Conference Call Script - 1Q20

Operator:

Good morning, ladies and gentlemen, and welcome to Afya's First Quarter 2020 Earnings Conference Call. At this time, all participants are in a listen-only mode. Later we will conduct the question-and-answer session and instructions will follow at that time. As a reminder, this call will be recorded.

I would now like to introduce your host for today's conference Renata Couto, Afya's Head of IR. You may begin.

Renata Couto

Thank you and Good Morning everyone. Thank you for joining us for Afya's first quarter 2020 conference call. With me on the call today is Afya's CEO, Virgilio Gibbon Luis André Blanco, our CFO and Julio de Angeli our VP of Innovation and Continuing Medical Education.

During today's presentation, our executives will make forward-looking statements. Forward-looking statements generally relate to future events or future financial or operating performance and involve known and unknown risk, uncertainties and other factors that may cause our actual results to defer materially from those contemplated by these forward-looking statements.

Forward looking statements in this presentation include, but are not limited to, statements related to our business and financial performance, expectations and guidance for future periods or expectations regarding our strategic product initiatives, and the related benefits and our expectations regarding the market as well as the potential impact from COVID-19. These risks include those more fully described in our filings with the Securities and Exchange Commission. The forward-looking statements in this presentation are based on the information available to us as of the date hereof. You should not rely on them as predictions of future events and we disclaim any obligation to update any forward-looking statements except as required by law.

In addition, management may reference non-IFRS financial measures on this call. The non-IFRS financial measures are not intended to be considered in the isolation or as a substitute for results prepared in accordance with IFRS. We have provided a reconciliation of these non-IFRS financial measures to the most directly comparable IFRS financial measures in this presentation. Let me now turn the call over to Virgilio Gibbon, Afya's CEO.

Virgilio Gibbon, CEO

Thank you, Renata, and thanks everyone for joining us today for Afya's first quarter 2020 earnings conference call. First, let me say that I hope everyone is in good health and safe during this global crisis.

Before start, I would like to acknowledge and thank all frontline workers who are facing this global crisis. We are fortunate that, as a business, we have been able to help by providing free courses at this time to assist hospitals, medical schools, physicians and nurses to deal with the rapid spread of COVID-19.

I also want to thank our employees and professors who made it possible, within one week, to move 100% of the on-site classes to our online platform. The feedback from students, professors and physicians could not be better – they are all very satisfied with the effectiveness of our online operation. While the environment continues to evolve quickly, our teams are managing our priorities and business very well.

Moving next to page 5

I am very pleased to report a strong first quarter 2020 results continuing the positive trend of 2019, and also reflecting the successful execution of our strategic initiatives. We are seeing the benefits from the synergies captured from the integration of the acquisitions completed over the past two years, and continue to deliver the combination of our strong and predictable growth with high profitability and healthy cash generation. Our balance sheet position is very strong with more than R$ 1.3 billion in cash.

On the student front, the intake process for the 2H20 have already captured candidates to fulfill all seats available, ensuring 100% of occupancy for the following semester - a 22% growth in our medical student base over the 1Q20, reaching 9,7k students already including the UNISL acquisition concluded this month.

In addition, we are seeing a better collection when compared to the same period last year, showing an excellent proxy for the 2H renewal rates and cash generation. All in all, and considering the external scenario, a very positive dynamic for the rest of the year.

I also would like to highlight that considering all acquisitions we have completed, our total medical seat per year reached 1,866 what means 13.4k students at maturation, an 11% CAGR in the medical student base until 2026.

Moving to slide number 6 - we can see our unique positioning in the medical community, our social responsibility and therefore we have played an important role in sharing knowledge with other institutions, physicians, students and patients through the initiatives below :

- Allowed free temporary access of our digital platform – MedCel, being already accessed by more than 9,000 medical students at 32 public and private medical schools, which will be a great opportunity to expand our market share and potential growth.
- Provide free content through online courses and a webinar week, which has been a success attracting a large number of participants to our platform.
- Donation of masks, gloves and other PPE (o que significa: Personal Protection Equipment) to health departments and hospitals in 13 cities where we operate medical schools

Now, with respect to actions we have undertaken for students, employees, and professors:

- We are currently operating our theoretical classes online for all students and reorganized the schedule of practical activities in order to avoid any significant impact on the academic calendar for the first semester of 2020.

- It is important to highlight that the in-hospital internships for the 5th and 6th year students have already resumed and will not impact the calendar.
- Most of our corporate staff started to work from home and are keeping all activities up and running well.
- We are also providing a full package of social and health assistance to our employees and families to help them during the pandemic, including HR initiatives such as online psychological care, yoga classes, corporate training platform, free lectures, support for family professional replacement and many others.

Moving to slide 7 we will discuss our Revenue and Intake Process.

Fortunately, our 1Q20 financial results were not impacted by COVID-19. Given the timing, we had successfully concluded our intake process cycle for 1H20 before the pandemic basically shut down the country. We had already completed the enrollment process with 100% occupancy as expected. And, as we look ahead, we are currently seeing a strong demand for new applications for following semester that will allow us to fulfill 100% of our medical seats, maintaining our revenue growth resilience and high predictability even under this uncertainty times.

We have kept our commitment to our professors maintaining all salaries during the pandemic, maintained our suppliers' contracts and also offering a high quality education to our students through our platform and practical activities for the 5th and 6th year.

We are seeing a positive impact on the cash collection during this period. The delinquency ratio by April 2020 is 400bps below the same period last year, reflecting our processes improvements implemented last semester.

Lastly, regarding revenue recognition, taking into consideration the interruption of on-campus activities and that a significant portion of non-practical educational activities being temporarily offered through the Company's online platform, we are expecting that some practical classes will have to be replaced during the 2H2020 postponing the revenue recognition proportionally. Those effects were already considered in our 1H20 guidance indicated by the Net Revenue guidance range, which already contemplated that a certain amount of practical classes would be delivered in the 2H2020.

Next, turning to page 8.

Afya's solid balance sheet and strong cash position put us in a healthy position with a competitive advantage to navigate these uncertain times.

As you can see, we ended the quarter with R$1.3 billion in cash position, raised essentially from the IPO and follow-on transactions, and with a limited debt. Our cash flow is robust, with an 81% conversion rate and a lower delinquency rate when compared to the same period last year.

Last but not least, our cash flow keeps being strengthened by the synergies raised from M&A integration. We have been efficient in all integrations, leveraging our operational margins considerably.

Given the high predictability of our business model, I am confident in our ability to generate meaningful cash flow, which combined with the strength of our balance sheet will sustain financial stability regardless of economic trends and enable us to continue executing our growth strategy.

Moving next to our discussion of M&A and our Integration Process on slide 9

We achieved our position as the leading medical education company in Brazil partially through acquisitions. We have completed acquisitions over the past two years and added over 400 seats in less than one year, or approximately 40% of our three-year target of 1,000 seats. Additionally, we currently have more than 500 seats covered under a Memorandum of Understanding.

M&A remains a key pillar of our growth strategy and we continue to evaluate opportunities to deploy capital into strategic acquisitions across medical school seats as well as digital platforms that can add services and value to our students. Our financial strength and cash flow generation capabilities afford us flexibility, and we intend to remain opportunistic.

Stepping back for a moment, we have outlined the stages that acquired companies go through before we start to see the synergies and margin contribution. Immediately, we guarantee 100% of occupancy of all seats available. Then, we begin to streamline discounts and to increase tuition after the implementation of our new curriculum. After, we migrate all transactional and administrative activities to Afya´s Shared Services to extract G&A efficiencies. Lastly, we implement Afya's career plan, to fully integrate and reaping the benefits from the acquired companies.

Importantly, the current operating environment has not slowed our integration process with recent acquisitions – we just finished integrating IPEMED and are moving with Uninovafapi and Medcel, even during the pandemic.

On page number 10

You can see our successful acquisition track record and how we have been able to extract synergies fastly. The revenue expansion and margin gains have been significant across all acquired companies.

As we integrate it and gain further scale, we have been able to see value creation and margin improvement higher and faster than we expected in all acquired institutions. Even considering the more recent acquisition concluded in 2019, such as IPEC and FASA, we can see a strong growth and operational leverage in less than one year. This solid track record shows our capacity to deploy capital into strategic acquisition creating great returns to Afya´s shareholders.

Now, I'll turn the call over to Julio that will show how the digital transformation accelerated by the COVID-19 crisis is changing the education process and opening many opportunities for us.

Thank you Virgilio.

Moving next to a discussion of Innovation and Technology and how this is changing the education process, in the next two slides.

Starting on slide 11 - All of us are seeing a rapid shift in digital transformation strategies. In an environment like this, the need for accessible solutions in all markets has become greater than ever and we are proud that we are leading the way in the medical education segment. The current environment is leveraging our core digital competency with an efficient process to create large and scalable medical educational materials, utilizing different formats, in one single easy to use and sticky platform.

Our cutting-edge platform can deliver a personalized learning experience for each student, including communication, learning, tutoring and assessment tools. As an additional feature, we have now launched our proprietary synchronous class capability to the experience we provide where our professors will be able to interact on a live environment with our students as an integrated piece of our methodology.

On the content delivery side, we are proud to launch the second season of our instructional “Medical Residency” web series. With 12 new episodes, we added another 50 clinical cases where 15 of our professors are acting and performing, as well as 100 new video lessons covering these cases. This is another important step of our edutainment strategy delivering content in formats that are connected to the reality of the new generation of students and innovating as it is needed in our industry.

The proprietary software and content development and adaptive learning technology allows us to offer a personalized learning experience for the student no matter where they are in their learning curve or career. This is critical for our solutions where we use the power of our data collection to help students to be more effective.

The following slide, on Page 12, discusses Technology as a Key Driver of our Growth Strategy

Afya’s core strategy is to combine quality medical education with intensive use of technology. We are committed to providing innovative technology solutions that assists our students as they spend more time online to work and study in this environment and later on. Even prior to the rise of COVID-19, we have been very intentional on strategic planning for enhancing our digital offerings.

The pandemic proved the efficiency of our digital platform as more than 90% of our undergrad medical students engaged online, with positive feedback and acceptance. Over 93% of our graduate students mentioned they would recommend their online class and course to a friend.

With respect to other students and as shown on these charts, these added digital products, content and features consistently delivered increasing customer count growth during the quarter. Our Monthly Active Users increased 17.5% from January to March to more than 16 thousand. At the bottom of the first chart you can see the current consumption of our content with over 2,4 million learning objects used by our students during the quarter. Adding to that, we see the monthly content consumption increasing more than 26% as we scale our tutoring system. Engaging more students to our platform is key to future conversion to other products and services Afya will be offering.

The strategy is to build and nurture the relationship generating loyalty with students and other medical professionals. With the proven effectiveness of our digital platform and services, we have strengthened our position as the leading innovation and Tech Company in the Brazilian medical education segment.

This shift in teaching and learning behavior is also giving us an opportunity to take a further look at our long-term digital strategy. While no one knows how long the current business environment will persist, it is our expectation that some of the programs and/or processes put in place because of COVID-19- will continue over time. As a result, we are actively assessing our current product offerings as well as expanding our view to potential acquisitions. Our strategy is to further build our share and drive long term profitable growth.

Now, I'll turn the call over to Luis to discuss our financial results.

Luis André Blanco, CFO

Thank you, Julio, and good morning everyone. Before getting into the financial results, I would like to add that it is a pleasure to be hosting my first call as Afya's CFO. As Virgilio said, it was certainly a very unique time that we are all living through.

I am particularly proud that we delivered a successful quarter that is tracking in line with our first half guidance. We are particularly pleased with the execution in the first quarter to quickly move all of the classes online, which, in turn, enabled us to report a good start to the year.

Moving to Slide 14

My discussion will focus on the main and most significant P&L items. There is additional info in the earnings press release that you can refer to for more information. As shown on this page, we had a very good quarter across all key metrics. We also reported higher margins. Let me highlight a few:

- Starting with medical seats and students, both of which saw significant increases during the quarter. With respect to the number of medical schools' seats, we added 417 seats year over year for a total of 1,684 by quarter end – a 32.9% increase over 1Q19.

  Reflecting the seat maturation process, the total number of students in 1Q20 was 7,956, an increase of 58.8% over the same period of the prior year.

  Subsequent to quarter end 2020 we added another 182 seats with the acquisition of UniSL, and with a potential upside of a further 100 seats. As a reminder, considering the acquisitions we have already made, our full potential as of today is 1,866 seats and 13.4 thousand students, which leads us to a 11% CAGR in students base, considering the period of 2019 until 2026.

- Pro forma net revenue for the quarter, was up 27.2% year-on-year to R$272 million. Excluding the acquisition of UniRedentor, which closed in the end of January 2020, Pro Forma Net Revenue grew by 20.1% YoY, reaching R$257.1

million. The increase was primarily driven by organic revenue growth, mainly due to the maturation of medical school seats.

- The strong top line growth combined with cost efficiencies and resultant synergies from acquisitions was reflected in Pro Forma Adjusted EBITDA increasing 36.0% to R$ 141 million and the margin expanding 330 basis points. Excluding the consolidation of UniRedentor, Pro forma Adjusted EBITDA increased 33.3% year over year to R$137.8 million and margin increased 530 basis points

- Adjusted Net Income up 131.7%, reflecting the revenue contribution, synergies captured and margin expansion from the consolidation of acquisitions. Our diluted earnings per share increased 54%, achieving R$1.09 per share.

I would like to remind you all that two types of seasonality affect Afya's business, as detailed in our earnings release, and, as a result, in a typical year, the first quarter is normally the strongest in terms of revenue, but not in terms of cash conversion, since Medcel's revenue recognition mostly happens in the first and fourth quarters.

Moving on to page 15 for a discussion of key operating metrics by business unit.

We delivered strong results in the first quarter, as both Business Units continue performing very well. Growth in key operating metrics as shown on this slide is being driven by a combination of organic growth and acquisitions.

Our average monthly medical tuition fees at quarter end were R$8,235 which was 8% above the same period in 2019. This reflects a combination of new students enrolling with a higher tuition rate combined with the students graduating with a lower tuition.

As shown in the middle chart, 77% of our combined tuition fees are derived from medical school. The combination of a 48% increase in the number of students and an 8% increase in average ticket resulted in combined tuition fees up 58% when compared with 1Q19.

With respect to BU-2, we had almost 12 thousand active paying students at quarter end, an increase of 22% over the same period last year. We can see an increase of 29% and 22% in the number of students of prep courses & CME for B2B and B2C, respectively.

Moving on to a deeper analysis of Revenue & EBITDA on Slide 16

Our business model enables us to generate highly predictable revenue growth. However, as mentioned previously, acquisitions are a key part of our growth strategy and as shown on this page we have provided a net revenue and adjusted EBITDA bridges from our historical 1Q19 revenue to reported 1Q20.

For the quarter, net revenue increased 88% to R$272 million. Excluding the consolidation of Uniredentor, net revenue grew 77.8% in the quarter, with a contribution of R$84 million from acquisitions and R$28 million from organic growth, which is comprised of the maturation of medical school seats and increase in average ticket.

On the right side of the page, we show 1Q20 Adjusted EBITDA. During the period Adjusted EBITDA increased 88% year-on-year to R$141 million. Excluding the consolidation of Uniredentor, Adjusted Ebitda grew 84.4%, with R$47 million contributed from acquisitions and R$16 million, from organic growth.

Aside from strong revenue growth, our results are also benefitting from synergies that are being realized from acquisitions as you already heard Virgilio discuss.

Moving next to a discussion of Cash Flow on Slide 17.

Cash is crucial in the current environment and we have a very strong and healthy balance sheet that was strengthened even further by the follow-on offering we completed earlier this year. It is the strength of our balance sheet that will enable us to continue to grow the business and support future acquisitions.

Cash and cash equivalents of R$1.3 billion at quarter end was up from R$960 million at year end 2019, a 35% increase. The significant increase in cash compared to year-end 2019 reflects strong cash flow generation and the proceeds from February 2020 follow-on offering. The majority of these funds is invested in low-risk Brazilian real-denominated instruments.

Total debt was R$487 million at quarter end 2020, up from R$361 million at year end 2019, with the increase related to due to accounts payable to selling shareholders. This quarter debt is 47% current.

Cash flow generation remained strong in 1Q20, which resulted in a cash conversion ratio of 80.7%, compared to 82.7% in the first quarter of 2019. This was a slightly lower cash conversion rate versus 1Q19 mainly due to the seasonality in BU2 associated with Medcel business. As I said in the beginning, revenues from our prep courses are recognized mainly in the first and fourth quarters of each year, but the receivables are mostly stable during the year. In this sense, Medcel's results negatively affects cash conversion in the first and fourth quarters.

Turning next for a discussion about Guidance on Slide 18.

As mentioned earlier in the presentation, our first quarter results were trending in line with our first half 2020 guidance. As a result, we are re-affirming our guidance provided during our year-end conference call.

As a reminder, the world is still in the midst of a pandemic, economies are slowly opening up, and our guidance takes into account the best information available at this point in time.

Two key metrics for first half 2020 are as follows:

- 1H20 Net Revenues: between R$475 million and R$510 million.
- 1H20 Adjusted EBITDA Margin: ranging between 45% and 46.5%.

Our guidance includes the impact of the adoption of IFRS16, includes UniRedentor starting February 1st, 2020 and excludes any other acquisition that may be concluded after the issuance of the guidance. I would also point out the possibility that revenue recognition for some practical classes could be pushed out to second half of 2020 upon resumption of classes.

Summing up – please turn to the next page – slide 19

We are operating in truly extraordinary times, times of great challenges, but also times in which we can see many key opportunities ahead. We are very confident in the strength, the resilience and the overall health of our company. We are navigating the current uncertainty well.

Our leadership position is creating even more demand for our medical seats. And, as mentioned earlier, we are currently seeing demand for the available seats, ensuring we maintain 100% occupancy.

The use of our digital platform is strengthening our brand and positioning and we see the opportunity to expand this platform both organically and via acquisitions.

Given the nature of our business, coupled with the high demand for seats, we have a model that presents us with highly predictable organic growth, given the maturation of the seats, with an expected CAGR of 11% in our student base from 2019 to 2026.

We are maintaining our long-term strategic focus of which M&A is a key component. We already have a solid pipeline and we are on track and generating synergies from the acquisitions completed over the past two years.

Integration is progressing even in the current environment. In turn, we anticipate further margin expansion.

Lastly, as you have heard throughout this presentation, we have a strong balance sheet and generate significant cash flow. These attributes coupled with the actions we are taking now enable us to manage through the situation today while funding targeted strategic investments that will benefit us going forward.

This ends our prepared remarks. We are now ready to take your questions. Operator, please open the lines for questions.

Q&A Portion

After Q&A, the operator will turn the call back to Virgilio for closing remarks