Conference Call Transcript
3Q17 Results
Estácio Participações (ESTC3.BZ)
October 27, 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 3Q17.

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, the Company's CEO. Please, Mr. Thompson, you may proceed.

Pedro Thompson:

Thank you. Good morning everyone. Welcome to our conference call to discuss the results for the 3Q17. 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 Q&A session as soon as the presentation is over.

Let us begin with slide two, where we can see the result highlights for the 3Q17. Our net revenue moved up by 5.9%, or R$45 million, over the same period in 2016, totaling R$808.1 million, while EBITDA came to R$223.6 million, and the EBITDA margin stood at 27.7%, an increase of 15% and 2.3 p.p., respectively, over 3Q16.

However, for comparison purposes, it is necessary to exclude the effects of the internal restructuring presented in the 3Q16, of R$3.8 million, and the M&A expenses, of R$4.9 million in 2016 and R$0.9 million in 2017.

Accordingly, comparable EBITDA came to R$224.5 million and comparable EBITDA margin to 27.8%, an upturn of 10.5% and 1.2 p.p., respectively, over the same period in 2016.

Estácio remains focused on the initiatives to increase operational efficiency and improve the management of costs and expenses, bringing positive gains to the result. We believe that it is possible to increase profitability in a challenging scenario, while making changes to important processes, such as student intake and pricing, whose results we will discuss in further detail now.

Turning now to slide number three, I would like to present another important highlight of our results this quarter. Our operational cash flow was positive by R$360.4 million in the 3Q17, a significant improvement of 101.3% over the 3Q16. It was an increase of R$181.4 million when compared to 3Q16.

In addition to the EBITDA increase, the following strategies contributed to this improvement in our cash generation. First one, the increase of R$97.5 million in collection of non-FIES revenues, due to a healthier student base. Second one, increase of R$48.2 million, related to FIES, due to the 2Q17 transfers that were damaged with the cash effects occurring only in this quarter, due to some problems with Estácio negative debt certificate which have already been settled, and the monetary correction of this PN 23 receivables, the old FIES receivables

In the 3Q the EBITDA to cash ratio came to 161.2%, once again highlighting the initiative implemented to improve our performance indicators.

I now give the floor to our head of IR, Flávia Oliveira.

Flávia Oliveira:

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

In the graph, we can see that our student base grew by 0.7% year on year, totaling 531,000 students, mostly fueled by the 15% increase in the distance-learning student base, thanks to the initiatives including the performance-based clustering of partner centers in order to better align incentives and results.

The distance-learning growth offset the 5.3% decline in the on-campus student base, which was under the effect of the 23.8% decrease in the FIES student base this quarter. Excluding the effect from the decrease of the FIES student base, non-FIES student base increased by 6.1%, as a result of the changes implemented in the intake strategy, aiming at a more sustainable student base.

It is worth noting that the objective of fostering a more sustainable student base, reducing discounts and scholarships and ensuring students' financial commitment in order to conclude the enrollment process, reduced our dropout rate by 42.6% this quarter.

Moving on to slide five, I will now talk about our average ticket, which continues reflecting the current pricing strategy.

The on-campus average ticket moved up by 10.2% to R$688, while the on-campus undergraduate average ticket climbed 8.9% to R$716, thanks to the new pricing strategy adopted by Estácio in the 2017 intake cycle and the 12,000 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 42.9% over the same period last year. The decrease in deductions contributed to this result, generating gains of 9.6 p.p. in gross revenue.

In the 3Q17, the distance-learning average ticket moved up by 12.1% over the same period last year, to R$212. Therefore, it was possible to see the result of the change in the strategy, which aims to leverage the operating revenue, given that 3Q distance learning net revenue increased by 29.6% over the same period in 2016.

In the distance-learning undergraduate segment, average ticket increased by 6.7% to R$215, and over 85% to R$191 in the graduate segment compared to 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:

Thank you very much, Flávia. Good morning, everyone. Moving on to slide six, I will begin with our net revenue in 3Q17. As we can see, 3Q net revenue came to R$808.1 million, 5.9% up compared to 3Q16, essentially due to: one, the R$170.8 million increase in revenue from monthly tuitions, an increase of 14.8% over 3Q16, due to higher average ticket and a more sustainable student base.

Second, the R$1.5 million reduction in Pronatec revenue, due to the graduation of the last students in this segment. Third, the R$1.5 million reduction in other revenue due to the end of the 2016 project, referring to training offered by Estácio to the volunteers of Olympic Games, which still generated individual revenues in 3Q16.

Fourth, the R$119.6 million increase in discounts and scholarships, as a result of the Company's new pricing strategy for new students. In this strategy, the increase in discounts is more than offset by the R$167.8 million increase in gross revenue.

The R$4 million upturn in taxes, in line with revenue growth. The R$2.4 million reduction in FGEDUC, due to the smaller FIES student base.

It is also worth noting that in 3Q17, approximately R$1.6 million was registered under gross revenue deductions, due to the adjustment to present value of receivables from Estácio's Installment Payment Program – PAR.

Moving on to slide seven, our cash cost represented 47.8% of net operating revenue in the 3Q, versus 48.7% in the same quarter last year, representing a 0.9 p.p. margin gain, mainly in the textbook materials line, which shows Estácio's effort to intensify its production of books, and the offering of virtual libraries to students.

It is also worth noting that in the 3Q16, the personnel line increased by R$17.5 million with the early vacation granted to the faculty, 15 days, in Rio de Janeiro, in view of the 2016 Olympic Games, increasing 3Q16 results over 4Q16.

Accordingly, excluding this effect, there was a 1.6 p.p. margin gain in the personnel line and a 3.2 p.p. increase in the total cash cost of services in the 3Q17.

Moving on to slide eight, we present our operating expenses. In the 3Q17, selling expenses represented 12.1% of net operating revenue, with a 2.1 p.p. margin loss over the 3Q16.

This quarter, Estácio decided to intensify investments in the enrollment campaigns in the first months of the 2S, anticipating marketing funds for the 3Q. This measure impacted the advertising line, increasing expenses, which accounted for 7.4% of net revenue.

Moreover, with the beginning of the provisioning of PAR, the margin of the allowance for doubtful accounts line fell by 1.3 p.p. in the quarter. It is worth noting that the allowance for doubtful accounts, non-PAR and non-FIES over net income ratio improved by 0.9 p.p. over the 3Q16.

In this quarter, general and administrative expenses represented 13% of net operating revenue, a 3.3 p.p. margin gain over the same period in 2016, chiefly due to third-party services. In the 3Q16, we had additional expenses of R$4.9 million with advisory and audit services referring to the revision process of accounting practices and policies disclosed in the 2Q16 and expenses with advisors and consultants involved in the M&A negotiations.

Excluding this amount, there was a 1.1 p.p. margin gain in the third-party services line over the 3Q16, underlining the efficiency gain in the management of third party-contracts.

On this slide, number nine, we can see the net income as R$149.3 million this quarter, up by 10% over the same period of last year, chiefly due to the R$29.1 million upturn in EBITDA in this period.

Third-quarter financial result recorded a negative impact mainly in the financial discount line, which increased by R$9.8 million, due to campaigns to recover past-due debts, aiming to increase cash generation. It is worth noting the success of these campaigns, whose recovery rates reached more than 50%.

Slide 10 shows Estácio's average receivables period. This quarter, we continue noting the good performance of the average non-FIES receivables period, which came to 69 days, four days less than in the same period last year.

On the other hand, the FIES average receivables days was 25 days lower than the same period last year, totaling 221 days. I can assure you we remain focused on improving our collection and student debt renegotiation campaigns.

On slide 11, in the first table, we can see the information on our capitalization and cash. Cash and cash equivalents totaled R$709.5 million at the end of this quarter, 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$856.4 million 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 11,638.

The R$45.2 million increase in the loans and financing line over the same period of last year refers mainly to the issue of promissory notes and debentures at the end of 2016. The objective of these operations was to recover the cash spent on the settlement of the 1st debenture issue and the payment of extraordinary dividends in November and December last year. In September 2017, the Company settled the 3rd debenture issue of approximately R$197 million.

Including the commitments of future payments related to past acquisitions totaling R$93.7 million and taxes payable in installments amounting to R$16.3 million, Estácio's gross debt came to R$966.4 million at the end of the 3Q this year. Accordingly, Estácio's net debt came to R$256.9 million at the end of the quarter, 1.1x our period EBITDA, versus 1.8x in the 3Q of last year.

Also on this slide, we show our 3Q CAPEX. We invested approximately R$44 million, 10.5% more than in the same period last year, essentially due to maintenance investments.

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

Pedro Thompson:

Thank you, Moretzsohn. Moving on to slide 12, I would like to emphasize that our plan for continued efficiency gain is at full blast. Throughout the quarter, we began working on important fronts, among which:

The restructuring of the curriculum matrix in the semester in order to implement the new Educational Model in 2018, with the objective of improving the management of class creation and faculty cost allocation. These changes comprise: increasing the sharing of disciplines, mainly in the first periods; offering more hybrid disciplines (on-campus and online) in the first periods; enabling alternative pathways, i.e. discipline interchange in the first and second periods.

In our online tutoring program we will implement new tools and processes in order to improve the student/tutor ratio, maintaining service quality and student satisfaction levels. In the 1H17, the distance-learning student/tutor ratio nearly doubled with the implementation of some of these tools. Estácio plans to further improve this ratio in the coming cycles.

We are also working on the optimization of the course mix. This initiative comprises, among others, transferring students from loss-making courses and shifts to other profitable units or shifts and limit the offering of courses whose demand is low.

We are carrying out a detailed analysis of our internal benchmark, reassessing the operational performance and business plans in all units, and preparing specific action plans in order to enhance productivity, considering the possibility of reducing, merging or closing a number of units. This initiative also comprises the evaluation of new opportunities for organic and inorganic growth.

In the last slide of our presentation, slide 13, I would like to reinforce that we continue to work on our growth drivers, of which:

The new distance-learning centers: At the end of September, we started to reach 338 active distance-learning centers. It is important to highlight that, during the quarter, we engaged 100 new poles from initial expectation and also in the 2Q release.

We announced that 131 new centers will be operating at the beginning of 2018. Including the new operational centers, another 86 new municipalities nationwide will have access to the Estácio brand, of which 20% in the São Paulo state.

It is worth noting that we have almost 10 years of experience in the segment and an expansion area entirely restructured to comply with the growing number of applications for new partnerships.

The opening of the Medicine Course in the Angra dos Reis unit: This quarter we started offering the Medicine course in the Angra dos Reis unit, as authorized by the Federal Government's *Mais Médicos* program. The course will begin this semester with 55 annual places.

In addition to the five existing Medicine courses, Estácio will launch three other Medicine courses in the 1H18 in Juazeiro (Bahia), Alagoinhas (Bahia state) and Jaraguá do Sul (Santa Catarina state). This significant expansion of the Medicine courses reinforces Estácio's position as a reference in the medical area.

High School: We are beginning operations in the high school segment and, in October 2017, we began enrolling students for the first groups of the next year. Firstly, classes will only be offered in seven units in the Rio de Janeiro state: Madureira, Rio Comprido, Ilha do Governador, Duque de Caxias, Niterói, Alcântara and Cabo Frio.

In addition to preparing students to join university, Escola Estácio plans to offer technical vocational training to high school students, focusing on the labor market.

Among the main differentials of Escola Estácio, we can highlight faculty experience – teachers who have already joined professional development programs at the institution – and the existing infrastructure of the post-secondary education units, such as complete libraries and well-equipped labs.

Finally, I would like to reinforce our commitment to maintain a disciplined capital allocation strategy, focused on increasing profitability, not only by reducing costs and expenses, but also by increasing revenue. Our goal is to continue growing, investing wisely in order to provide the best return to shareholders and ensure student satisfaction and business sustainability.

We can now move to our Q&A session.

Thank you all.

Susana Salaru, Itaú:

Hi, guys, good morning. Congratulations on the results. We have two questions here.

First, on the efficiency gains, you listed four levers. How do you expect them to mature? Which ones should mature first? Which ones are more medium to long-term projects?

And, also on efficiency gains, which ones do you consider the most relevant one from the cost perspective? That would be our first question.

Second, the advertising expenses seemed to be concentrated in 3Q. If this understanding is correct, could we understand that that opens room for a margin expansion in 4Q?

That is it, guys, from our side.

Pedro Thompson:

Thank you for your questions, Susana.

The first question, the much higher disruptive full initiative that we have for next year, in terms of efficiency gains, is regarding faculty cost. Inside this faculty cost, making a drill down of the opportunities of the faculty cost. The first one is to make like a restraint of our interest basis, because we have a lot of difference between the average ticket of the labor costs of these professors.

We had the opportunity to equalize the salaries with bringing new people and firing some people and we have to make a rebalance of our total teacher cost basis.

So, first of all, this is the more disruptive tools that we have in terms of hanging fruits margins expansion for the next year.

In the second question, you want a guidance for the next semesters regarding margins?

Susana Falaru:

No, I am just thinking that if you anticipated marketing expenses for 3Q, that would implicate that in 4Q we would expect less marketing assets, which would facilitate a higher margin. Just the rational of the marketing expenses anticipation.

Pedro Thompson:

We already anticipated, but in terms of margin for the next quarter, I think it is very early to talk about that, but in terms of, specifically, marketing expenses budget, in fact, we anticipated 4Q expenses to this 3Q. You are right.

Susana Falaru:

Thank you. That was very clear.

Operator:

As there seems to be no further questions, I would like to turn the floor over to Pedro Thompson for his closing 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:

Estácio Participações' conference call is now over. Thank you all for joining us and have a good day.