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15th June 2015 | Business Design Centre, London

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Credit crunch

Brazil has one of the biggest for profit university sectors in the world. But a shock reform to the student system has the sector reeling, finds **Daniel Thomas**

To call Brazil's for-profit higher education industry a success is to understate the facts. About 80% of the country's seven million university students are privately educated and demand from the emerging middle classes is rising rapidly. Not surprisingly, shares in the country's leading providers have soared despite a sharp slowdown in the economy, with Brazil's biggest player Kroton climbing 600% between 2011 and 2014.

But a shock announcement from the government before Christmas has taken the shine off the sector. The recently re-elected socialist government has promised to curtail access to a major student loan programme, known as Fies, which bankrolls a large proportion of privately educated students (public sector universities don't charge fees). The market response was severe, with shares in Kroton falling 40% in the first two weeks of January and rivals Ser Educacional SA , Estacio Participacoes SA and GAEC Educacao SA slumping 40%, 24% and 34% respectively. (At time of writing they all remain in the dumps.)

The government says it is trying to raise standards, arguing perhaps fairly that it has been too easy to obtain a Fies loan in the past. For this reason, it's raised the minimum passing grade to be eligible for the loan – a move that would have rendered about half of recipients in 2013 ineligible.

Most, however, believe it's really trying to rein in spending as it grapples with Brazil's yawning public sector deficit. The giveaway is that it has also prohibited students from having multiple loans at once and slowed the rate at which it disburses Fies funds to providers. Subsidised by the state, Fies loans do come with highly attractive terms and carry a paltry interest rate of just 3.4%, compared with typical consumer credit rates of over 10%. Take-up of the loans also spiked in 2011-2014, just as the economy was slackening.

"For the government there a big question mark over what proportion of the students will actually start repaying their loans next year," explains an analyst who prefers not to be named. "That is obviously linked to a student's

ability to find a job after graduation, but if the economy continues to perform as it has been the chances are fewer will."

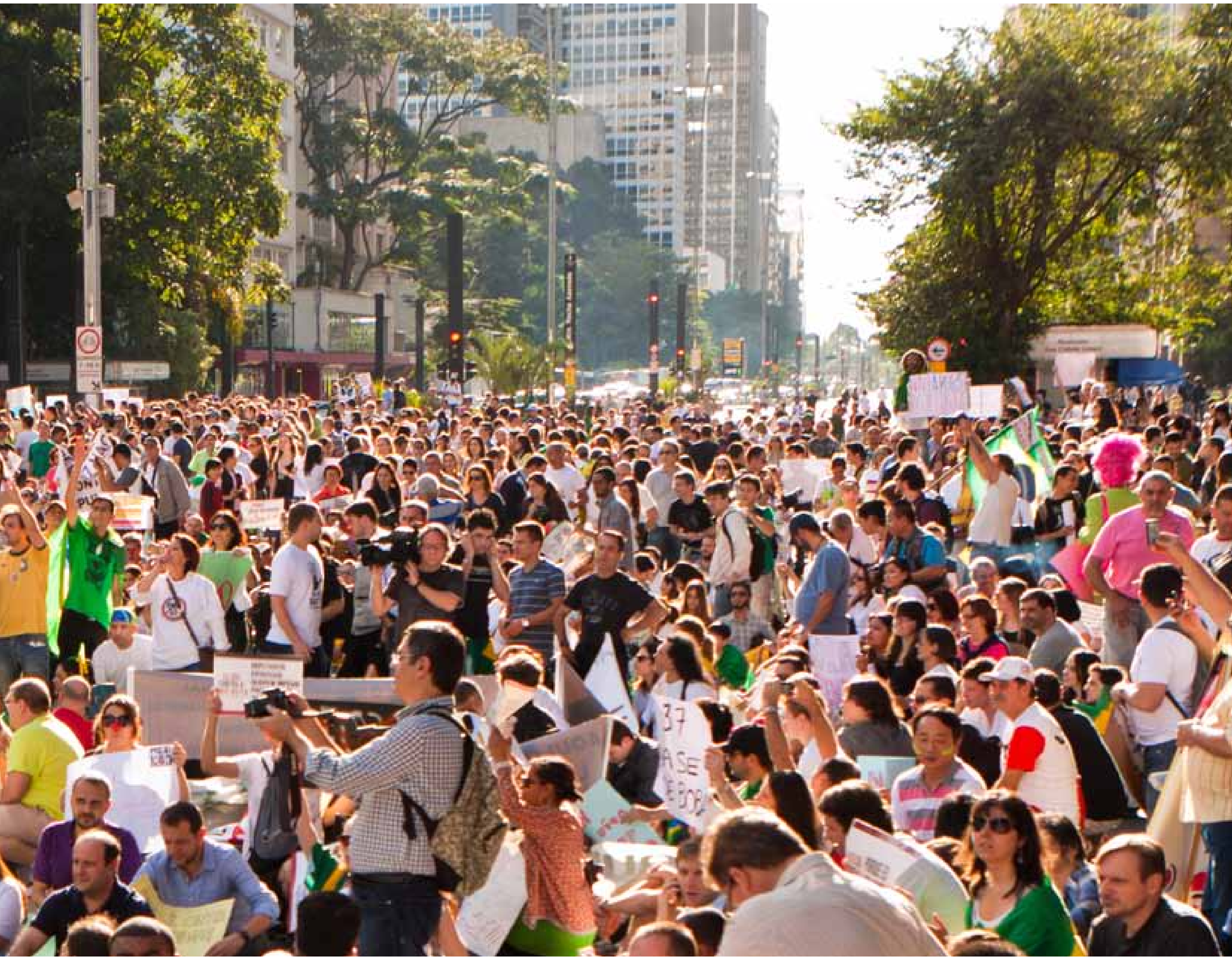
The for-profit sector's exposure to risk at first appears severe. 5.4 million enrolled at private universities in 2013 and there were about 900,000 loan holders last year. Private sector enrolments are climbing at 4% annually. However it's likely some providers will suffer much more than others, suggests another analyst.

""The markets may have overreacted," says another analyst, "as some are less exposed to Fies, such as the higher quality self-paid private ones. But all the biggest players are nervous as it will hurt the core of their business."

Smaller standalone universities – which make up the bulk of for-profit sector – may have something to worry about too, not to mention the investors backing them. In 2012, private equity firm Actis bought a minority stake in Grupo Cruzeiro do Sul, a university with about 100,000 students, for 180 million reis (£46 million). Beatriz Amary, director in Actis' Sao Paulo office, says the market has offered strong growth over the last few years, but that "until we understand the impact of these policy outcomes and how much sway the larger companies can have with the government, then the market is going to be very volatile."

> 'If the government wanted to reduce the amount it spent on Fies, it could have simply tampered with the income thresholds'
>
> **Beatriz Amary**

Like others, she finds it staggering the government did not consult providers before changing the rules around Fies, given that Brazilian HE is mostly



delivered by business. She also questions whether raising the quality threshold was the right thing to do. While it may have been too easy to get the loans, tightening eligibility could threaten participating in HE – the reason Fies was created in the first place.

"If the government wanted to reduce the amount it spent on Fies, it could have simply tampered with the income thresholds," Amary says. "A lot of students who currently go to university under Fies can actually afford to self-fund and would not be out of the system if it wasn't for the programme."

What happens next is an open question. An industry association is currently in negotiations with the government, but there's little sign this will lead to a rapprochement. However, the full impact of the policy changes is hard to predict.

One analyst watching Brazil closely is optimistic. "If you ask commentators and people who've been part of the system, you'll realise that the government probably won't reduce the overall amount of funding available. I think companies will feel some pain in the short term, with enrolment falling at most by 10-20%, but over the long-term it will level out."

For another analyst, though, things could get tougher, with some colleges theoretically losing up to half their students. The situation is redolent of recent events in the US, he adds, where the government has restricted loans at low quality for-profit colleges with ▶

> ‘think the re-pricing is going to drive consolidation, because you've got a need to continue offering growth to investors, and it that's not possible organically it will be achieved externally’

The Brazilian for-profit higher education sector

In 2013 there were 7.3 million enrolments in higher education: 1.9 million at state universities and 5.4 million at private universities. From 2010-2013 private enrolments grew by about 4% per annum while those at state institutions grew at 5%.
In the private sector, the top four providers have a 20% share of the market and include in descending order:

1. Kroton e Anhanguera (the two firms recently merged to become Brazil's biggest); listed on the BM&F BOVESPA stock exchange with a market cap of £5.3 billion. It is said to have over a million students.
2. UNIP (owned by Grupo Objetivo, a private provider of education services)
3. Estacio Participacoes SA; listed on BM&F BOVESPA with a market cap of £1.3 billion.
4. Laureate (US based); NASDAQ-listed with a market cap of £2.1 billion.

The rest of the market is fragmented and comprised mainly of single site providers held by individual entrepreneurs. Private equity is fairly active: Kroton was previously a part of Advent's portfolio and Actis owns a minority share of Grupo Cruzeiro do Sul. "Brazilian HE is fairly highly traded by private equity," says one analyst. "A number of these PE providers hold assets of a fairly reasonable scale and in individual local markets they could be quite large."

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high dropout rates. Some of the biggest US players, such as the University of Phoenix, are still grappling with falling enrolments and depressed profits.

There are upsides to all this though. Firstly the policy will begin to discriminate between higher and lower quality providers, which could drive up quality in the system. We may also begin to see consolidation, says the analyst.

"You've got a need to continue offering growth to investors, and if that's not possible organically it will have to be achieved externally. Weirdly, too, I think it's going to open up the market to opportunistic foreign players. So far the market has been mostly domestically driven."

This may be the case for those yet to enter Brazil, but those already there such as Apollo Education Group, Devry and Laureate may be less inclined to agree. Like others, they must play a waiting game as the government ponders its next move. If they're lucky, the sector will adjust after a period of tightening, and Fies will remain intact. The big fear though is that Dilma Rousseff's government will tighten the screws.

"It's a real worry that they'll go further and cut Fies," says Amary. "Brazil needs to increase penetration of higher education, compared to other emerging markets we're still quite far behind. But it's not going to be achievable without Fies or the private sector." ■