slide number nine show our quarterly cash flow. This quarter, we changed our reporting methodology, so the tables shown can be better compared to the quarterly financial information. This table is already adjusted by the delays in the FIES auctions, both in December R\$44.0 million and March, R\$63.1 million, as if they were accrued in the respective months.

In this quarter, we recorded a positive operational cash flow of R\$22.2 million, R\$13.5 million higher than in first quarter 2013. It's important to highlight that the negative variation in assets and liabilities is mainly due to the increase in Accounts Receivable, which is directly linked to the high number of students still contracting FIES by the end of March around 20,000.

Operational cash flow before CAPEX came to R\$58.6 million in first quarter 2014, R\$36.2 million higher than the same period last year. It's worth noting that R\$22.2 million cash generation after CapEx, a 155 involved[ph] first quarter 2013 has come into a level of CapEx 22 million over the same period, last year.

I will now hand you back to Melzi, for his final conclusions and remark. Thank you.

Rogério Melzi {BIO 16212298 <GO>}

All right, thank you. Virgilio. On slide number 10, I'd like to comment a bit on our growth strategy, there is no doubt that the educational sectors going through a very good moment for business standpoint, unlike many sectors that seem to swing against the growth, our segment has been profiting from a series of (inaudible) that help the group companies which today are more exposed to the financial markets to reach great results.

In our P&L, however it is really important that each company establishing clear strategy to take advantage of this moment, not only to generate good results in the short and middle terms, but also to prepare for the future in a scenario where they will be there always be uncertainties. After all, it is easier to prepare for the future doing prosperous (inaudible) than having to do so under the pressure of an eventually not so positive scenario.

Here in this past year we have been doing that with a lot of discipline. And I think it is atmost importance to experience strategy and its implications to our investors, shareholders and all the stakeholders, so that everyone may have the right expectations with respect to our operations, so as to be able to do this scholarship for all the players and their own strategies. One of the most efficient ways to illustrate the strategy is to use cases of companies. There are reference to us, case[ph] that served as inspiration to our operations, in parallel we may also mentioned (inaudible) through the work managed to securely translates into words and expressions the strategy used by this great companies.

In this contest, few examples of why Estacio as kept at three as the book Great by Choice by Jim Collins and Morten T. Hansen, they discussed the 20-mile March. According to the authors, companies as big as Microsoft or Southwest Airlines obtained success for several decades because they among other things, had a discipline to grow with these certain ranges in a broaden way not using to the temptation of accelerating too fast when the wind was blowing in the right direction, but also FIES as we are growing during the bad times while never losing focus on their beliefs.

While you look at the slide number 10, I think that we see something similar, although of course in a different stage, analyzing FIES evolution between 2008 and 2013 we verified that the growth rates, within a certain range and we can identify a certain pattern, a kind of consistence throughout the years.

We can see a company that manages to growth during the hardest period of its history, when there were no positive (inaudible), expand on the contrary, there were pressures and expectations from every side.

But you can also see that when the period of (inaudible) ended and we began to face more favorable wins, there were no other groups change leading to a sustainable expansion pace which is very aligned to Collins and Hansen's theory.

On slide number 11, we illustrate the way we think about the group for our institution. The basic idea is that we want to make the most of the good times, we are facing right now because we also like to grow in the short term. At the same time, however, we want to use this moment to prepare our company for the medium term and in parallel to also plant some seeds for the long run.

For this reason the focus of our team is to get the best possible results in 2014 with our averaging the operational standards we constantly see to improve. In this contest, the excellent intake and good renewals rates that we saw in the first quarter do open many doors for us to generate another series of spectacular results.

We believe that as in previous years, the expansion of service in the first quarter may be a good proxy for the rest of the year although at this time we still have some upside with that may help us to sustainably accelerate this within. For example, we know that Pronatec and there assisted transfer process barely contributed for the results this quarter, we still have net income for year-end[ph], but we believes that after the conclusion of the guidance rolling and the subsequent appreciation in our shareholders meeting, we will be able to show more clearly all the opportunities we have with the expansion of this first(inaudible) operation. And with that, how we will be able to seek for even better returns to our shareholders.

We continue to (inaudible) expansion area, which is not only responsible for getting authorization for new courses in our campuses (Technical Difficulty) we have more in size in the near opportunities in the pipeline and the keep working to establishes a relevant player in all the segments, such as revenue products, short term courses, prep courses procedures and segments and Corporate Solutions. That said, there is a whole range of possibility reach if materialize, can help us get even better results in 2014.

At the same time that you take care of 2014 with a lot of energy, we have several teams dedicated to prepare stands for the medium term, because we believe that in the coming years it will become increasingly important to differentiate Estacio from its peers. We think the differentiation will come basically from new technologies and innovation applies to our academic model.

High level of service offered choice to this relationship with (inaudible) society's perception to our brands, alignment with the job market and the student employability with that said, we have ahead of top note teams taking care of each of these topics for almost three years.

In other words, we are using this good period to prepare the stocks of the future. While reaping the benefits of positive (inaudible). Finally, we also think about the long run because that if we want to keep growing like we have been doing and at the same time generating satisfactory returns we can never get soft or accommodates with our success.

For this reason, we are always aware of new opportunities several areas that are correlated to our core business by the same time we open new horizons in the way we like, safely gradually and responsibly.

After all of this call is as I say, it's major we are responsible for improving our performance and not to blame on the circumstances much less on the environment. That brings us to the end of our presentation. So, now let's go straight to the Q&A session. Thank you very much.

Questions And Answers

Operator

Thank you, ladies and gentlemen we will now begin the Q&A session. (Operator Instructions). And our first question comes from -- Lazard Asset Management. Please go ahead.

Q - Unidentified Participant

Hi, thanks for taking the question. If I can just ask two questions, one is related to -- on the government programs that are in place and we obviously at the moment, the government is very supported the space to all the players in the sector. But just kind of want to understand what the company's backup plan would be in event, just reverse itself at some point down the line?

A - Rogerio Melzi {BIO 16212298 <GO>}

Hi, Anala[ph], great question, this is Melzi speaking like so far so good. I think the government has been walking the top pretty much. I go to Brazil, very often I speak to a lot of members from the governments and I think, I believe that they finally have put education in high level of, as a high level of priority to Brazil. So why now, even though you are going through election this year as you know, right now there is no sign whatsoever that there will be any change in the two most important problems we have the PROUNI is older one for scholarships for students and FIES the new one, which is a lower. It's been around for maybe two or three years the new version of -- so far there is no sign whatsoever that there will be any change.

But having said that, here I discuss we all think the entire time long term, that's the way we've behave here, so I don't know if you are familiar with our strategy for Estacio example but only I mean there's not a lot of strategy for PROUNI, PROUNI is a lot you have to respect a lot, there is a certain perception of students we need to have going forward.

But FIES, as there is kind of option here, it may be more or less enthusiastic about FIES so, here it is faster. I believe we adopted a kind of farm is move adoption curves that FIES the students had at that start we are reaching 33% or 30% of our on-campus student base, well now it's less quite that which is I think, I believe much less than our peers already has. So, how we deal with, in this scenario with the event of change in the future even though

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there is no, again let me reinforce that even though there is no sign of a chance, maybe there is a change in our government because of elections.

I believe this problems are so important to our contrary in terms of improving our education but I can't see, I can't foresee there is scope since we think long-term, we need to be ready for this kind of uncertain future. So, when you think of PROUNI for example, we have our team here Virgilio as a CFO, we think a lot of opportunities to offset whatever losses we may have because PROUNI gives us a tax shield for net income taxes. So if we (inaudible) Pronatec as part of the project, we have our team here, working a lot of potential tools to offset that simply by doing that if you (inaudible) something that we so far we haven't needed to improve because we pay very little income taxes.

So, there are some opportunities on the table if we need to do so, even though, again we do not expect any major change when it comes to PROUNI. As far FIES besides being very careful in terms of about to FIES to our students, we keep thinking here about eventually a cash for sales, if we reach a certain percentage of students about FIES, we may try to slowdown a little bit, I say we made because it is possible, we keep studying and obviously, if we get safer about the duration of this problem, especially if there is a change in our government and the problem keeps growing.

I think we can relax a little bit more. So, we tried to control that, we try to use FIES, in a more responsible way. But from a strategy standpoint, it was not an accident that it starts to -- the fact that thinking more carefully about new business lines two years ago, we are trying to diversify, a little bit to try to speed from this dependency we have in problems that are regulated by nature, because the newer certification has a lot of power when it comes to Estacio authorizations to open campuses to offer (inaudible) but also because the payments of FIES is likely to increase over the coming year.

So, we now have our distance learning operation, which by the way, students are not allowed to take FIES at least until now, so it is kind of a natural hedge to us when it comes to FIES but we are also investing a lot of time in that here to launch these new platforms for example, like the corporate training or the great problems which had, much less regulated or no regulated at all if you compare to our core business. So, this is a way to mitigate this eventual risk but again let me finalize this answer by saying that so far there is no sign whatsoever of any major change when it comes to this problem. Okay.

Q - Unidentified Participant

Okay. And then If I can ask answer another question on from the macro fund on to the company as well as the competitor are pretty sensitivity to it will change unemployment range. So again, so far so good here but if you can just kind of run me through. What kind of system are in place (inaudible) happening. What kind of company is in this scenario?

A - Rogerio Melzi {BIO 16212298 <GO>}

Well, I think there is change and we are going to come back to peers I think there is a (Technical Difficulty) change in the landscape that are puts a big question mark in this question, because two or three years ago, when we don't have an alternative like sales

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they prove is that the correlation between the level of unemployment and our demand was very high. I would say may be closed to one because in our case starts when I think our peers, most famous peers as well as in this case.

I think 75% to 80% of our students attend their (inaudible) out of their own pockets, meaning they work and over-day and then they started overnight and they pay from their pockets. So obviously this -- the work an in spite in unemployment, we would have a lot of trouble to keep our growth rate. However, there is a change in the scenario, which is the launching of the new FIES, because as the student are taking this FIES now, and they have no need to pay the principle during their program.

I think that at least this would partially offsets whatever problems could arise from an unemployment rate in spite not to say that eventually could actually offset or even be positive because if there were an in spite again the unemployment Brazil chances could be there, as student would like to take this time will be working anyway to finance the studies and to get ready for better times when the academy ramps up again.

So it's the early to say because we haven't gone through any kind of crisis in terms of unemployment, since FIES was launched, but I think we would see kind of an insurance happening because of FIES -- since FIES is uncertain obviously, we need to think about all the ways to mitigate this and it probably is here is (inaudible) we launch a complaint last year we bought an insurance to at this disturbance is day prove their jobs for one semester.

So, they have time to try to find another job without having to give up their studies with us, this is the tool that we are using here to attract students to show them come to us, with us so much in their capacity to find another job, and even if they lose their job they're going to be happy to study with us.

So, we giving science to our students, about how much we believe in them, but obviously unemployment doubles in the medium term for whatever reason if FIES doesn't work in the way, I'm telling you eventually that could be damage to us, nobody's (inaudible) from this risk.

Q - Unidentified Participant

Okay, great thank you.

A - Rogerio Melzi {BIO 16212298 <GO>}

Thank you.

Operator

(Operator Instructions). Since there seems to be no further questions at this time. I would like to turn the floor over to Mr. Rogerio Melzi for his final remarks. Go ahead, sir.

A - Rogerio Melzi {BIO 16212298 <GO>}

So well, let me thank you all for joining us today, there are lot of problems on calls happening right now. (inaudible), we are still living great time. But keep working hard to prepare our company for the future, so that we should be able to keep delivering great returns to you as time goes by and to have good call as we had today. Our investor relation team is always available to you, and Flavia, Virgilio, and myself. So, I hope to see you all very soon and thank you again. Have a great day.

Operator

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

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