

# Is For-Profit Higher Education the Future? The Case Of Brazil

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# BRAZILIAN EDUCATION MARKET

# BRAZILIAN EDUCATION SECTOR | INDUSTRY AT A GLANCE

## K-12 Market

- ✓ 50.5 million students
- ✓ 16.5% in private schools
- ✓ US\$ 19 billion market - CAGR 11-13: 10.8%<sup>(1)</sup>
- ✓ Highly fragmented – listed players operate mainly in the books or learning systems segments
- ✓ National Plan of Education 11-20: public investments will focus K-12
- ✓ Little governmental support for private expansion
- ✓ Major players:



Source: Hoper 2013, INEP, MEC, BofA Research

<sup>(1)</sup> Including learning systems and educational books. CAGR in BRL terms.

<sup>(2)</sup> Including post-graduate, excluding corporate training. CAGR in BRL terms.

## Post-Secondary Market

- ✓ 7.0 million students
- ✓ 73% in private institutions
- ✓ US\$ 16 billion market - CAGR 11-13: 12.9%<sup>(2)</sup>
- ✓ Still fragmented but consolidating rapidly – top 12 players hold ~33% of revenues market share
- ✓ Underpenetrated: GER of 30% (OECD average of 69%)
- ✓ Strong governmental support for private expansion – FIES, PROUNI, PRONATEC
- ✓ Corporate training: new growth frontier (~US\$ 3.5 billion market)

- ✓ Major players:



# HIGHER EDUCATION | TIMELINE OF IMPORTANT EVENTS

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- 1996** Education Law of 1996: first step towards giving to the private sector the ‘responsibility’ of providing higher education while the government refocused its efforts on managing primarily quality and accessibility. **First wave of for-profit universities expansion with government focusing on K-12.**
  - 1999** Creation of “ FIES 1.0” (subsidized student loan program): opening up public support for the sector.
  - 2005** Creation of PROUNI (tax-breaks for scholarships): first effectively large-scale public program to increase the penetration of higher education in Brazil.
  - 2007** IPOs of the big players Kroton, Anhanguera, Estácio and SEB. **Start of the consolidation wave.**
  - 2010** The creation of “FIES 2.0” further improves access to higher education through even more subsidized loans.
  - 2011** PRONATEC (private technical courses fully funded by the government) is created.
  - 2012** Higher education enrollments reach 7 million being 1 million in distance learning courses.
  - 2013** IPOs of Ser Educacional (“Mauricio”) and Anima.
  - 2014** **Merger of the big names:** Kroton and Anhanguera; Estácio and SEB (higher education division); Anima acquired São Judas & Whitney. Ser Educacional already acquired UNAMA (a big player in the North region) and is likely to use the remaining proceeds from the IPO to also make a big strategic move.

# BRAZIL'S REGULATORY ENVIRONMENT

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**MEC** Federal ministry that exercises primary jurisdiction over higher education sector and determines national education strategy as well as control over institutional accreditation. It decides whether an institution is accredited as a university, university center or college.

**SERES** Unit within the ministry with regulatory oversight of higher education that serves as the supervisory arm of the federal ministry regulating all higher education institutions (HEIs), federal, state, public, private at undergraduate level as well as distance providers

**INEP** functions as the federal agency for data collection from the private education sector.

**CONAES** serves as the agency which designs the survey/measurement instruments which feed into the assessment work carried out by INEP.

**CTAA** is an appellate body that oversees the work of INEP and hears appeals brought forward by institutions that challenge the assessments done by INEP.

**CNE** serves as an allied agency of the Ministry of Education (MEC) and assists it with accreditation, re-accreditation, increase in authorized spaces and recognition/validation of courses taken abroad. CNE operates under the purview of MEC and all its recommendations/decisions are ratified by MEC

**CAPES** serves as an agency that oversees graduate education, specifically MA, MSc and PhD programs.

# REGULATORY ENVIRONMENT

MEC uses General Index of Courses (IGC) as an indicator of the quality of HEIs

## ENADE

- Exame Nacional de Desempenho de Estudantes
- Measures student achievement at undergraduate level

## Censo da Educação Superior

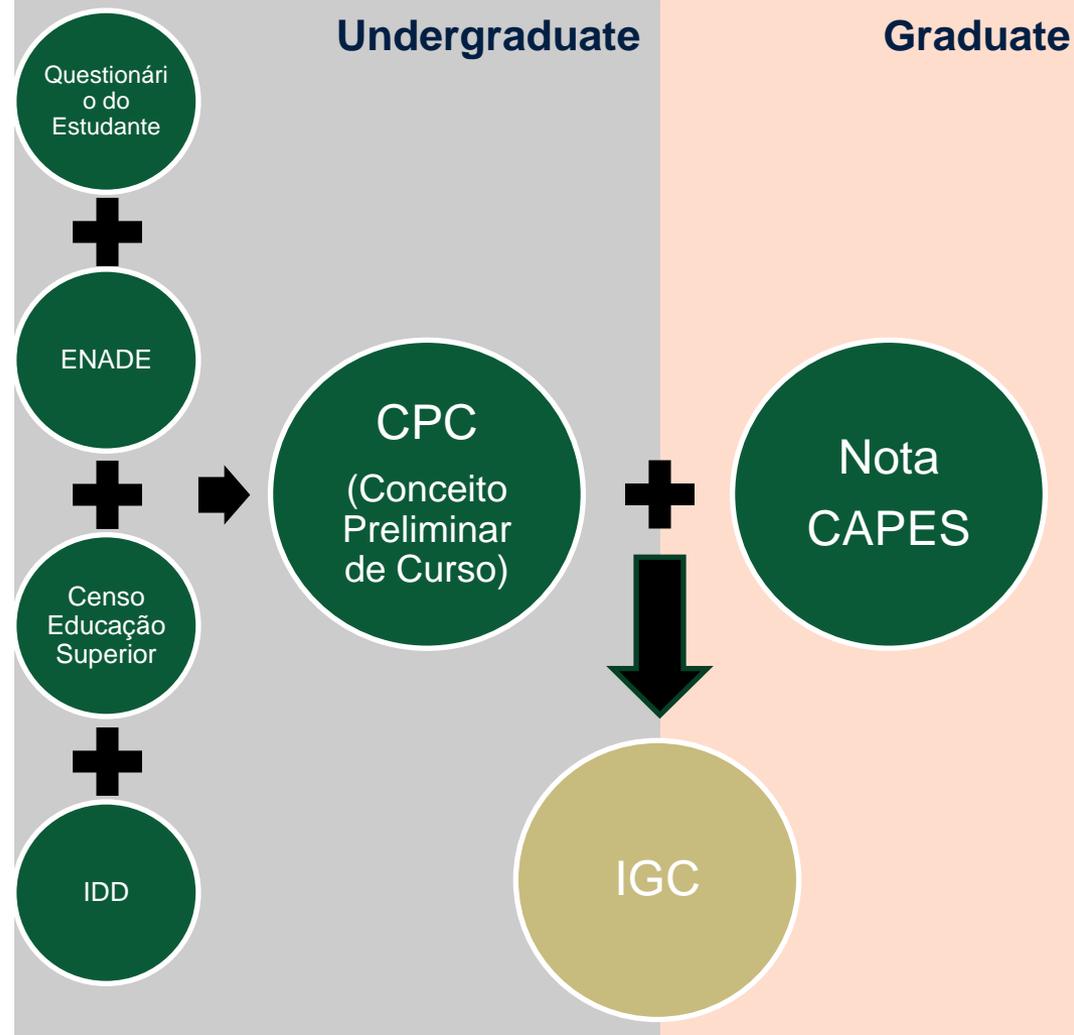
- Collects data on institutions, including student enrollment, program portfolio and faculty

## IDD

- Compares undergraduate student performance among peer institutions

## Nota Capes

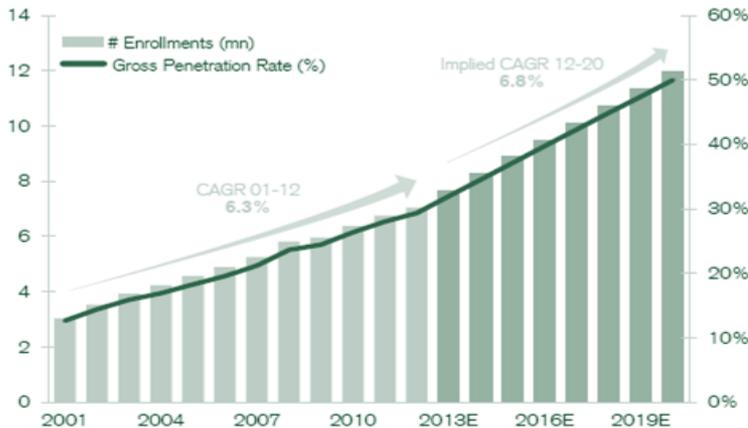
- Annual survey of all graduate programs and courses



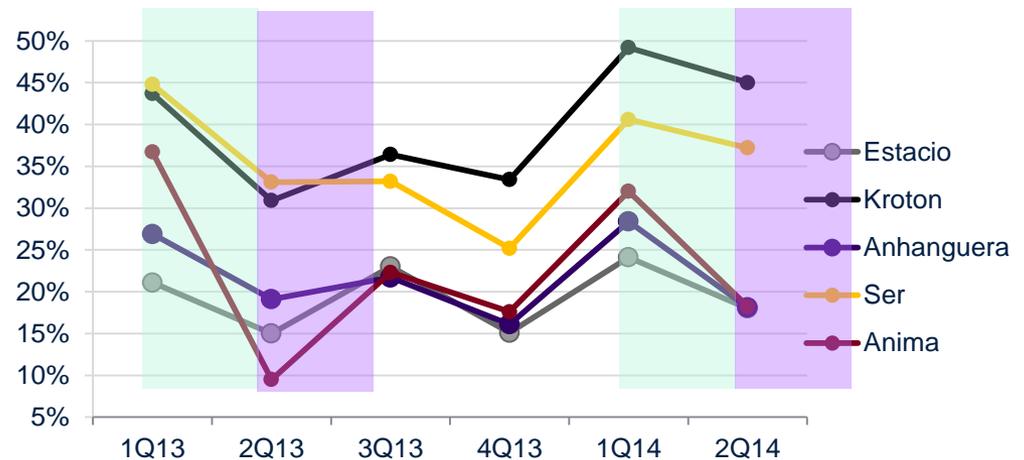
# HIGHER EDUCATION | THE FRONTRUNNERS OF THE INDUSTRY ARE THRIVING

- ✓ The Government has been quite effective with the goal of universalizing basic education. However most students come unprepared to enter the highly selective and few available top quality public universities or lack the financial resources to access private education. As a result, a large pent-up demand for higher education was created over the past decades;
- ✓ Since the first reforms in the Education Law in 1996, enrollments in post-secondary education have been increasing fast and there are no indications that the existing sector tailwinds will not continue in the next years. The recently approved National Plan of Education (PNE 11-20) aims to strengthen this trend and has defined that as much as 10% of the GDP might be destined to all levels of education, including higher education. Funding will come from royalties from the pre-salt oil extraction.
- ✓ Recently, the listed players have strongly increased revenues, gained market share and improved cash generation due to: (i) better cost efficiency; (ii) higher average tickets mostly due to better course mix, higher prices and lower FIES students' price sensitivity [+14% YoY as of 1Q14 for the top 3 companies]; (iii) better WC control (due to FIES); (iv) increasing penetration of distance learning; (v) accretive acquisitions [~170 deals since 2007]; (vi) PROUNI's tax breaks and most recently (v) PRONATEC (gov. Scholarship).

## PNE 11-20 Goals: 50% GER and 33% NER



## EBITDA margin (%) evolution



# HIGHER EDUCATION | THE ROLE AND SUSTAINABILITY OF GOVERNMENTAL SUPPORT

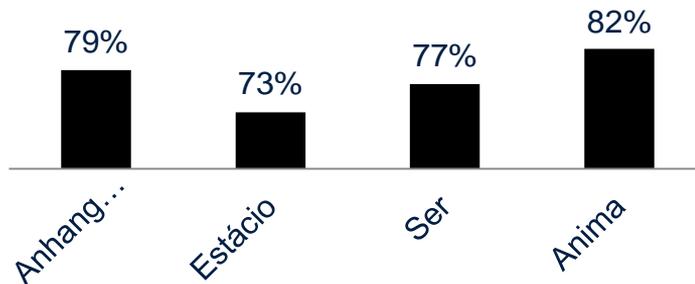
- ✓ The following Government-backed programs to help low-income students to pursue higher education were first introduced in the 1990's and transformed the sector. The programs aimed to expand access and address the high dropout rates between high school and post-secondary enrollment and also during higher education. In addition to lower dropout and delinquency rates, private sector has benefited from higher intakes, higher profitability and better cash flow

Program	PROUNI	FIES	PRONATEC
<b>Creation</b>	2005	1 <sup>st</sup> version: 1999 2 <sup>nd</sup> version: 2010	2011
<b>Characteristic</b>	Tax-breaks in exchange for scholarships	Subsidized loans with negative real interest rates and large tenor	Tuition for technical courses fully paid by the government
<b>Numbers</b>	Over a million scholarships granted	Over 1.5 million outstanding contracts and adding ~600K annually	Goal: enroll 8 million students until 2014
<b>Propability of Discontinuation in the medium-term</b>	Low: it does not affect public accounts directly.	Low: this will largely depend on delinquency rates to be seen after 2016.	High: It affects public accounts directly and is mostly seen as a complementary business by companies and analysts.
<b>Potential risks</b>	The ratio of scholarships per paying student might increase reducing effective average ticket and reducing margins.	In case of higher delinquency, companies might be requested to increase their contributions (today at 5.63% of tuition) to the public guarantee fund impacting margins. Research analysts estimate that if delinquency surpasses 10% (current ~7%) the fund may require extra funding.	Be eliminated in the next 2 years or transformed into FIES for technical courses

# BRAZILIAN EDUCATION SECTOR | THE QUALITY AND EMPLOYABILITY ISSUE

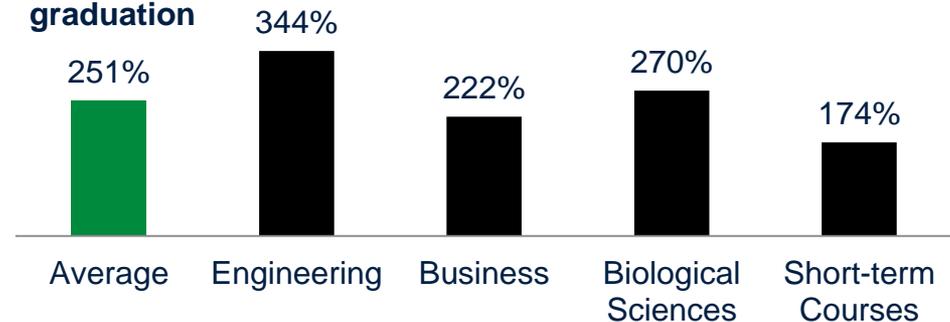
- ✓ Our research indicates that for the biggest players, quality is becoming increasingly important for students and employers as tertiary education becomes ever more popular.
- ✓ Most employers' perception of the quality of private universities is not high, even though they comply to the Ministry of Education's minimum standards of quality. Players defend themselves blaming low quality of high school students;
- ✓ Despite imperfections, post-secondary education generates significant value added to students. As per market knowledge, salaries of higher education graduates aged 25-34 years old average ~2.5x those of high school graduates; and even higher in less favored areas such as the Northeast (2.7x) and in some majors (3.8x in engineering, 3.5x in law). Premium universities figures are closer to 8x. Unemployment is also half for those with higher education vs. secondary.
- ✓ We believe that private universities will improve their interaction with employers to gather feedback to improve their curriculum. Other business lines such as corporate training might as well bring some extra knowledge for that matter.

Placement Ratio – listed companies



Source: Companies

Kroton's Students increase in income up to 4 years after graduation



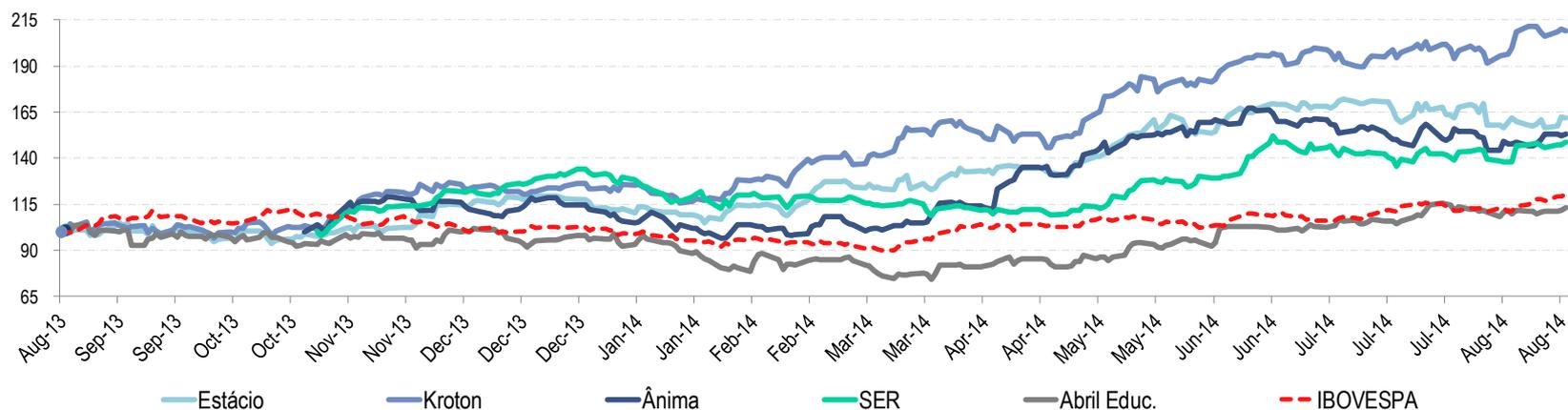
Source: Kroton (ex-AEDU)

# BRAZIL EDUCATION | EQUITY PERFORMANCE OF LISTED PLAYERS

- ✓ Across the board, the Brazilian education companies have been outperforming Ibovespa on the back of (i) governmental policies aimed at developing the private education sector, (ii) continued strong student intakes; (iii) highly capitalized companies engaging in M&A transactions in a still fragmented and highly underpenetrated market; and (iv) the lack of good alternative equity investments in a slowing economy.

Company	Market Cap in US\$ mm	Current Price	Stock Performance YTD*	Street Consensus				EBITDA LTM Margin (%)	P/E 14	P/E 15	EV / EBITDA 14	EV / EBITDA 15
				Target	BUY	HOLD	SELL					
KROTON	11,652	65.2	109%	68.6	14	4	0	39%	22.2	16.2	21.2	16.6
ESTACIO	3,928	28.2	62%	32.5	11	5	0	20%	20.0	15.5	16.0	11.3
ANIMA	1,034	28.2	53%	34.7	7	0	1	14%	17.6	13.7	14.4	10.1
SER	1,443	26.0	49%	29.9	6	4	1	34%	17.6	14.3	13.7	10.9
ABRIL EDUCACAO	1,476	38.3	13%	40.8	6	2	3	25%	25.1	18.8	8.9	7.8
<i>Average</i>			57%		69%	23%	8%	26%	20.5	15.7	14.9	11.4

Source: Bloomberg as of 08/27/2014 \* IPO to date for Anima and Ser



# BRAZILIAN EDUCATION SECTOR | CHALLENGES

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- **Macroeconomic Outlook**
- **Market Consolidation**
- **Increased Regulatory Oversight**
- **Profitability**
- **Regional Developments**

**How will all this impact Quality?**



**THANK YOU!**