Conference Call Transcript
4Q16 Results – Q&A
Estácio Participações (ESTC3.BZ)
March 16th, 2017

OPERATOR:

Good morning, ladies and gentlemen, thank you for standing by and welcome to Estácio Participações' call to discuss the results for the fourth quarter and full year of two thousand and sixteen.

This event is also being broadcast simultaneously on the internet, on the Company's IR website: www.estacioparticipacoes.com.br/ri.

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. Should you need any assistance during the conference, please, request the operator's help by pressing star 0.

This conference call may contain forward-looking statements that are subject to known and unknown 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:

Thank you and good morning everyone.
Welcome to our conference call to discuss our results for the fourth quarter and full year of 2016.
With me here today are Leonardo Moretzsohn, our CFO, and Flávia Oliveira, our Head of IR.
Just to remind you all, there will be a Q&A session as soon as the presentation is over.

Let us go straight to slide two, which shows the agenda of our presentation. We will be talking about the following points:
Quarterly Highlights, where we present the priorities of this new Management and the results highlights;
Operating Performance, which deals with the student base and the increase in the average ticket, thanks to the various recovery initiatives introduced during the second quarter;
Financial Performance, showing more consistent indicators, after the implementation of new policies; and
Final Remarks, where we highlight some of the new strategies and guidelines for two thousand and seventeen.

Moving on to slide three, where I will talk a little about this New Management's priorities.

The year 2016 was a period of changes, which began with the election of the Board of Directors in April. The entry of new independent members and the election of a new Chairman of the Board of Directors provided Estácio's Management with a more accurate view on Governance.

From the beginning, it became clear the need to review our strategy, policies and internal practices, mainly because of the economic downturn and regulatory restrictions experienced by the Company.

Therefore, we began with the replacement of the entire Board of Executive Officers and some of the main corporate managers. I was elected as CEO at the end of September. Subsequently, we hired new Executives with extensive market experience to key positions, as Mr. Leonardo Moretzsohn, our CFO. We are also concerned with the appreciation of our internal talents to compose the new Board of Executive Officers, people with energy to change and the internal knowledge required to recognize the strengths and credibility of a company with more than 45 years of operations. This team develops strategies to face the current challenging environment experienced by Estácio.

Thus, we readjusted the corporate structure with the objective of focusing on our core business**.** From the beginning, we understood the need to improve our operating leverage opportunities, so we restructured our business to eliminate non-priority projects, given the macroeconomic crisis in Brazil, and to strengthen our processes and the management of our business unities, in a separate way, the on-campus and distance-learning modalities.

We also revised our significant accounting practices and policies, which were responsible for adjustments in the results of the second quarter of two thousand and sixteen. Based on the best governance practices and in order to ensure the correct comparability of information presented to the market, we restated the comparative information for 2014, 2015 and the 1Q16, and made one-off adjustments in the second quarter of fifteen. With these lessons learned, the Company created a Compliance area and an Internal Controls area, which together with the Governance, Risk Management area aims to ensure that the revision of policies and practices will continue and become a permanent fixture.

I can say that the changes were not easy, but were absolutely necessary in order to realign our management and prepare the Company for sustainable growth and to be able to exploit the operational leverage of its scale.

I will now continue with this quarter's highlights on slide 4.

We see that our net revenue came to R$3.2 billion in 2016, 7.6% up on 2015, excluding the effect of the present value adjustment of FIES receivables in 2015.

In the fourth quarter of sixteen, EBITDA totaled R$ two hundred and seventeen point three million, more than a hundred percent up on the fourth quarter of two thousand and fifteen, with the following positive impacts:

(i) R$43 million from the reversal of the provision accrued on the second quarter for some FIES receivables;
(ii) R$7.2 million from the FIES discount rate, as of the second half of 2016; e
(iii) R$46.7 million from the sale of the receivables.

For a fairer comparison, excluding these impacts, comparable EBITDA would have come to R$ 134.8 million, 30% more than the 4Q15, accompanied by a margin of 16.9% (up by 3.4 percentage points).
In 2016, EBITDA came to R$ 652.4 million, 3.1% up on 2015. Excluding the following non-recurring effects or effects that did not occur in prior periods, as shown in the table, comparable EBITDA would have come to R$ 691.2 million, 10.5% up on 2015, accompanied by a margin of 21.7% (up by 0.6 points. year-on-year), virtually flat over 2015.

I will now turn the floor over to our IR to present, with more details, the performance of our student base and ticket.

FLAVIA OLIVEIRA:

Good morning, everyone, I will talk about slide 5.
Estácio closed 2016 with a total of 508,000 students (2.0% more than in 2015), as it can be seen in the chart on the right side of the page.
This growth is mainly due to the 3.4% increase on the on-campus undergraduate base, which was significantly influenced by the 3.8 p.p. increase in the segment retention rate. We believe that with the changes in the students' accounting policy, our base is cleaner and tends to show lower dropout rates.
The 27.2% growth in our distance-learning graduate base also contributed to the increase of the total student base. Our partnerships also played a key role in the segment intake process.

I must comment on the 2.2% reduction in our distance-learning undergraduate base over 4Q15, which came to 106,900 students. In 2016, distance learning had three enrollment cycles only, unlike the previous years when intake occurred every quarter. We thus extended the period of its two main intakes, in order to reduce the operating costs of smaller enrollment cycles. In spite of the decline in the segment's student base in 4Q16, it is worth noting the 3.7 p.p. increase in the retention rate over 4Q15.

Moving on to slide 6, I will talk about distance-learning and on-campus average tickets. Beginning with the on-campus segment, ticket increased by 9.5% in 4Q16, over the same period last year. Analyzing the on-campus undergraduate segment only, we see an increase of 7.0% in 4Q16, in line with the inflation adjustments.
The on-campus graduate segment increased by 29.5% in 4Q16, due to higher prices for new students and the gradual reduction of scholarships and discounts granted. Therefore, it is worth noting the deductions line, which dropped 11.5 percentage points over gross operating revenue.
In 4Q16, the distance-learning average ticket increased by 23.2% over the same period last year, due to the changes mainly with regards to the relationship with partner centers and the management of their performance.
In 2016, we see an increase of 5.4% and 6.5% in the on-campus and distance-learning segments, respectively.

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

LEONARDO MORETZSOHN:

Thank you very much, Flávia.

Good morning, everyone.

On slide 7, I will present Net Revenue figures.

As we can see in the first chart, net revenue came to R$796.9 million in 4QT16, 8.2% up on 4Q15.

In 2016, net operating revenue came to R$3,184.5 million, 8.6% up on 2015. In spite of price adjustments applied based on inflationary costs in the year, net revenue was negatively impacted by:

- The R$51.3 million reduction in Pronatec revenue, due to the graduation of the last students in this segment;
- The R$17.0 million reduction in other revenue, chiefly due to the end of the Rio 2016 project, related to trainings offered by Estácio to the volunteers of the Rio 2016 Olympic Games;

- The R$14.3 million increase in other deductions, due to the accounting of transfers to distance-learning partners as of 4Q15;
- The 1.8 p.p. increase in scholarships and discounts as a percentage of gross operating revenue between 2015 and 2016, chiefly due to the significant increase in monthly tuition exemption and discounts granted during the intake cycle of the first half of 2016.

Moving on to slide 8, I will talk a little bit about our operating costs.

The cash cost of services represented 57.1% of net operating revenue in 4Q16, an increase of 2.2 percentage points versus 54.9% in 4Q15, essentially due to the personnel line, which had three positive impacts in 4Q16:

- The R$14.5 million increase in collective bargaining agreements, mainly due to the payment of retroactive amounts;
- A non-recurring amount of R$6.9 million referring to faculty severance, due to internal restructurings; and
- An amount of R$17.9 million referring to a difference of fewer vacations days granted in 4Q16 over 4Q15.

It is worth remembering that vacations to be granted in 4Q16 were granted in 3Q16, due to the Rio 2016 Olympic Games, increasing 3Q16 result over 4Q16.

Excluding these points highlighted on the slide, the margin in the personnel costs line would have increased by approximately 2.3 percentage points in 4Q16.

On slide 9, we present our operating expenses.

Selling expenses margin increased by 15.5 percentage points in 4Q16.

PDA margin increased by 10.9 percentage points in 4Q16 over 4Q15, due to the reversal of R$43 million from the provision, conservatively recorded in 2Q16, to comply with the obligation with the FNDE, related to specific receivables from FIES students.

In the second half of 2016, we evaluated the matter with our internal and external legal advisors, deepened the study of students' academic performance and concluded that it has not breached the rules on academic performance, which were object of the provision, and thus reversed, in 4Q16, the amount previously accrued. Note that the net effect in the year is null.

Another factor that significantly influenced the PDA in 4Q16 was the sale of the receivables portfolio, in the net amount of R$47.1 million, of which: R$62.7 million from the sale of the Customer portfolio and R$15.6 million from the APV

It is worth noting that the sales of the receivables portfolio are thoroughly approved and should always represent a better opportunity for the Company, when compared to the historical recovery of said values.

Regarding marketing expenses, the end of the Olympic Games' institutional campaigns and the review of our marketing campaigns began to produce results, generating a year-on-year margin gain of 4.5 percentage points. It is worth noting that this line represented 6.7% of net revenue in 2016, of which 8.0% in 1H16 and 5.4% in 2H16.

In 2016, general and administrative expenses represented 11.8% of net operating revenue, a 0.8 percentage point down on 2015, chiefly due to one-off adjustments in 2Q16, in the amount of R$28.1 million, as a result of the revision of the Company's contingencies base, taking into account their nature and market assumptions.

The following lines also underwent one-off adjustments:

- Personnel, due to internal restructuring, as a result of the reduction on the corporate structure and staff adjustments; and
- Outside services, due to additional expenses with advisors involved in the ongoing M&A negotiations.

It is worth noting the R$19 million reduction in the institutional events line in 2016, due to the end of the Rio 2016 project, which partially offset the one-off effects I have just talked about.

On slide 10, we see that net income of R$124.3 million recorded in 4Q16, was a result of the 133.2% increase in the period EBITDA, which exceeded the increase in the depreciation and amortization line and in the negative financial result in the period.

Net income fell by 16.4% in 2016 over 2015, essentially due to increases in the negative financial result and depreciation and amortization lines.

In 2016, the financial result totaled R$86.3 million, negatively impacted by the increase of approximately R$27.0 million in the financial discounts line, due to the more aggressive campaigns we carried out in 2H16 to recover credits, mainly from students who lost FIES support. It is worth noting that revenue with fines and interest on monthly payments in arrears also increased by approximately R$17.1 million, which did not exceed the increase in financial discounts.

On slide 11, we present Average Receivables Days.

We continue to focus on improving our collection campaign and student debt renegotiation policies, the results of which have already become apparent in the performance of average non-FIES receivables days, which improved by 12 days in comparison with 4Q15.

The increase in the accounts receivable in 4Q16 was primarily due to the upturn in FIES accounts receivable. Estácio's average receivables days came to 132 in 4Q16, 2 days lower than the same period last year, even being impacted by the delays in amending the FIES contracts for the second semester of 2016 and the consequences on the flow of transfers this quarter. As a result, FIES receivables days averaged 236 days.

On slide 12, in the first table, we see the information on our Capitalization and Cash.

Cash and cash equivalents closed 2016 at R$404.0 million, conservatively invested in fixed-income instruments pegged to the CDI interbank rate, government bonds and certificates of deposit with top-tier Brazilian banks.

Bank debt of R$1.01 billion corresponded mainly to:

- the Company's debenture issues (2nd series of R$300 million, 3rd series of R$187 million and 4th series of R$100 million);
- the loan from the IFC (first installment of R$48.5 million and second of around R$20 million); and
  the capitalization of equipment leasing expenses in compliance with Law 11638.

The R$38.6 million reduction in the loans and financing line over 4Q15 was essentially due to the settlement, in 2016, of a foreign-currency loan from Banco Itaú of R$227.1 million and the entire 1st issue of debentures, of approximately R$214.1 million. To compose cash spent with these operations, we issued R$300 million in Promissory Notes in November 2016 and R$100 million in debentures in December (4th issue), both operations carried out with Banco Itaú.

Including commitments for future payments related to past acquisitions, which totaled R$125.9 million, as well as taxes payable in installments of R$15.9 million, our gross debt came to R$1.15 billion at the end of 2016, resulting in net debt of R$748.9 million.

Still on this slide, we present our investments. In 2016, we invested R$186.8 million, R$118.8 million of which in maintenance, mainly in the upgrading of systems, equipment, libraries and laboratories in our units.

In 2016, the investments accounted for nearly 5.9% of the period net revenue, mainly in our academic model and in the new IT architecture project, which increased by 25.1% and 59.1%, respectively, over 2015.

On slide 13, we present our Cash Flow.
Our Operating cash flow was positive by R$51.7 million and R$339.7 million in 4Q16 and 2016, respectively, substantial improvements over the same periods last year, especially when analyzing the EBITDA to OCF conversion ratio, which stood at 23.8% in 4Q16, versus 3.8% in 4Q15. In 2016, this ratio was 52.1%, against -14.4% in 2015.

I will now turn the floor back over to our CEO, Pedro Thompson, for his closing remarks.

PEDRO THOMPSON:

Thank you, Moretzsohn.

Well, to finish our presentation, I present our 2017 objectives on slides 14 and 15.

Since we took on the challenge to manage Estácio, we implemented relevant changes, focusing on three great drivers of value creation:

- Maintain the organizational climate. With so many changes in such a short time, our major concern was the maintenance of the organizational climate in order to establish a good level of productivity among the employees. Therefore, focal points have been appointed in each Executive Area, whose main mission is to report their needs, concerns and perceptions of the new challenges faced by the Company. The first results could already be observed in the Annual Climate Survey, concluded in February 2017. The survey, conducted by an external consulting firm specialized in Human Resource projects, was answered by more than ten thousand people, equivalent to an engagement of seventy three percent of Estácio's employees, and achieved a significant overall result of seventy four percent level of satisfaction.

- Redesign one of Estácio's most important projects: enrolling new students, and apply changes in the first cycle of 2017. We believe that Estácio's profitability growth is mainly driven by the "scale" of its operations, it focused its efforts on making significant changes to some on of the main pillars of the Company's intake strategy, including:

  - Our new pricing strategy*:* we reduced the number of scholarships and discounts granted in order to simplify the management of process to enroll new student;
  - Regionalization of marketing campaigns*:* we changed our advertising strategy, from a more national and institutional focus to a more regional appeal, using cheaper and more efficient communication channels in each location;
  - Resizing of the sales force*:* the number of sales advisors nearly triple, betting on a aggressive approach with high financial return vis a vis the investment on this channel;
  - New goals and compensation system*:* at the same time we expanded our sales force, we also restructured our goals (KPIs) in order to associate them with quality, rather than just quantity – the implicit net operational revenue.

Moving on to slide 15. Another major objective is to recover operating and financial results focusing on the cash generation. The need to restructure policies and practices in the financial area, aiming at greater control, also resulted in some changes in the management of the financial area itself.

One of the greatest projects we began implementing was the redesigning of the Charging and Collection processes**.** The work will be focused on creating a culture of timely payment, with a significant reduction in regular and aggressive benefits granted to defaulting students, and the creation of policies that encourage timely payments. The focus is no longer on PDA and debts more than a hundred and eighty days overdue, but on collection since the beginning of the debt, exclusively through specialized companies contracted for such purpose. In addition, the charging process will be more rigorous, with shorter contact intervals, blacklisting and protest, using cluster strategies based on the debtor's profile.

We also had the launch of Estácio's Installment Payment program. Students enrolling in Estácio as of the beginning of 2017 can pay their monthly tuitions through Estácio's Installment Payment program, or PAR, which allows students to pay half of the total amount of the course while studying and the other half after graduation. The payment in installments will occur gradually: students can pay 30% of the tuition in the first two semesters; 40% in the third semester, 50% in the fourth semester and 60% as of the fifth semester.

We believe that a healthy business, with an interested student base willing to study, is the secret for the sustainability of a post-secondary education company. For this reason, it began its plans to build student loyalty, mainly focused on reducing dropout rates. The reduction in dropout rates is a great opportunity to improve profitability, given that the Company's full cost structure is better used, optimizing the returns on efforts to attract students.

Before concluding our presentation, I want to show on slide 16 that our two thousand and fifteen ENADE results, disclosed last week, which, similarly to the previous year, reaffirm the success of our teaching model.

In this cycle, 98% of our courses were evaluated with positive results, with grades above 3, as we can see in the first chart. In the second chart, we also can see the evolution in the number of our institutions with positive grades, totaling 97% - eight of our institutions were graded 4 (on a scale of 1 to 5, with 3 being the minimum). We are proud to say that Universidade Estácio de Sá, the largest single institution of our group, is among the eight institutions graded 4 in this evaluation cycle.

It is worth noting that institutions and courses graded 4 or higher have priority in some MEC processes, leveraging potential and autonomy to open new courses, distance-learning centers and increase the number of places, reducing regulatory growth restrictions, with qualitative results that prove the Group's educational sustainability. The level reached in our group is something totally disruptive to our business model.

I would also like to emphasize that students of courses evaluated in the two thousand and fifiteen cycle account for approximately 55% of our total base, which allowed a significant qualitative growth in the general indicators. Universidade Estácio de Sá, for example, reached the level of institutions graded 4 and became the second best private university in the Rio de Janeiro State, only behind PUC-Rio, a traditional non-profit institution.

We are very happy with the results achieved, which are part of a sustainable, long-term work, with the collaboration over than 7,000 faculty members, and whose work we continue with great diligence and care.

With these ENADE results, I can affirm, on behalf of Estácio, that we are proud to be one of the educational groups whose results of academic quality evaluations most improved. I highlight our commitment, as one of Brazil's largest education institutions, to balance an operation with a scale of more than 0.5 million students in order to deliver academic excellence.

Therefore, I can say that Estácio is beginning 2017 with energy, focusing on the ongoing pursuit of better operating, academic and financial performance. We learned a lot in 2016 and we are sure that 2017 will be a year of hard work!

We can now move on to the question-and-answer session. Thank you.

Bruno Giardino, Santander:

Hello. Good morning, everyone.

First question – could you help us understand the movements and the provisions for doubtful accounts in the quarter? When we look at your financial statements, we see that the R$47 million from the net sale of receivables had already been written off, but apparently, this transaction represents a gain of a similar size in this line, so I just want to understand this movement, if my understanding is correct.

Pedro Thompson:

Bruno, can you repeat your question, please? We did not understand it.

Bruno Giardino, Santander:

You had this R$47 million net impact from sale of receivables in the quarter and as far as I understand, this R$47 million was already out of your provision for doubtful accounts. And we saw this coming back to your results as a gain. Is this interpretation correct? So when we look at your PDA, we should adjust for this R$47 million, is that right?

Pedro Thompson:

Yes, you are right. The accounting policy was reversed to PDA of this value, this is to emphasize that the sale of the receivables was a related trade and we compare the return of the discounts that we had in this receivable with our organic recovery of this receivable. And it was much higher than the opportunity to sell. But your thoughts about the accounting treatment are correct.

Bruno Giardino, Santander:

OK, thanks.

And the second question, if I may, in the cost line, you commented on the impact of 15 million regarding retroactive agreements with your faculty, I just want to understand if you already expected this when you assumed the Company, or this was a new negotiation you had to make recently. That is it.

Pedro Thompson:

No, I did not expect it in those terms.

Bruno Giardino:

OK, thanks.

Operator:

Since there seems to be no further questions, I would like to turn the floor over to Mr. Peter Thompson, for his final remarks.

Pedro Thompson:

I would like to thank you all for participating in our results conference call. Our Investor Relations Department is at your disposal to help you with any questions you may have. Our contact information is available on our website. We hope to hear from you again at our next quarter conference call. Again, thank you very much, and have a great day.