

Q3 2018 Earnings Call

Company Participants

- Gustavo Artur Ciocca Zeno, Chief Financial Officer & Investor Relations Officer Vice-President
- Pedro Thompson Landeira de Oliveira, Chief Executive Officer
- Rogério Tostes, Director of Investor Relations

Other Participants

- Marcelo Santos, Analyst
- Maria Tereza Azevedo, Analyst
- Rodrigo Gastim, Analyst

MANAGEMENT DISCUSSION SECTION

Rogério Tostes

Welcome to the teleconference of Estácio Participações for discussing the results referring to the Third Quarter of 2018. My name is Rogério Tostes and I'm the Director of Investor Relations. Here with me, the CEO of the company, Pedro Thompson and the CFO, Gustavo Zeno.

Following the opinions and suggestions of interaction with analysts and making market benchmarking for better practices, we decided to reformulate all the promotion material with the aim of making our communication more efficient. We've launched the new Investor Relations website, www.estacio.br/ri, where the audio and the slides of the presentation are being broadcast simultaneously.

I'd like to thank the Investor Relations team for their contribution and commitment in this stage. Before giving the words to our CEO, I inform that the teleconference is being translated simultaneously to English regarding best governance and avoiding asymmetry of information between our stakeholders.

All participants will only be hearing via the conference during the presentation. And afterwards, we will start our Q&A session, when more instructions will be provided.

This conference may contain predictions about future events that are subject to risks and uncertainties that can make that can - and the expectations may not be fulfilled or they can become totally different. These predictions convey their opinion uniquely on the date they are made and the company is not obliged to update them in the light of new information.

Now Pedro Thompson will speak. Please you have the floor.

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

Welcome, everybody. This is Pedro Thompson. Well, I'd like to highlight (00:01:51) and thank the whole Investor Relations team for this new stage. Well, the first slide, what are the highlights of this quarter.

Our total student base has been stable when compared to the third quarter of 2017 with 531,000 students. I'd like to highlight the segment grew in e-learning with the growth of 90% in the last 12 months compensated the performance of classroom-based courses. I'm sure that Estácio has the best e-learning system in the country when it comes to satisfaction, product and performance and we believe in its growth today about 40% of our student base is in the segment.

My second highlight is the performance of profitability of the base, which has been our focus especially in moments of challenging scenarios, be it by the macro or competitors. We've attained solid growth of average ticket price, be it in classroom-based courses with 13% year-on-year or e-learning with a growth of 80% when compared to the same period in 2017.

In this period, we launched and approximately added new courses between classroom-based courses and e-learning and Flex courses. We've also strengthened substantially our e-learning with geographic expansion, new polls, new courses and offers. And these actions not only with classroom-based courses but also with e-learning allowed a strong performance in the financial results as we can see in the lower hand-side of the slide, where we can see continuous growth in all solid drivers, be it EBITDA margin, cash generation, net profit or revenue. And we also announced the extraordinary distribution of dividends totaling BRL 400 million.

Next slide now on page number 4, we can see future scenario and attraction of students in the second semester because of lower economic activity because of the slowdown of governmental program of financing scholarships and also a competitive scenario. When it comes to competition, we see pressure on prices, discount augmentation, and also the number of scholarships. And these actions they focus a lot on the bulk and they relinquish fundamental issues that we think are important for the sustainability of the business in this context.

Estácio has adopted a different posture looking obviously at the bulk issue with technical actions for capturing new students and with a bigger focus on this craft, and we avoided disruption in prices. We focus on the present value per students and the healthy expansion of the segment of e-learning and also the augmentation of offers for courses especially engineering and health care. We're also prioritizing new campuses in medicine. Estácio opened four already (00:04:44) in the last year. With this approach, we hope we got good results, important results such as stability of our student base, finishing the quarter with 531,000 students just like the same period in 2017.

Excluding the governmental scholarship financing program, the total base has grown 7%. Distance-learning segment, for example, FIES we also have the growth of segment of e-learning in target courses at 19% and also the average ticket price growth, and also the indicators related to maintenance and renovation of student base. So we were able to promote improved (00:05:22) and outline of results for supplement revenue, net profit and generation of cash.

Next slide, number 5 now. There are some highlights here when it comes to operational improvements. First, average occupancy, we had improvements not only in classroom-based courses but also in e-learning. This improvement happened because of some market inspections. For classroom-based courses, there is an increase in the number of subjects, better sharing of subjects among courses, and a new career for professors.

We also have an e-learning, perfecting of tools of methodology and interaction between professors and students, and also improvement into the care of students per tutor without affecting the satisfaction of the students. The number of campuses is now one unit below when compared to the same period in the last year because of optimization because of the merging of seven campuses in the last 12 months. And this movement towards their efficiency was compensated by three new campuses of Medicine besides the other - three other new Greenfields.

When it comes to e-learning, we have a strong expansion in a number of polls through partnerships. Besides the 268 ones that are active in the last year, more than 70 were in the phase of activation at the end of the quarter. And I'd like to highlight the performance of the staff cost per base of students with the reduction of 12% when compared to the third quarter of 2017.

Now, the issue of quality into slide 6. And according to the National Institute for Educational Studies, there have been considerable improvements and difference indicator between observed and expected performances in tests like ENEM and ENADE, and that means before entering and after leaving college. We had a 12% improvement in the year 2014.

And I'd like to highlight the e-learning segment with an index of 95% of satisfactory grades. Talking about the National (00:07:25) analogy, it got a prominent position. It held its position. 50% of our courses that were evaluated had a very satisfactory grade, which was a great performance not only from institution but also from our students when it comes to the university rankings of Folha de São Paulo Newspaper. Estácio was ranked among the best private universities in Brazil and no other institution of higher education in Brazil can combine scale and quality and the standards offered by this university.

Now, a few more details when it comes to slide number 7. We had in these 12 months an accelerated expansion and we keep a very strong pace. The number of active polls compared to the last quarter of 2017 more than doubled. Now, we have 506 active polls. That's a growth of 113%. This expansion has been possible, thanks to our partners.

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We also launched the program of Partner Management that means it comes from guidance and also monitoring of the poll and also the aggregation of best practices and award giving to partners with highlighted performance. We also launched 15 new courses of e-learning and direct courses, Flex e-learning and also e-learning that totalized 47 courses and 3,423 offers that included 401 municipalities. That means 149 new cities and we mapped out more than 1,500 municipalizes with potential for e-learning, especially in cities with 500,000 inhabitants.

I'd like also to talk about our efficiency programs that bring a complete change to our company. In slide number 8, we highlighted with bigger detail the characteristics of the projects and financial impacts especially in costs and expenses. When it comes to revenue group, the pricing and fidelity projects are in its initial stage. We've already worked initially with project pricing and (00:09:27) enrollments. Full implementation will happen in the first semester of 2019.

Talking about revenue, the fidelity project is already running and we've already started the value capture phase. When it comes to costs and expenses, we went a step forward. When it comes to explaining the potential benefits, the strategic sourcing and credit and collection projects having already initialized, for the first one we've seen again 21 categories of spending of the company. And this has also been a more advanced stage. So we have to capture more than BRL 50 million at the end of the project. There is a second project which is credit and collection with a focus in increasing recovery of credits and improving the collection departments. We are in the initial stage with a 5% of the total estimated when it comes to BRL 60 million.

Now, let me pass the word or the floor to Gustavo Zeno, our CFO.

Gustavo Artur Ciocca Zeno {BIO 19036323 <GO>}

Thank you, Pedro. Thank you, everybody. On my first slide on page 9, I'd like to show (00:10:28) the improvement of our revenues. As Pedro mentioned, we have a more cautious posture when it comes to pricing. We are using other leverages such as retention, new courses, campuses and polls and the very good results in evolution of our revenue. We had a 6% growth and we also showed very continuous improvement from quarter to quarter.

We also had very good results when it comes to cost contention and also restructuration project of staff. The line has shown a drop of 12% and it represents 29.7% of our net revenue, which compares with a 35.7% in the third quarter of 2017. As a result, the gross profit has grown 20% in year-on-year comparison, and it reached BRL 487 million. And the gross margin reached a level of 57% which is a great lead over the margin of 50% in the third quarter of 2017.

Now slide number 10, expenses and EBITDA expenses. We had an augmentation of 21% of trading expenses in a year-on-year comparison, especially because of the increment of better provision and this happened because of the changing of criterion for the bad debt provision calculation as it was decided in the beginning of the year. And new product

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(00:11:52) offered by the company. The PAR (00:11:58), the installed payment for example is done on payment with more than 3,300 students which is a lot more than in 2017, and the DIS which has been offered in the attraction of students in the first cycle of 2018. Besides the provision on long-term balance, Estacio complements a provision for 100% of the value of the outstanding balance of when, for example, there is no agreement with the student (00:12:24) payment. This criterion value is a better conservative when it comes to non-recovery of credit and delay. And it reached 6.9% in this quarter and 8%.

On the upper right-hand side of the slide, I can show you from some (00:12:39) up the maintenance of administrative expenses we totalized BRL 138 million and it dropped which is important of revenue from 17% in the first quarter of 2017 for 16.2% in the third quarter of 2018.

One of the culprits that we are having this year are the extraordinary expenses of consultancies referring to efficiency projects that were mentioned in the previous slide by Pedro. As a result of revenue improvement in fourth - the strong control on cost and expenses, EBITDA have expanded 23% year-on-year towards BRL 275 million. And when we adjust them to extraordinary services and non-recurring services of consultancy, the adjusted EBITDA shows a growth of 26%, reaching BRL 283 million.

And when we look at the EBITDA margin, we keep a very strong improvement, reaching 32.2% that is the reported one and 33.2% when it's adjusted. The adjusted percentage is compared with the level of 27.8% in the third quarter of 2017.

Now, my last slide on page number 11, I'd like to highlight the solid position of cash in the company. We finished the third quarter with BRL 771 million in cash, and an EBITDA indicator of 0.3, and the operational cash flow reaching BRL 204 million, which is superior to the BRL 193 million of 2017, which is a growth of 6% year-on-year.

When I talk about the governance scholarship financing program, we had an additional of BRL 342 million in the cash flow totalling BRL 546 million in the third quarter, 52% of growth when you compare to the period of 2017. The EBITDA conversion indicator reached the mark of 63% in nine months in 2018 and 97% in the third quarter 2018, which is actually on (00:14:47). Our cash was especially applied in the program of share buyback, dividends and also CapEx. There are other options for cash usage, for example, reinforcement of the programs of scholarship financing and also mergers and acquisitions.

Now, I'll give the floor again to our CEO for the final considerations. Pedro, please?

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

Thank you, Zeno. This is Pedro Thompson. In slide number 12, as the synthesis of the results - prospectus for our business, I'd like to highlight four fronts; first, in the operation, the efficiency project, the focus on the present value per student, new courses, the work on retention, and the loyalty of the students, and also the expansion of courses of medicine. And the second one, talking about the e-learning segment and its rapid expansion, we already have 70 higher polls for the fourth quarter, 38 new courses for 2019

and a potential to reach - I think we've been cut. There was an interruption in the transmission.

And as a last front, we are going to use this cash flow in a very - we're disciplined and we're going to allocate this money on buyback on the guidance, financing program for students. And also we're going to keep on monitoring options for M&A.

As subsequent event of the results of the third quarter, we'd like to announce the Board of Directors approved the proposal for distribution of dividends at the value of BRL 400 million, BRL 1.33 per share and they are going to be negotiated (00:16:41) in November and the last installment will be paid on December 21, 2018. This extraordinary distribution along with distribution at the beginning of the year and the program of executed shares and buyback are the evidences - are the proof of our focus on the generation of value for our shareholders.

Rogério Tostes

Well, thank you, Pedro and Gustavo. Now let's go now to the Q&A session. Operator, please.

Q&A

Operator

Ladies and gentlemen, we are going to start our Q&A session. Our first question comes from Mr. Rodrigo from BTG Pactual

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Good morning, everybody. I have a doubt when it comes to the dynamics of attraction of student, this is something surprising over the first quarter. I think the strategy is very clear, which is something different from what the marketing is doing because they're focusing more on prices. When it comes to (00:18:09) dynamics as operational leveraging is very important and sometimes we have a very negative effect when it comes to the front. And this pressures the margin.

The doubt that I have is do you take into consideration any possible change in the strategy? I think on the macro, first, how macro can help when there is, for example, very strong competition in some sectors? (00:18:38) prices to make up with volume. I'd like to try to understand because this strategy is very clear to me when it comes to improving prices. But this base pressure becomes more important to me. So, the objective is to find this optimal line. And so, I would like to see what - I'd like to know what's your take is when, for example, when this attraction of student has a drop? So, maybe we can focus on volume and less on price. So, this is my doubt.

A - Rogério Tostes

Thank you for the question. Pedro Thompson is answering to you.

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

When it comes to strategy of P versus Q, using reference to the benchmarking of the status, which was a strategy change that we had. Especially what I have been attracted recently when it comes to the figures that have been disclosed in the last eight quarters despite the decrease of the volume of attraction and based on how this converse with our indicators be the PTT (00:19:52), net profit and margins and also cash generation. I think this strategy has demonstrated that this is a correct strategy because it has a direct impact and the indicators of margins showed very good improvements in this last quarter with this change of strategy.

But on the other side, the perplexity is our volume of students because it's not exactly in alignment with what we have as a goal when it comes to ticket value for example. We've already started some improvements in terms of the strategies, new commercial planning which is very granular and new policy of pricing, not if we're going to change for example the ticket value of policy, but we're going to give more agility to pricing when it comes to decision-making and benchmarking. But in the general plan, in the background, the strategy is correct. But obviously we have to focus on volume and we are working hard towards this. And I think we are on the right path and I think that our focus is also correct when it comes to ticket and also volume.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Thank you, Pedro. Let me see if I can understand what you're talking about attracting new students. Can you explain a little better how the dynamic was for the sector that's divided between Northeast, North? So, where in Brazil is it harder to attract new student and have you been losing volume for example because of prices? Well, I think it's too early to look at 2019 because we're in November, but what do you feel about the next year when it comes to macro dynamic? When it comes to demand for potential students, do you think that there can be a positive cycle? Is it the initial idea that you have based on what you have been able to attract so far?

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

Perfect. First of all, when it comes to sectors we categorize them between classroom classes and the e-learning, but the more difficult ones were in North and Northeast, especially because of prices. Not only because of prices, because of power fees down to waivers, perennial scholarships, and we have already anticipated the attraction of new students and we have a stock of students. So, it's too early to talk about it because we're still organizing, we're still in this initial phase of attracting students that are already enrolled for taking the preparation exams, admission exams. But what we have for 2019, for the first quarter of 2019 in this initial stage, especially in these sectors, we're already satisfied with the work that is being developed. I think we are in the right path, and there will be some improvements in our commercial process, we've already done some of them. Our market dynamics is much more granular now. We've already improved our sales force. The call to action when it comes to pricing has been improved too. The processes have been improved. And it's based on new management methodologies. We are just following new trends of methodologies, and we have a team that looks at pricing 24 hours, and they make decisions in a correct manner with empirical data. So I think that for 2019, the strategy that we - I think it will be kept but we're working on the student

base because we want to reverse this trend that we've had in these five or eight last quarters.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Thank you, Pedro. That was clear to me.

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

Thank you.

Operator

Our next question comes from Marcelo Santos.

Q - Marcelo Santos {BIO 20444938 <GO>}

Well, just piggybacking on what he said, how the changes in the commercial process happened in the last year? What were the main changes in your management? And what timing did you implement? Is there a qualification missing on the edge? This would be my first question. And the second question is when it comes to the ticket dynamics, I think it's positive. How do you divide, for example, between veteran and newcomers? How much increase do you offer to the veterans?

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

Thank you, Marcelo, for the question. This is Pedro. So, revising what (00:25:08) when it comes to commercial processes, we implemented the sales funds. We reached the last stage of the student. We consider the student as a student. So with the invoice that is - when he pays the invoice, we see that he is able to stay with us. It is the first improvement. And with the internal benchmarking, we were able to see some more aggressive issues, for example, related to waiverings and scholarships that lasted in whole cycle of the student which was the attractor of value that reduce value, and I believe the evolution of our revenue year-on-year in the last two years was something perceptible and it was something positive.

And what we are doing now is, first, this call to action that refers to prices and specific campaigns, so we are operating in a granular level and we highlighted this to you, because it's a structuring processes that will be in power in the beginning of 2019, not only when it comes to counting with intelligence and monitoring, and we get - also has a few, so we can take better decisions that are assertive. And there is a second point we're going to operate more aggressive when it comes to our commercial team, because we were too regionalized. Now we have a commercial team which is very granular. And when it comes to the last point, when it comes to the ticket dynamic, this is a normal flex. We check what we had in terms of inflation in our operation and the inflation is regionalized based on geography. And this inflation is forwarded to our veteran students. And the increase was very different when it comes to the veterans and the newcomers. While we don't - actually, we don't disclose this information. But in general, the increase comes from the veteran student.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you.

Operator

Our next question comes from Maria Tereza Azevedo from Banco UBS.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Thank you for the question. You talked about attracting students. How do you see the issue of default on payment and what strategy have you adopted to break the cycle in the long-term?

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

We've been talking gains and efficiency as we commented on the call. There are expected gains for 2019, which are results from projects which were carried out during this year. There is a captured curve that is expected for 2019. And after 2019, we will be very close to a new grade when it comes to the project that has been implemented. In this case, we created some new categories in the company. For example, digitalization (00:29:27). This is also on our discussion. This is a topic of discussion. We don't have any concrete initiative that is aimed at digitalization. We're studying this possibility and I think it's going to bring some benefits. This is part of our work plan. There are some additional deficiencies that are expected too. When it comes to retention, the company invested time and resources in a project we called the Fidelity project, which is made up of each initiatives and they are already running.

We had good news when it comes to the retention rate of our base as we showed in our release. And when I talk about classroom classes, we have 75% of retention. We had good news when it comes to the DIS retention. And also the EBITDA, we've had a retention of 75%.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

And the deviation, just to make it clear, is that a deviation as is in your product?

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

It's a crop (00:30:54). So, the period when we lose more students is between the first and second period. And when you talk about the crop (00:31:03) when you compare students from the first to the second period, there is a symmetry. We didn't stop renovating. We didn't stop reenrolling. This 85% is not - it cannot be compared with the 72% because this 85% of classroom classes includes the whole system.

And the DIS just includes the renovation of the first and second period. And if we compare these renovations, it is a symmetric between DIS students and non-DIS students.

And when it comes to collection, the PTT is very important. We checked our collection overseas, we customized our profiles. And I think this is going to generate concrete

results. And I think we're going to capture these new gains in the beginning in the third and fourth quarter, but the benefits will come in 2019.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Thank you. And there is a second question, about the allocation of capital. You had a cash generation that was very solid and the dividend. How do you see the best use of cash from now on? Do you see any possibility of a takeover? Or going, for example, to recommend the distribution to shareholders. What do you see is the priority?

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

Thank you, Tereza for the last question. We are in a position of cash, which is very substantial. We have net cash and not net debt. This is the origin of our dividends. When it comes to future usage, we are thinking about expansion. We are very cautious about organic expansion.

In fact our hub for a new camp - for the implementation of new campus makes us be very cautious. And I think that we are on the right path based on what the company has shown us. And our campuses of medicine and they bring very good return when compared to other campuses, traditional campuses. I think it's too early to talk about results. When it comes to the expansion of the business and organic, like I think were completely inserted in this agenda.

And when we talk about the sources the company has a perspective of being an excellent cash generator. And we can even get an additional leveraging. So we have many advantages when it comes to using this future capital for organic growth and non-organic growth and also for new processes of buyback and dividends.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Thank you, folks.

Operator

Our next question comes from Marcelo Santos.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you for taking my second question. I want to talk about the intake. What are the improvements that you have made when it comes to processes? What are your prospectus for 2019, when it comes to planning, how much do you plan to spend on marketing? Is it reasonable to imagine that with so many drops, do you think there is going to be, for example, a stability, a new rhythm? Do you think there is going to be something close to stability? Is it to be expected in the next year?

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

Thank you for your question Marcelo. Pedro Thompson is speaking now. This is subjective. This is the focus number one of the company. And I believe that a good demonstration

would be our retention rate. And in fact, this is our number one priority. This issue of attracting new students and breaking this trend of losing new potential students.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you.

Operator

We are finishing now our Q&A session. I'd like to give the floor to Pedro Thompson for the final consideration. You have the floor.

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

I'd like to thank everybody for the participation and also result call. So I hope to see you again in our next result disclosure for the next quarter. So this teleconference is finished. I would like to thank you for your participation.

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