Q2 2013 Earnings Call

Company Participants

- Rogerio Frota Melzi, Chief Executive Officer
- Virgilio Deloy Capobianco Gibbon, Chief Financial and Investor Relations Officer

Presentation

Operator

Good morning, ladies and gentlemen, thank you for standing by and welcome to Estacio's conference call to discuss the second quarter 2013 results. This event is also being broadcast simultaneously on the internet, via webcast, which can be accessed on the companies' IR website, www.estacioparticipacoes.com.br/ir, together with the respective presentation and the earnings release.

We would like to inform 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 and further instruction 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'd now like to turn the conference over to Mr. Rogerio Melzi, CEO. Please, Mr. Rogerio, you may proceed.

Rogerio Frota Melzi {BIO 16212298 <GO>}

Okay. Thank you, very much. Good morning, everyone. I'm sorry about my voice, I got a bit of a flu here but I'll do my best. So welcome to our conference call to discuss the results of the second quarter of 2013. Virgilio Gibbon, our CEO, is with me here today and will be helping me with the presentation. Just to remind you that we will have a question and answer session just as soon as the presentation is over. So let's go straight to slide two of our presentation, which is also available on our website.

Once again, we feel very good as we release our results and comment on our second quarter 2013 highlights. This quarter we continued to follow the trend that began in the second half of 2011, when all the effort we put into the turnaround of our institution began to generate consistent results. We recorded excellent numbers in virtually all our financial statement lines and our EBITDA margin moved up for the tenth consecutive quarter.

Thanks to exceptionally strong enrollment at the beginning of the year and improved renewal and dropout ratios, our total student base increased by 20% year-on-year including acquisitions. Together with the increase in the ticket, which Virgilio will comment later on, this led to net revenue of R$443.6 million, 30% more than in second quarter '12.

Based on this top line growth, and once again underlining the scalability of our business model, our results posted a substantial improvement over second Q12. EBITDA stood at R$66.6 million, 80% up year-on-year, with a margin of 15%, up by 4.2 percentage points. Year-to-date EBITDA came to R$153.6 million, 62% higher than in the first six months of 2012, followed by a margin gain of 3.8 percentage points, confirming our path towards a new profitability level.

Net income totaled R$46.7 million, a hefty 209% year-on-year improvement, with a net margin of 10.5%, up by 6.1 percentage points. In addition to all the organic growth, we continued our efforts to accelerate our growth rates, aiming to take full advantage of the good times we are experiencing.

In this context, we obtained an important victory when the Diario Oficial published the official recognition of our distance-learning Pedagogy program, thereby concluding the second of three steps towards concluding the process of expanding the scope of our centers, currently under way with the Ministry of Education.

On another front, which is likely to become increasingly important in the coming years, our graduate programs also reported strong results, fueled by the changes in the management of this segment following the creation of the Continuing Education Department at the end of 2012.

Our graduate student base increased by 26.4% to 15,800 on-campus students and over 5,000 distance-learning students. We follow working on the implantation of a new graduate program model, along the same innovative lines as our undergraduate model, which will be gradually introduced in the second half of 2013. We also began activities in the Corporate Solutions area, which was created to directly meet the needs of Brazil's most important employers, and advanced in the creation of an area to explore in a more organized manner the so-called short-term courses, which are not regulated at all.

In the Expansion area, we announced the arrival of ASSESC, an acquisition of enormous potential in Florianopolis. We carry on with the careful planning for the expansion of our units at the optimal time, and continue to prospect the best way to enter new markets that interest to us.

I will now hand you over to Virgilio, who will go into the details of our results.

Virgilio Deloy Capobianco Gibbon {BIO 16679141 <GO>}

Thanks, Melzi. Good morning, everyone. To begin, I would like to call your attention to slide three, which deals with our operating performance. As you can see on the first graph, we closed the second quarter 2013 with 313,000 students, 20.2% more than in second quarter 2012. The same-shop student base grew by 16.6%.

Our on-campus student base totaled 245,000 students, already including the 9,200 students acquired in the last 12 months. In same-shop terms, growth came to 13.9%, reinforcing the sustainable organic student base growth trend following six consecutive record high intake cycles. Our distance learning base grew by 29.8% over second quarter of 2012 to 58,800 students. It's worth noting the improvement in total year-to-date distance-learning enrollments. A total of 32,900 new students enrolled in distance-learning undergraduate courses in the first half, 23% up on first half of 2012.

Another very positive feature was the reduction in the dropout ratio, which recorded a year-on-year decline of 2 percentage points in the second quarter. As you can see on the graph at the side, net operating revenue increased by almost 30% over second quarter, reaching R$443.6 million, thanks to the expansion of the student base and the increase in the average ticket.

In the second quarter 2013, the average on-campus and distance learning ticket recorded respective increases of 9.7%, above inflation, and 6%, in line with inflation, once more achieving our aim of ensuring that price hikes are at least in step with inflation. Our capacity to increase prices in a sustainable manner, at a similar pace to last year's, is the proof that students have a higher perception of our quality and are attributing more value to our product. As a highlight, after the student enrollment period, the discount and scholarship ratio decreased by 1.9 percentage points as a percentage of gross operating revenue, illustrating an improved capacity to convert approved candidates into new enrollments.

In the first six months, the gain came to 0.3 percentage points, demonstrating sustainable student base growth which is not tied to the growth of scholarships and discounts. It is worth emphasizing that 9.7% gain in the on-campus ticket would have been even higher without the reducing effect of FIES FGEDUC revenue. Remember that we adopted the new FIES accounting criterion as of fourth quarter 2012.

Moving now to slide four, you can see a vertical analysis of our operating costs and expenses. Our cash cost recorded an efficiency gain of 4.6 percentage points over 2012 same period, mainly due to gains in the following lines. 2 percentage points in personnel, 1.7 percentage points in the labor tax line, partially due to a R$3 million reversal on this quarter thanks to improved tax management, offsetting the negative effects of labor claims which have been impacting Estacio throughout 2013. Three, 0.2 percentage points in rentals, due to cost dilution with the growth of the student base and 0.7 percentage points in third-party services, thanks to scale gains.

Selling expenses represented 12.6% of the net revenue, generating a margin gain of 1.6 percentage points over the same period 2012, due to the 2.8 percentage point gain in PDA, which more than offset the impact of the Provision for FIES line, which dipped by 0.5 percentage points.

It is worth noting the organic improvement in PDA over the previous year, reflecting the reduction in delinquency in the second semester of 2012, even considering the impact of the Provision for FIES, which was recognized under PDA in second quarter 2012. It is also worth remembering that the Provision for FIES line refers to provisions for FIES students that we now recognize the contribution to the Guarantee Fund as a deduction from net revenue. More details on the Provision for FIES can be found in our Earnings Release.

G&A expenses represented 14% of net revenue and recorded a 2 percentage point year-on-year margin loss, chiefly due to losses of 1.5 percentage points in personnel, due to salary increases following the collective bargaining agreement, and the increase in the workforce due to investments in new areas which are still generating little or no revenue, as well as the linearization of bonus provisions in 2013 and 0.7 percentage points under provision for contingencies, largely due to the reversal that positively impacted this line in second quarter 2012.

Slide five shows our accounts receivable. The number of days receivables averaged 79 days in the second quarter, six less than in first quarter 2013. Excluding FIES net revenue and receivables, the ex-FIES days receivables came to 85 days, nine days more than the second quarter 2012, directly related to freshmen students still adhering to the FIES program and the increase in delinquency.

The stability of this figure over first quarter 2013 was directly related to the June 30 deadline for contracting FIES in the first semester. As a result, at the end of the half, we had around 5,000 students adhering to FIES, whose non-FIES tuitions were not yet paid. Subsequently, once the contract of these students is confirmed, we cancel the unpaid tuitions, with a counter-entry under FIES Accounts Receivable. If we exclude these students, our ex-FIES days receivables would have come to 79 days.

As you can see on slide six, FIES accounts receivables fell by R$4.9 million over first quarter 2013, as a result of the normalization of FIES certificates transfers, following the period of greater volume of contract amendments in first quarter 2013. In fact, there was R$153.2 million in FIES transfers in this quarter, R$78.5 million up on the previous quarter.

As observed in first quarter 2013, the concentration of contract amendment processes in the odd quarters increased the FIES days receivables. This scenario was reversed, due to the reduction of the FIES days receivables to 66 days in the second quarter, 23 days less than first quarter 2013 and 22 less than last year same period, despite the substantially higher FIES student base.

We believe the level of our FIES accounts receivable, around R$77 million, or approximately 1.5 to 2 times net revenue from FIES per month, is appropriate for the sustainable expansion of the FIES base in our operation. FIES carry-forward credits remained in line with first quarter 2013, as a result of repurchase auctions and tax payments that have been occurring normally.

On slide seven, we have the aging of our receivables. Our second-quarter receivables portfolio remained healthy. Thanks to the continuation of our strict debt renegotiation policies, in first quarter 2013 only 7% of total receivables came from renegotiations with students, 2 percentage points lower than in second quarter 2012, maintaining the improvement recorded in first quarter 2013.

In addition, the percentage of receivables from renegotiations overdue by more than 60 days accounted for 41% of total agreements, or only 3% of total accounts receivable. Our criteria remain rigid, clear and objective, exemplified by the fact that we provision 100% of receivables overdue by more than 180 days, complemented by the FIES provisions. The smaller graph on the right in slide eight shows our cash flow.

In second quarter 2013, in which we recorded a positive working capital variation of R$4.4 million, while CAPEX excluding new acquisitions totaled R$29.9 million, reflected the expected increase in investment levels after first quarter 2013. These variations plus EBITDA of R$66.6 million generated positive operational cash flow of R$41.1 million, confirming our expectations of higher cash generation despite the quarterly increase in CAPEX.

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

Rogerio Frota Melzi {BIO 16212298 <GO>}

Okay. Thank you, Virgilio. Now moving on to slide number ten, I would like to talk a little bit about the way we are thinking about Estacio's current moment.

As we've commented in some occasions, we like to divide our recent timeline in four different stages. The first stage, which goes from the foundation of the Institution to GP's arrival in 2008, is marked by a lot of pioneering, entrepreneurship and innovation, which resulted in very rapid growth, but with no focus on internal processes that every great company needs.

The second stage, which comprises the period between 2008 and 2011, was characterized by Estacio's turnaround, a period where we recorded low growth rates and decided to reorganize the entire operation around the tripod we believe sustain any successful business, product, processes, and people.

Such turnaround not only helped us to foster the organizational culture we strongly defend, but also provided us with a series of competitive advantages that have been allowing us to experience a period of excellent results, between 2012 and 2014. We believe much of what is happening today is a direct result of what has been done here during the turnaround years, with the eventual help from an external positive scenario for our segment.

Proof of our good moment is the intake cycle currently under way for the second semester of 2013, which once again presents very promising results. Our on-campus undergraduate enrollments should conclude the admission cycle with a 15% to 20% year-on-year growth, while the distance learning undergraduate enrollments should grow between 20% and 25% over the same cycle in 2012.

With these numbers, we expect to keep the strong and sustainable growth pace during the second half of the year and of course, to build the foundations for another good year in 2014. At the same time, we harvest these results, we keep accelerating our organic and inorganic expansion projects both for the on-campus and distance learning undergraduate segments.

We are also investing in the creation of the new business area which focuses on Continuing Education, in order to expand our horizons without distancing ourselves from our core business. Parallel to this, we are also using this moment to prepare our Company for the future, so, when this period of harvesting comes to an end, we can begin a new phase with an even stronger Company, with even more opportunities to create value for our shareholders.

Several programs we are conducting right now, such as Operations Benchmarking, the Academic Model 2.0, our Corporate University, the New Grad Segment, Innovation, Hospitality, Relationship with Alumni, and so forth, should begin to make the difference and bring results in future cycles. So that we can avoid growth spikes followed by stagnation and thus, continually and sustainably aggregate value. We believe that slowing down based on our recent good results, or on the other hand letting ourselves get too enthusiast to the point of accelerating our growth beyond the reasonable level, could be potentially risky. This is the reason we are constantly with one eye on the present, while keep the other on the future.

That brings us to the end of our presentation, so now let's go to the question and answer session. Thank you.

Questions And Answers

Operator

Ladies and gentlemen we will now begin the question and answer session. (Operator Instructions) I'm showing no further questions, I will turn the floor over to Mr. Rogerio Melzi for his final remarks.

A - Rogerio Frota Melzi {BIO 16212298 <GO>}

Well, as we've said in recent quarters, we are currently experiencing our best ever period in terms of fundamentals, results and prospects, always seeking to improve our efficiency and at the same time, keeping an eye on good opportunities for the future. Thank you for participating in this quarter's conference call. I remember that our Investor Relations department is always at your disposal to help you with any questions you may have. We hope to see you again at our conference call. Have a great day.

Operator

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