Conference Call Transcript
2Q17 Results
Estácio Participações (ESTC3.BZ)
July 28, 2017

Operator:

Good morning, ladies and gentlemen, thank you for standing by and welcome to Estácio's conference call to discuss the results for the 2Q17.

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/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 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, CEO and IRO. Please, Mr. Thompson, you may proceed.

Pedro Thompson:

Thank you. Good morning everyone. Welcome to our conference call to discuss the results for the 2Q17.

Leonardo Moretzsohn, our CFO, and Flávia Oliveira, head of our IR team, are here with me. Just to remind you all, there will be a question-and-answer session as soon as the presentation is over.

Let us begin on slide two. As you all know, we had important challenges over the last year. It was a period of great change and transformation in the Company. However, we have kept three major commitments in mind at all times:

First, I should point out that our main goals were to maintain operational performance and climate at a time of transition. We had a deal that was being analyzed by the Brazilian antitrust authority and we were committed to meeting the wishes of our shareholders and closing the deal without affecting the Company's performance during this period.

We thus worked together with Kroton to prepare an integration process. I can assure you that we have devoted our team's time and best efforts to ensure that this process was as smooth as possible, always in compliance with the antitrust legislation.

And, last but not least, we were also committed to being transparent to our shareholders, with strict governance and the implementation of a compliance culture.

Although the CADE did not approve the deal, I can say that our care and concern to improve the Company's performance while the antitrust agency was analyzing our request have produced significant results. Over the last few quarters, and specially this quarter, our results proved that Estácio is able to improve its performance.

Moving on to slide three, we can see the result highlights for the 2Q17.
Our net revenue moved up by 9.3%, or R$78.1 million, over the same period in 2016, totaling R$913.4 million, while EBITDA came to R$254 million, and the EBITDA margin stood at 27.8%, an increase of R$210.4 million and 22.6 p.p., respectively, over 2Q16.

However, for comparison purposes, it is necessary to exclude the effects of one-off entries totaling R$105.7 million recorded in the 2Q16, the R$6.6 million related to the fee of 2% of net revenue from FIES contracts as of the 3Q16, and non-recurring M&A expenses of R$0.7 million, giving a comparable EBITDA of R$261.3 million and a comparable EBITDA margin of 28.6%, an upturn of 74.9% and 10.7 p.p., respectively, over the same period in 2016.

This performance was a consequence of our initiatives to increase operational efficiency and improve the management of the Company's costs and expenses. I believe we have been able to show that it is possible to increase profitability in a challenging scenario, still impacted by the lower volume of FIES contracts, while making changes to important processes, such as student intake and pricing, whose results we will discuss in further detail now. I now give the floor to our head of IR, Flavia Oliveira.

Flavia Olvieira:

Thank you, Pedro. Good morning, everyone. I will begin by talking about our operational performance, on slide number four.

In the graph on the left, we can see that our student base grew by 0.9%, year over year, totaling 539,000 students, mostly due to the ten point three percent 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.

The distance-learning growth offset the three percent decline in the on-campus student base. The base decrease reflected the reduction in the 1Q intake cycle due to the changes in the strategy to attract new students designed to create a more solid student base, which complies with their payment obligations. It is worth noting that the on-campus student retention rate improved by 7 p.p. to 90.6% at the end of the period. One of the first signs of the quality of our student base.

We would also like to draw your attention to the fact that the decrease in the number of on-campus students this semester was much lower than the decline in the FIES student base, which fell by 15.6% percent compared with the second quarter of two thousand sixteen. Net revenue growth and the adoption of an installment payment program for a more solid student base, showcase Estácio's strategies and differential advantages to maintain its sustainable growth.

Moving on to slide five, I will now talk about our average ticket, which reflected the pricing strategy we began adopting this semester in order to ensure a sustainable student base that combines compliance with payment obligations with lower dropout rates.

The on-campus average ticket moved up 11.7% to seven hundred R$51.6. while the on-campus undergraduate average ticket climbed 10.9% percent to R$784.six, thanks to the new pricing strategy adopted by Estácio in the 1Q intake cycle and the seven thousand PAR students, who also positively impacted the average ticket, as there are no discounts or scholarships under this program.

The on-campus graduate average ticket increased by six point seven percent over second quarter two thousand sixteen, due to the decrease of approximately fourty percent in the deductions line, generating a gain of nine point one percentage points in relation to gross revenue.

In the 2Q17, the distance-learning average ticket moved up by 27.8% over the same period last year, to R$239, with an increase of 23.3% to R$247.9 in the undergraduate segment, and an upturn of over 80% to one R$175.4 in the graduate segment compared with last year.

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.

Moving to slide six, I will begin with our net revenue in 2Q17. As we can see, 2Q net revenue came to R$913.4 million, 9.3% up on 2Q16, essentially due to: the R$219.7 million increase in revenue from monthly tuitions, 18.3% up on 2Q16, due to the higher average ticket and a more sustainable student base; the R$3.5 million decrease in Pronatec revenue, as reported in the last few quarters, due to the graduation of the last students in this segment; the R$4.6 million reduction in other revenue, due to the end of the Rio 2016 project, under which we provided training to the volunteers of the Olympic Games; the R$109.9 million increase in scholarships and discounts, due to the change in the Company's pricing strategy for new students; the R$8.1 million upturn in taxes, in line with revenue growth; the 2% retention of net revenue from FIES contracts pursuant to Executive Decree 741 (MP 741) as of the 2H16, which had an impact of approximately R$6.6 million this quarter.

It is also worth noting that approximately R$9 million was recorded under gross revenue deductions in the 2Q17, due to the adjustment to present value of PAR receivables.

Moving on to slide seven, I will talk a little bit about our operating costs. Our cash cost represented 48.1% of net operating revenues in the 2Q, versus 56.8% in the same quarter last year, representing an 8.7 p.p. margin gain, which was concentrated in the personnel line, underlining the results of Estácio's restructuring of faculty cost management.

Some of the initiatives implemented at the beginning of the year include the offer of 20% of the on-campus syllabi online and the increase in the number of students in distance-learning classes, all of which are part of the process of restructuring the management of Estácio's faculty costs.

In addition to the decrease in personnel costs this quarter, the textbook materials line also played a role in the 8.7 p.p. gain, when comparing the total cash cost to revenues ratio, over the 2Q16. We intensified our production of books and offered virtual libraries to students.

The result of these efficiency efforts, mainly in the distance-learning segment, combined with revenue growth this quarter, led to a 30.5% year-on-year increase in the Company's gross profit to R$445 million. Excluding the period depreciation and amortization, the gross margin climbed 8.7 p.p., from 43.2% in 2Q16 to 51.9%.

On slide eight, we present our operating expenses.

In the 2Q17, selling expenses represented 12.7% of net operating revenue, with a 9.4 p.p. margin gain, impacted by one-off entries in the 2Q16. Excluding the effects of these entries, the selling expense margin gain came to 4.3 p.p. even including the impact of the PAR.

The allowance for doubtful accounts line was adversely affected in 2Q16, as Estácio conservatively provisioned R$43 million to comply with obligations related to the FIES. However, after an in-depth analysis with our internal and external legal advisors, we have concluded that we have not breached the rules on academic performance and reversed the accrued amount in the last quarter of 2016, generating a null net effect in the full year.

I wanted to mention this adjustment in order to allow a fair comparison between 2Q16 and 2Q17. As we exclude the R$43 million recorded in 2016, we see a 1.7 p.p. margin gain in the allowance for doubtful accounts line, due to a stricter collection process and student retention efforts, which offset the negative 0.4 p.p. impact when we began accruing provisions for the PAR.

The 3.0 p.p. gain in the advertising expense margin in the same period was also impacted by the non-recurring effect of the end of contracts and institutional campaigns, which led to a one-off R$15.5 million increase in advertising expenses in the 2Q16. Excluding this effect, we had a 1.1 p.p. margin gain compared to the 2Q last year. I would like to remind you that, since the beginning of 2017, the campaigns have been focusing more on regional, cluster-driven strategies and less on the institution itself, using more efficient, lower cost channels.

Second-quarter general and administrative expenses represented 11.3% of net operating revenue, a 3.2 p.p. margin gain over the same period last year, impacted by one-off entries in 2Q16. The Company booked a non-recurring contingency item totaling R$28 million in 2Q16, due to the revision of the Company's base, taking into account the market nature and assumptions. Excluding the effects of these entries, the general and administrative expense margin would have remained flat.

Jumping to slide 9, we can see net income totaled R$166.3 million this quarter, accompanied by a 20.5 year-on-year p.p. increase in the Company's net margin, mainly due to the R$210.4 million upturn in EBITDA in the period.

Slide 10 shows Estácio's Average Receivables Period. I can assure you we remain focused on improving our collection and student debt renegotiation campaigns. It is worth noting the R$5.3 million year-on-year reduction in the monthly tuition fees line of accounts receivable. As a result, Ex-FIES average receivables days improved by nine days, from 83 days in 2Q16 to 74 days.

On slide 11, in the first table, we can see the information on our Capitalization and Cash.

Cash and cash equivalents totaled R$542.3 million on June 30th, 2017, conservatively invested in fixed-income instruments pegged to the CDI interbank rate, government bonds and certificates of deposit with top-tier Brazilian banks.

Our bank debt of R$1.03 billion corresponded mainly to: our debenture issues, the loans from the IFC, the issue of promissory notes and the capitalization of equipment leasing expenses in compliance with Law 11638.

The R$237.7 million increase in the loans and financing line over June 2016 refers mainly to the issue of R$300 million in promissory notes in November 2016 and over R$100 million in debentures (4th issue) in December last year. The objective of these operations was to recover the cash spent on the settlement of the 1st debenture issue, totaling approximately R$214.1 million, and the payment of extraordinary dividends in November and December 2016, amounting to R$420.0 million.

Including the commitments for future payments related to past acquisitions totaling R$109.5 million and taxes payable in installments amounting to R$14.6 million, Estácio's gross debt came to R$1.16 billion at the end of 2Q17, resulting in net debt of R$615.5 million.

Also on this slide, we show our 2Q CAPEX. We invested R$31.5 million, 10.7% less than in the same period in 2016, mainly because we did not make any acquisitions in the last 12 months that required integration CAPEX.

Jumping to slide 12, we present our cash flow.

Operating cash flow was positive by R$172.1 million in 2Q17, an improvement of R$23.9 million over the same period last year.

Let me remind you that we expect to receive the amount related to the second installment of 2015 receivables accrued due to PN 23 at the beginning of August.

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

Pedro Thompson:

Thank you, Moretzsohn.

Now, we will move on to the last part of our presentation, on slide 13, where I want to show how much efficiency we were able to obtain during one of the most important transformations in Estácio's history.

Comparing the results for the twelve-month periods between the second half of 2015 and the first half of 2016 and between the 2H16 and the 1H17, we can see an efficiency gain of over R$217.7 million.

This result was obtained thanks to the initiatives implemented over the last year, including measures to attract a more sustainable student base and maximize the present value per student through a healthier average ticket and longer student retention.

In addition to increasing our top line, leading to better cost dilution, we also improved our cost structure, especially in regard to personnel, advertising and general and administrative expenses.

We also began revising the Company's collection policies and have already observed an improvement in the EBITDA to cash conversion ratio, as well as a gradual reduction in the average receivables days, as our CFO mentioned earlier.

We recorded an 8 p.p. margin gain. It is worth noting that there was no room for major strategic moves in 2017. We were mainly focused on EXECUTION, which led to a gradual and consistent improvement in the results of the last few quarters.

In the coming quarters, we plan to implement over 100 initiatives in order to continue obtaining efficiency gains. These initiatives have already been mapped and we have begun implementing them this semester.

In addition to these short-term initiatives, which are practically low hanging fruit, we are developing a new long-term strategic plan and I intend to present news on this front before the end of this year, at our Investor Day, which should take place in mid-November. As soon as we set the date, we will widely publicize this event. We want to share our vision for the future of Estácio and we will do it as soon as possible.

On slide 14, I would like to finish this presentation by talking about our growth drivers.

The first is the launch of new distance-learning centers. We currently have three institutions accredited to provide distance-learning education: Universidade Estácio de Sá (with a 3 CI), Centro Universitário Estácio de Ribeirão Preto (with a 3 CI) and Centro Universitário Estácio de Santa Catarina (with a 4 CI). Given these grades, the new regulations allow us to launch 250 new distance-learning centers.

With the authorization for these new centers, we will launch 76 new centers in the 3Q intake process and already have 55 prospective partners, all in the process of formalizing the partnership and organizing the necessary infrastructure.

As a result, at least 131 new centers will be added to Estácio's current network of 238 centers during the 2H17, and will be able to operate in the first intake cycle of 2018.

Another growth driver is the launch of four new Medicine campuses through the Mais Médicos program at the beginning of 2018. Thanks to this program, we are authorized to offer another 225 Medicine places per year at the new Angra dos Reis, Jaraguá do Sul, Alagoinhas and Juazeiro units.

Please bear in mind that Estácio already operates Medicine courses in four campuses, totaling 3,000 students. It is also worth noting our expertise in the Health area, with 17 courses and over 100,000 students in this field.

Another important growth driver was inorganic growth through good M&A opportunities. We have a robust cash position and, certainly, a more efficient operational structure, so we are analyzing opportunities for consolidation of the Education sector. Our Board of Directors authorized the prospecting of financial advisors to assist in the identification of potential assets for acquisition.

Our organic growth pipeline is another growth driver that we have been working on more intensively. We have ten applications for new campuses already approved by the Ministry of Education (MEC), which will be launched in a phased manner over the next 18 months.

To wrap up, I would like to say we have begun a new phase of our history, but we are doing this supported by solid results, achieved during an extremely challenging year in which we were fully focused on Execution. We currently have a more efficient management structure and continue improving our academic quality indicators. I believe we have sound fundamentals to continue our growth trajectory, creating value for all our stakeholders, now with a long-term strategic and sustainable vision.

We can now move on to the Q&A session.

Thank you.

Marcelo Santos, JPMorgan:

There are actually two. The first, just wanted to understand a little bit better the gain on the distance learning (30:14) you put more students per class. Just wanted to understand the class concept that you use in the fully online course, and I'd imagine if you're putting more students per tutor, or something like that. Does this mean that the tutors were being underutilized before? Just wanted to understand a little bit better the logic of gains in this line.

And the second question is regarding FIES. So, you still have roughly 1/3 of your revenues coming from FIES, and FIES has a higher ticket, at least it looks like a higher ticket than your average, what do you think should be the impact on the margin next year, since a lot of FIES students are going to graduate by the end of this year?

Do you expect a negative impact on your margins due to that? These are my two questions.

Pedro Thompson:

Thank you. The first question regarding the distance learning efficiency, we changed our education methodology with a (31:13) about (31:14) more students per (31:19) in the last year.

Flávia Oliveira:

Instead, now we have some systems helping our tutors, so we're able to answer the doubts of our students (31:40) a better relation with our students in less time than we had in the past. So, we maintain the quality of answers to our students (31:53), because we are better equipped in terms of systems.

Pedro Thompson:

The second question, regarding FIES, we're not allowed to give guidance, but (32:15) the whole sector, the exchange of average ticket regarding lower FIES penetration will be a concern to all players of the sector.

Marcelo Santos:

OK. Thank you.

Operator:

And since there seems to be no further questions, I would like to turn the floor over to Pedro 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 always at your disposal to help you with any questions you may have. Our contact information is available on 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. This concludes Estácio's conference call. You may now disconnect, and have a good day.