Y 2017 Earnings Call

Company Participants

- Flavia Oliveira, Head of IR
- Leonardo Moretzsohn de Andrade, Chief Financial Officer
- Pedro Thompson Landeira de Oliveira, Chief Executive Officer

Presentation

Operator

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

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

This conference call may contain forward-looking statements that are subject to risks and uncertainties that could cause the company's actual results to differ materially from those in the forward-looking statements. Such statements speak only as of the date they are made and the company is under no obligation to update them in light of new information.

I will now turn the conference over to Mr. Pedro Thompson, the company's CEO. Please Mr. Thompson, you may proceed.

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

Thank you. Good morning, everyone. Welcome to our conference call to discuss the results for the fourth quarter and the year of 2017. Leonardo Moretzsohn, our CFO; and Flavia, our Head of IR are here with me. Just to remind you all, there will be a Q&A session as soon as the presentation is over.

Beginning with the slide two of our presentation, available on our IR website. I would like to make a short review of what 2017 was for Estacio. Since 2016 when significant changes took place in the company's management, Estacio has undergone a restructuring process, the results of which had already been observed during this last exercise. Until the CADE judgment on the merger with Kroton, we focused on -- our efforts on redesigning the funding strategy through less initiatives but with short and medium term results. Such actions can be organized into four major workfronts -- into four major workfronts.

The first of these was the new intake structure, which we started to operate in the first semester of 2017 capture [ph]. With it, we now have more healthy student base with an average ticket increased, improved retention rates. This strategy was also instrumental in overcoming the effects of a reduction of the FIES student base, which fell by 20.4% in 2017. It is important to note that the non-FIES student base, however, increased by 3.9%, due to the factors, such as the change implemented in the commercial strategy, the allowance of PAR among others.

The second work front was optimization of processes in the management of faculty cost. With the goal of improving the efficiency of our operations without affecting the quality of service provided to the students, we implemented throughout 2017 several measures to improve faculty staff productivity.

These initiatives, which will be detailed by our CFO soon, have a lot -- have allowed us to increase by 4.5% in the average number of students per class in the on-campus segment and by a 124% in the distance-learning segment.

Another major transformation, which I consider very important was the distance-learning restructuring. With the new regulations implemented in 2017, we are now authorized to launch 350 new units annually. As a result, we structured the organic expansion of this business unit and ended 2017 with 394 active units, almost the double the amount we were operating at the end of 2016, which contributed to resumption of growth in our student base after good intake in improvement cycles in the renewed innovation indicators.

The last work front which I would like to highlight was the rationalization of marketing expense. We integrated from an institutional marketing model to a model that contemplates regionalize its campaigns, always focusing on a higher return of allocation of capital.

Continuing with our short review of 2017, as from July after CADE's [ph] unfavourable decision of the transaction with Kroton, we developed a plan with more disruptive actions aiming evolution even better in company profitability. This plan began to implemented by the end of the year and has three main work fronts.

The first front is the organizational restructuring, based on the implementation of a new FCP, faculty career plan, which in addition to providing productivity gains should improve motivational and technical aspects and also work climate of our faculty. The second front is the footprint review. As I spoke at the last Estacio Day in November of last year, we conducted an internal benchmark process in which we evaluated several variables to assess the performance of each unit. Accordingly, [ph] we were able to prepare individual actions -- action plans for the unprofitable units involving actions, such as the merging of units, the review of the portfolio of courses offered, pricing, among others. Therefore, we decided by the merger of activities in each of our units during 2018, five now at the beginning of the year and the other three at the second half. It is important to remember that the students of these units were transferred to nearby units. We remind you that in

2017, we had already closed activities on five campuses, and we did not have any disruption due to these movements.

Another great opportunity for efficiency gains, will be the reassessment of the academic model. Although, nationally integrated and with unique features, such as the nationalization of the curricula and the standardization of our own teaching resources, our educational model needed to be updated to increase productivity.

Therefore, we reviewed the curriculum matrix, which are now being implemented in 2018. Our goal is to increase the sharing of disciplines between courses and also to offer more hybrid disciplines. The result of this review also foresees a more efficient class formation process, such as a continuous improvement in our academic quality indicators.

Moving to slide three, we can see the chart of the results of our organizational climate survey, which we carry out every year with the help of a renowned external consultant. At this point, it is important to note that even through a very complex periods in our history, our indicators did not fall, we remained with 74% of favorability, which shows and reinforces how much Estacio's employees are engaged with the products being developed.

This was only possible because we seek to act with a great transparency towards our -- all our stakeholders and mainly towards our employees. Without them, we would not be able to achieve the results, we will show you here today.

I now give the floor to our Head of IR, Flavia Oliveira, who will comment on our operating results.

Flavia Oliveira {BIO 20130905 <GO>}

Thank you, Pedro. Good morning, everyone. I will begin by talking about our student base on slide number four. As we can see in the graph, our student base grew by 1.5% year-on-year, totaling 515,000 students, mostly fueled by the 17% increase in the distance-learning student base, thanks to initiatives including the performance-based clusterization of partner centers in order to better align incentives and results.

In addition, we closed 2017 with 394 distance-learning centers, an increase of 185 centers in relation to 2016.

The distance-learning growth offset the 4.8% decline in the on-campus in student base, which was under the effect of the 20% decrease in the FIES student base at the end of 2017, and the changes implemented in the intake strategy aiming at more sustainable student base. Excluding the effects from the decrease of the FIES student base, non-FIES student base would increase by 3.9%. It is worth noting that the objective of fostering a more sustainable student base, reducing discounts in scholarships and ensuring student financial commitment in order to conclude the enrollment process leading to an improvement 1.6 percentage points in the retention rate of our students.

Moving onto slide number five. I will now talk about our average ticket, which continued reflecting the current pricing strategy. The on-campus average tickets moved up 10% to BRL742, while the on-campus undergraduate average ticket climbed 10% to BRL770, thanks to the new pricing strategy adopted by Estacio in the first half of 2017 intake cycle, and as well as the discontinued of exemptions and the restructuring of scholarships and discounts, fully enhanced [ph] by the present value per student.

The on-campus graduate average ticket increased by 8% over the same period last year, amounting to BRL300. At the end of 2017, the distance learning average ticket moved up by 5.9% over 2016 to BRL224. And the distance-learning undergraduate segment average ticket increased by 2.4% to BRL230, and over 47.8% to BRL189 in the undergraduate segment compared with the same period last year.

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

Leonardo Moretzsohn de Andrade {BIO 15216920 <GO>}

Thank you, very much, Flavia. Good morning, everyone. I'll begin talking about some highlights in our financial performance for 2017 on the slide six. Our net revenue reached BRL3.4 billion in 2017, an increase of 6.1% and BRL194.5 million compared to the same period of 2016. With these results, our adjusted EBITDA in 2017, reached BRL943.9 million in margin of 27.9%, growth of 39.5% and 6.7 percentage points in relation to the previous year.

In order to present this result on an adjusted basis, we have excluded the effect of the organizational restructuring in the total amount of BRL117.1 million and the footprint revision in the amount of BRL18.4 million, chiefly -- mainly due to the provisioning of non-recurring costs and expansions arising from the closing of eight units which, will be merged into other units.

In addition, we decided to make one-off entries in the fourth quarter results of which highlights the following.

First, BRL26.8 million from the write-off of judicial deposits in the provision for contingencies line.

Second, BRL14 million due to the impairment of Nova Academia do Concurso, a company acquired in 2011, which focuses on preparatory courses for civil-service examination, but whose results recorded over the last few years along with the future prospects of this investment did not sustain the amount of goodwill recorded at the time of acquisition.

Third, BRL7.1 million, due to the review of the provision for receivables from the rental of business areas in some acquired companies. Fourth, BRL3.3 million, due to the write-off of tax credits, which have not been realized and are no guaranteed to be used.

Fifth, BRL6.4 million in the provision for doubtful accounts, of which, 3.4 million related to the provision of the receivable sales from previous years. And BRL3 million due to the provision related stock private financing program previously applied in acquired company.

And finally, BRL1.7 million due to an M&A expansion, which were in progress in 2017.

Moving to slide seven, we can see our net revenue in 2017. As we can see net revenue in 2017 came to BRL3.4 billion, 6.1% up compared to 2016, essentially due to a BRL631.1 million increase in revenue from monthly tuitions, and increase of 3.3% over 2016, due to a more sustainable student base, and increase of 10.6% and 5.9% in on-campus and distance-learning average tickets, respectively.

The BRL11.6 million reduction in Pronatec revenue, due to the graduation of the last students in this segment. BRL12.9 million reduction in other revenue, mainly due to the end of the Rio 2016 project in relation to volunteer training for Olympic Games.

The BRL374 million increase in discounts and scholarships corresponding to an increase of 3.7 percentage points in gross operating revenue in 2017 when compared to the previous year, as a result of our new pricing strategy for new students. In this strategy, the increase in discounts is more than offset by this BRL606 million increase in gross revenue. The BRL18.9 million upturn in taxes, in line with revenue growth remaining unchanged at 2.8% on gross revenue.

BRL 7.4 million increase in FGEDUC mainly due to the FIES rate, which increased by BRL11.4 million this year fees begun to be applied only as from third quarter of 2016.

It is also worth noting that in 2017, we launched Estacio's private financing program PAR, and approximately BRL11.4 million was registered under gross revenue deductions, due to the adjustment to present value of receivables from the program.

Jumping to slide eight, I will talk a little bit about operating growth. Our adjusted cash costs represented 46.2% of the net operating revenue at the end of 2017 versus 53.3% in the same period last year, representing 7.2 percentage point margin gain. This gain was mainly due to the increase of personnel line, and also contributed to this gain, the textbook material line, resulting from increase in the use of own books migration to digital format and better inventory management.

In relation to the personnel line, it is important to mention that as Pedro mentioned before, we are implementing a restructuring project to provide productivity gains and structural improvements. This project involves the dismissal of employees leading to a one-off impact of BRL115.3 million in the personnel costs in the fourth quarter of 2017.

Very important to remember that had affected one-off items 18.1 million due to the revision of the contingency base in the adjustments of benefit in the second quarter of 2016.

Excluding these effects on an adjust base, the personnel line would show an improvement of 6 percentage points accounting for 35.3% of the net operating revenue. This result is related to the universalization of 20% of our online courses in on-campus curriculum, alternative path, expansion offer of equivalent subjects, offer of probation classes, and also anticipation of the start time of night classes. These initiatives led to an increase of 4.5% in average number of students per class in the on-campus segment.

In the Distance Learning segment, we implemented these initiatives to improve faculty efficiency and responsive time to interactions with students, resulting in an increase of 124%, in the average of students per class in this segment without affecting the quality of the service provided.

The same initiatives we carried out for the distance learning disciplines also benefited the online disciplines available on the on-campus segment.

Moving to slide nine, we see our operating expenses. In 2017, adjusted selling expenses represented 12% of the net operating revenue, with a margin gain of 1.3 percentage points over the year of 2016.

To analyze the adjusted performance, we need to exclude the following non-recurring effects. First, receivables sale in 2016 in the amount of BRL47.1. Second, the PDA, Estacio's Installment Payment Program, PAR, which was released in 2017, first semster of 2017 totaling BRL30.8 and also the receivables on portfolio sales prior years in proper installments that exit on acquired total amount of BRL6.4 million.

In 2017, general and administrative expenses accounted for 13.5% of the net operating revenue up by 1.1 percentage points compared to 2016, due the impact of provision for contingencies line. Conversely, it should be noted that expansion with third-party service decreased by approximately BRL10 million, mainly due to the reduction in expenses, with consulting and data communication. In addition, expenses with institutional events were reduced by BRL14 million due to the end of the Rio 2016 project.

On the slide 10, we can see that net income for the year 2017 totaled BRL424.6 million, an increase of 15.3% when compared to the year of 2016, mainly due to the increase of 85.4 million to the EBITDA in this period. It is important to mention that the financial results we are reporting 2017 recorded an increase of 29.2% in relation to 2016 mainly to the following. First, FIES receivable adjustments revenue, which decreased BRL21.6 million, due to the reduction in the balance of FIES accounts receivable after the payment of the second installment of PN23, which we received by mid-2017.

Revenue from financial investment returns, which dropped by BRL14.4 million, mainly due to the lower interest rate (inaudible) on our financial asset is linked to the fluctuation of the CDI rate, and also due to the financial discounts, which increased by approximately BRL13.3 million, due to the campaign we conducted to recover credits from the 14 students, especially those students who stopped studying, because they were discontinued from the FIES program. And finally adjustments of contingencies, which increased by BRL10.4 million, referring to define the interest paid on borrowings. [ph]

On slide 11, we present our average receivables days. The average FIES receivable days the end of '17 showed a reduction of 45 days -- 44 days in relation to the same period of 2016 totaling 187 days. The average of non-FIES receivable days, on the other hand, increased by 3 days in relation to the previous year, mainly due to their own installments we begun to offer in the first semester of 2017.

In '17 -- 2017, Estacio's average receivable days totaled 190 days a reduction of 23 days compared to 2016.

We may focus on the process of improving our policies for campaign to collect and renegotiate students' debt.

Moving to slide 12. We show in the first table the information about our capitalization costs and cash. At the end of 2017, our cash and cash equivalents totaled BRL524.4 million. Conservatively invested in fixed income instruments pegged to the CDI rate in federal government bonds and certificates of deposit of first-tier national banks.

Our bank debt of BRL567.3 million basically corresponded to our debentures issues, on the loan from IFC, the issuance of promissory notes, subsidized financing from regional development agencies and banks, and the capitalization of equipment leasing expenses in compliance with the Law 11,638. The reduction of BRL455.2 million compared to the previous year was mainly due to the settlement of the third issuance of debentures in the total amount of BRL197 million in September last year and the payment of the first tranche of the promissory notes issue in the amount of BRL187 million in November 2017.

In addition, bank loans, commitments for payments related to acquisitions in the total amount of BRL87.1 million combined with the taxes payable in installments BRL14.6 million, determine Estacio's gross debt which totaled BRL669 million at the end of 2017.

As a result, the company's debt -- as a result the company's net debt reached BRL144.6 million at the end of the last year 0.6 times [ph] our adjusted EBITDA for the period.

It's important to highlight that our debt level and operating cash flow allowed the company to conduct its operational activities, honor its financial commitments, and implement new expansion and growth strategies, through the use of its own funds in the contracting of loans and financing for such proposals.

On this slide, we can also show the CapEx during this period. Last year 2017, we invested approximately BRL153.8 million, a reduction of 17.7% over the same period in 2016.

Now moving to slide 13, I'd like to talk about what I consider to be the great highlights for our results this year. In addition -- in 2017, our adjusted operating cash flow was positive by BRL913.8 million, a significant increase of 213%, which correspond to an increase of BRL621.8 million when compared to the same period of 2016, in addition to the increase in operating income, the increase of 328.3 million in revenues non-FIES, also contributed to this improvement, due to the new pricing strategy into a more sustainable student base.

The EBITDA to cash conversion reached 96.8% at the end of 2017, proving once again, the effectiveness of our cash generation initiative.

Now I will turn to our CEO, Pedro Thompson for his closing remarks.

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

Thank you, Moretzsohn. Turning now into slide 14. I want to conclude in line with the slide that our CFO Leonardo has just presented by reminding that Estacio is in a very opportune moments.

Our solid financial position and the prospects of keeping the pace of performance improvement over the coming cycles with greater process control and transparency motivates our entire team to continue delivering results and preparing Estacio for new phase of growth and expansion.

2018 will continue to be a year of hard work for all of us here at Estacio, especially in relations with future gains. But we are confident in our execution capacity. We can now move on to the questions -- to the Q&A session. Thank you, all.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions) And so there are no questions, I would like turn the floor over to Pedro Thompson from his closing remarks. Mr. Thompson, the floor is yours for closing remarks, sir.

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

I would 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. Estacio Participacoes' conference call is now over. Thank you all for joining us, and have a nice day.