Y 2018 Earnings Call

Company Participants

- Carlos Alberto Bolina Lazar, Investor Relations Officer & Member of Board of Executive Officers
- Jamil Saud Marques, Chief Financial Officer
- Mario Ghio, Primary and Secondary Education Executive Officer
- Roberto Valerio Neto, Postsecondary Education Executive Officer
- Rodrigo Calvo Galindo, Chief Executive Officer

Other Participants

- Leandro Bastos, Analyst
- Luiz Mauricio Garcia, Analyst
- Marcelo Santos, Analyst
- Maria Tereza Azevedo, Analyst
- Rodrigo Gastim, Analyst
- Susana Salaru, Analyst
- Unidentified Participant

Presentation

Operator

Good morning, ladies and gentlemen and thank you for waiting. At this time, we would like to welcome everyone to Kroton Educacional's Fourth Quarter 2018 Earnings Conference Call. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the Company's presentation. After the Company's remarks are complete, there will be a question-and-answer session for analyst and investors. At that time, further instructions will be given. (Operator Instructions)

Also today's live webcast, both audio and slide show may be accessed through Kroton Educacional's Investor Relations website at www.kroton.com.br/ir by clicking on the banner 4Q '18 Webcast. The presentation will also be available to download on the Company's website. The following information is available in Brazilian real in accordance with Brazilian Corporate Law and Generally Accepted Accounting Principles, which now conform with International Financial Reporting Standards, except where otherwise indicated.

Before proceeding, let me mention that forward-looking statements are based only on the beliefs and assumptions of Kroton management and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of the Company and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Kroton's CEO, Mr. Rodrigo Galindo, who will begin the presentation. Mr. Galindo, you may begin the conference.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Good morning, everyone, thank you for participating in this earnings call of Kroton Educacional on the results of the fourth quarter and the year 2018.

Today with me IR Director, Carlos Lazar; Finance VP, Jamil Marques; and heads of business areas K-12, Roberto Valerio, sorry, Higher Education, Roberto Valerio; and K-12, Mario Ghio.

2018 was an important year, the Company dealt within internal and external factors that were really relevant, reduction in FIES student base, increase in Distance Learning competition and favorable macroeconomic scenario. But we used this adverse scenario to take care of conditions for future growth.

We decided to implement four strategic pillar focused on student success, grow higher education because this year, we saw lots of opportunities, focus on basic education, go back to Kroton's origin very intensely in K-12 and for digital transformation. So student success, higher education growth, focus on basic education and digital transformation. The four pillars of the strategic plan were doing really well in the organization, we'll talk about their evolution in today's presentation.

2018 was an important year, we overcame short-term challenges, we delivered the financial results announced in the guidance and at the same time, we made all the necessary investments to continue to grow. Financial performance shows Kroton once again attained its goal.

Slide 4 compares projections and the results delivered. Slide 4, we see a consolidated revenue of BRL5.6 billion, 1.3% above expectations, which proved our commercial strategy was assertive, strong brand and a program portfolio aligns to market demand. In addition to the initial positive contribution from greenfield. Adjusted annual EBITDA BRL2.3 billion above the guidance by 1.2% margin was 41.5% following the same trend as with revenue. Higher level of efficiency was possible because of lever to obtain cost efficiency, commercial levers and student retention to neutralize the anticipated pressure of change in the profile of our students. And also expenditure to launch new unit sectors through cash and earnings, and will ramp up. This year, we had the greatest reduction of FIES students and still we delivered the results announced.

In revenue and EBITDA, we overcame the guidance, more in consolidated results than in the ex-greenfield view, which means the performance of greenfield was even better than the rest of the operation. It means, we delivered results of course the original business plans, which shows the financial soundness of the greenfield project. Consolidated adjusted net income, BRL1.9 billion, a margin of 35%. The total investment accounted for 12.7% of the net revenue in 2018, a reduction compared to the guidance of 13.5% even with the increase of EBITDA, another very relevant project for the Company in 2018, digital transformation and expansion projects among other.

We're happy with the results, they confirm the fairness of our operations and the assertiveness of our strategies that have high profitability and efficiency even facing the challenges we mentioned. We're even happier becasue all of that is followed by higher educational quality and better service offering to students. Therefore, we are certain that 2019 has all conditions to deliver even more positive financial indicator. I'll give the floor to Mario Ghio, our Vice President of Basic Education and next, he will talk about Somos.

Mario Ghio {BIO 17352490 <GO>}

Thank you very much, Rodrigo, good morning to all. Let's -- please turn to Slide 7. Since October last year, we started the integration of Somos and we've been making great progress in recent months trying to maximize synergies and between the two companies. I would like to show you in broad lines the numbers that's keeping the dimension of this process.

One of our first step was to establish governance at Somos, covering the most important topics of the operation and specific focuses to ensure that we have focused delivery of targets, capture of opportunities to support our growth. What we felt was that to achieve all of this, we have to create five new committee reaching 19 in total, and in those committees, we discuss education of quality, revenue, CapEx among other subjects.

We have 12 fronts currently in execution in addition to the fourth operating front that will have convocation by the end of this semester and with high cost in the capture of synergies. For example, we have integration and centralization of strategic areas of our shared services center at Kroton Valinhos.

The definition of the financial ERP, and systemic migration, integration of our print shop and storage and logistic operation at Kroton and renegotiation of agreements with suppliers with the implementation of the strategic sourcing projects at some. I can say that now the Company is integrated and all corporate areas have been essentially integrated from the systemic point of view. Some systems have completed the integration and others will not be integrated because they support some very specific processes to some of them, the integration will not result in synergies. So the integration is proceeding better than expected.

Moving now to Slide 8, we see the integration of the budgetary process with the development of the 2019 budget at Somos. According to the model, we use at Kroton, a company that prides itself on its budgetary processes. We have a process that last 50 days and 200 people were involved, we had two workshop and three specific committees involved.

In relation to the budget, Somos is organized in different business units. We have K-12 FAC schools and language schools, all of them with a different dynamic and seasonality pattern. And of course the budgets treats each of them independently. We also adopted the official budgetary session and a centralized control of expenses for Somos to ensure better management of some lines such as materials, leases, marketing, travel and legal. We also introduced zero-based budget process of Kroton methodology budgetary management including system locks to make sure that our expenses are compliant with the budget, one of the first systemic integration. We performed was the system lock that locks purchase orders with no budget allocation, often takes pride in its budgetary culture and the specification of the processes. We allowed budgets being allocated. It did not even started the procurement process. And like there is no one will discover budget overruns exposed after the facts added productivity cannot be made. And all system adjustments were made at Somos. And since the beginning of 2019, Somos were following these rules and this increase predictability of our costs and expenses in terms of treasury. We integrated cash and debt management including the integration of debentures contracts creating more opportunities to reduce debt-related costs.

Now, I would like to discuss slide number nine. Before we begin, it's important to remind you that some of our three major business lines. First, we have would be editorial program geared to the Federal government, the National Textbook Program. We also have the school management program very similar to higher education. And finally, the integrated K-12 platform, which is in fact a B2C unit.

And Slide 9 shows our attention over this business and the different services that make across the platform. We would like to become a full range provider of services for K-12 schools in Brazil. The most important service we offer today is learning materials, which could be a textbook or handouts both in print or in digital format. But there are several other services that complete our portfolio such as technology, educational support, teacher training and counter shifts activity. We have several competitive edges and among them the most solid and well reputed brands in the country. And now this the fresher, we have an addressable market that's very significant. Currently, we have 6.2 million gained the private schools using text book, 3.8 million used learning systems and 2.4 million used textbooks. Somos has all of those options in its portfolio, and as such, our addressable market is higher than anybody else's. We want to meet this -- the needs of our schools by providing the best educational solution, and based on this concept, we position ourselves as K-12 Education Solution platform that is permitted by the use of technology. So one stop partner powered by technology. This is the concept we use. We want to meet the needs of each partner company in earnings of July 3, offering learning systems, textbooks, teacher development, technology solutions and adopted learning in addition to counter-shift activities such as language development and also other skills. We believe that we can increase penetration and seize more business opportunities in addition to the schools we already serve and also expand our market with the 34,000 schools that don't use our solutions yet. We'd like to show the K-12 platform successfully implemented throughout our brands and current solutions.

And now let's turn now to the next slide, in which we will talk about the most important aspects of our go-to-market strategy and we'd be also explaining to to the market the Allied Schools project that we're going to engage in, it's going to be a totally different platform, non-core services under our responsibility. And we want to provide the schools, for example, such as correction, legal services in addition to e-commerce, so that the focus of schools will be on their core business which is education.

So now moving to Slide 10. Since October 2018, we have been working very hard to with New Somos go-to-market and to adopt a different approach based on the commercial relationship of a sales force platform. Somos commercial teams were working in isolation and now all incentives are in line with this new concept. Our sales team is working very hard to understand the needs of schools, which is total changing our mindset and we believe that this will add a lot of value in the relationships we maintain with partner companies and potential profit, to we have a flexible integrated portfolio with recognized brands including learning systems, including books and also we provide learning assistance, feature development and adaptive learning opportunities. Our portfolio also has an integrated offering in counter-shift solutions such as English learning and social emotional skills. And so the value in our proposition is to offer these activities inside the schools, the schools will become a holistic center for the development of the students, and this will also strengthen our relationship with partner companies.

We are also optimizing and strengthening to focus our commercial leaders in integrated solutions to take this transformation even further and also to back up our vision for the future of the K-12 segment. In terms of our sales team, we have the largest number of consultants and bachelors. By school in the whole market, we're trying to solidify our relationships with schools, always paying attention to the demands and specific needs they report to us. This is only possible, thanks to our technology that is incorporated in the complete portfolio. We are currently engrasping the new technology solutions to make the life of our students and their parents even better driving the digital transformation of the company.

Now I would like to turn the word to Mr. Carlos Lazar, who will talk about Somos' results in 4Q18.

Carlos Alberto Bolina Lazar {BIO 21631606 <GO>}

Thank you, Ghio. Now the next deck of slides on Somos, talk about adjustment in Somos' results reported today, with the transfer of control, Kroton annualized the financial statement of Somos to align criteria and accounting practices to those of Kroton. So, this is reflected in the results and the balance sheet of 2018, many are non-recurrent and have no effect on cash, they relate to previous fiscal years. After these nine months, the comparatives will be affected, with now the implementation unified the accounting practices between Somos and Kroton, so in the future, they will be comparable.

Slide 12, first important review were the punctual payment deduction values no longer as financial expenses but now as deductions from the revenue, as it relates to the operation, they are not really financial events. Secondly, we've implemented a new concept of provision for inventory obsolescence based on production ageing, but this is more in line with our business and Somos and Kroton strategy. We reviewed provisioning criteria for losses in receivable accounts and the criteria for the capitalization of cost and expenses. In addition to write-off of assets. We also wrote off active deferred tax and time barred recoverable tax, this is only to reinforce these adjustments will make future results fully comparable with no impact on cash.

To quantify these adjustments, let's look at Slide 13 and begin from the EBITDA. We would have presented for Somos without these adjustments which is being BRL499.3 million in 2018. First, reclassification of punctual payment deduction, now on net revenue. So EBITDA -- recurring EBITDA is BRL473 million. Based on recurring EBITDA, we had a few other adjustments, the first impact refers to inventory totaling BRL116.2 million because of the new concept of obsolescence for inventory. We've also reviewed provisioning criteria for receivable account losses including the impacts of books shelf creditors agreement request totalling BRL36 million and also write off of fixed assets and intangibles BRL11.4 million.

Now active deferred tax and time bond recoverable. Tax impacted EBITDA by BRL7.7 million and review of other provisions almost BRL28 million. So with that, the whole impact was -- the whole impact without any effect in cash was BRL225 million. Now on the other hand, we also had non-recurring expenses that had an effect on cash totaling BRL189.1 million of which BRL23.7 million was for other non-recurring expenses and EBITDA after adjustments of BRL84.6 million. In the future, we will consider the recurring EBITDA BRL473 million becasue it shows the results of 2018 without the adjustments and it allows for the comparison with 2019 results in future years. Now, I'll give the floor to Rodrigo to talk about the guidance for Somos for 2019.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Carlos. The final slide deck on Somos will talk about the guidance of Somos for 2019. It's Slide 15, the guidance of Somos and the Educational Business Unit, so that's Somos company without including (inaudible) and it includes SAFe, which used to be part of Somos, so you have the guidance of Somos and we shall track the guidance of Somos during 2019.

Now, to allow for comparison with the guidance and results to be announced in 2019, we depart from the recurring result of 2018, which is that result BRL473 million in addition to allow for comparison, we considered the hypothetical impacts of IFRS 16 on 2018 results. So the comparison to 2019 which will already have the IFRS 16 impact, so we are applying IFRS 16 to the EBITDA BRL473 million of 2018 and it becomes BRL556 million in 2018.

This is the best number to compare to the guidance of 2019 EBITDA, Now, again, about the main lines, we project net revenue of BRL1.933 million for 2019, an increase of only 3.5%. The new management took control in October only, went almost all actions to ensure the future year revenues had been implemented because of the characteristics of our business, estimated recurring EBITDA BRL670 million for 2019, margin of 34.7%, it's a relevant growth of 20.5% in relation to 2018 already adjusted by IFRS.

So margin goes up 490 basis points and EBITDA -- the EBITDA guidance is BRL670 million or 490 basis points higher reflecting the integration of Somos and Kroton and synergy gain. We come from a loss of BRL258 million in 2018 up to an adjusted net income of BRL100 million in 2019, a significant improvement.

Finally, this is perhaps the number one message, company announces an operating cash generation moving from negative BRL9 million in 2018 to a positive cash generation of BRL115 million with an EBITDA cash conversion rate of 24.2% already considering the IFRS adjustment, now BRL150 million will be the positive cash generation coming from a negative BRL9 million in 2018 and this is the first year after integration. So all the efforts to revert this cash generation situation already in the first year. The initial projection show the great potential of Somos in terms of profitability gains, in addition to the impact from integration, which brings great improvement. Academic and educational improvements. We are convinced that our unique portfolio of educational solutions at Somos and our new positioning plus the management model, robust governance structure, the highly qualified team we have at Somos and aligned incentive build all the necessary conditions for growing an sustainable value generation. In all senses, educationally, academically, and financially in the long term. We're very optimistic about Somos in the long run.

Now Slide 16, you see details on the timing of synergy gains in '18, '19 and then as of 2020. Let me begin saying that in the 2018 earnings, we already had 20 million synergies raising our recurring EBITDA from BRL536 million to BRL556 million, which is the number we showed in the previous slide. On a basis of comparison with the guidance. BRL556 million, the third bar is recurring EBITDA of 2018. The guidance of 2019 is BRL670 million. Of the BRL114 million increase, BRL19 million came from organic operational growth, and BRL95 million from efficiency or efficiency initiatives or synergies from the transaction. Up until December 2019, we will capture BRL115 million synergy, BRL20 million in 2018 and BRL95 million in 2019.

Now Slide 17, an update of the synergies we expect from the integration. I'd like to remind you, when we announced the operation in April '18, we announced an estimate of BRL300 million of synergies in four years, but we've raised that by 20% through BRL360 million on May 2018 [ph]. When we started the integration. Now we have more access to numbers and opportunities, again we raised the expected synergies according to Slide 17. Today, we expect BRL375 million, an increase of 20% compared to the original synergies announced in April 2018, which was BRL300 million. As you've seen in the previous slide, BRL115 million will be captured until December 2019 first phase. Another BRL245 million will be captured until -- as of 2020, totaling BRL360 million as announced in the second estimate presented. Today again, we review upwards this estimate another BRL15 million of opportunity on the integration front. So we move to BRL375 million, an increase of 25% compared to the initial estimate.

So we were right when we made the decision to make this investment in Somos iversifying operations and opening new growth front. I will close here and invite our Financial VP, Jamil Marques to continue.

Jamil Saud Marques {BIO 21416820 <GO>}

Thank you very much, Rodrigo. In the next session, I will make some comments about performance in the most important lines of results, loss provisioning and also average receivables from first segment considering cost standalone without the Somos impact.

So starting with Slide 20, we see the most important line -- results in this quarter. And following the disclosure we had this year. We are showing the results on two different perspectives in the higher side of the slide we have consolidated figures excluding the results of asset sold in 2017. And in the lower part, we exclude the results of 2018 in relation to the new units launched this year from greater clarity. In this slide there is three points I would like to call your attention to. Both in the consolidated ex sales vision as in the excluding sales vision, our net revenue had an increase of 4% which reflects our robust student recruitment processes, reentrollment and an improvement in the mix of programs, both in -- once a weekend business learning decide to be initial impact of new campus -- campus and also the sound of correction in 2019. We see a decrease in consolidated results as seen in the previous semester and this becomes more evident when we see the growth in adjusted EBITDA. It's important to highlight that this increase in cost was expected and is below the business plan, BRL42 million [ph]. And finally, we have adjusted EBITDA on net income that had decrease in the annual vision because of slow pace of drivers of differentiation and in some sense it has been announced in our guidance.

Now, let's turn to Slides 27 and 30. To see the provisioning for losses and also the students in this segment. It's important to remind you that like in previous quarters, we exclude from this analysis the numbers relating to the units we sold in 2017. Starting with the analysis of higher education. On Campus, we see an increase in the loan losses provision and also in the average terms of receivables, following the natural trend.

If we consider only the out-of-pocket balance, we also see an increase in loan losses and also -- larger provisions in -- important receivable terms. It's important to remind you that the macroeconomic scenario continues to be very challenging with higher delinquency rate and we also have realized a fewer agreements with on the spot payment which increased the volume of financial charges and includes also the average term of receivables. The level of losses continued to be higher in spite of the tendency towards (inaudible) once again increase the losses provisions.

Now going through this inferno in spite of the increase in the losses provision, We see also reduction in the average term of receivables. Once again, the macroeconomic scenario continues to be challenging with driving delinquency and we also see high efficiency in collection and reduction in the number of agreements which has positively contributed to the reduction of the average term of receivables and losses levels.

And we also see a positive tendency, we increased loan losses provisions because of the level of losses remaining high. And also in K-12, we had an increase in losses provision reflecting the population of schools, Leonardo da Vinci and Lato Sensu. In short, we continue to observe the impact of a very challenging macroeconomic scenario with high unemployment rates, and this of course creates impacts in our average term of receivables and loan losses provisions. However, we were able to register the second time the provision for doubtful account and also we see a return in relation to the out-of-pocket students. We have implemented several collection policies and for 2019, we continue to surge and seek the responsible quality growth we are characterized by now.

Now moving onto the profit, next session. I will talk about the evolution of CapEx and cash generation considering the impact of -- I'll first start with CapEx on Slide 25. On the left side of this slide, we see recurring annual CapEx representing 7.9% of net revenue in the period, down 1.2 percentage points vis-a-vis 2018. Thanks to optimization and efficiency gains. On the right side of the slide, we see also the investments relating to special projects from greenfields totaling BRL266 million [ph]. This took total CapEx to 12.7% of the annual net revenue below the guidance, which was 13.5% [ph].

Moving on to Slide 26 in relation to operational cash generation in the quarter. There are two points to highlight. First of all, both CapEx cash generation saw a conversion of difference with cash of 49% along the year. These represents a reduction of the annual contract and relates to the impact of the working capital consumption from the change in compliance in our student base. With a reduction in the number of FIES students and also reflecting the high number of graduations and lower student recruitment rate. And in 2018, we generated BRL994 million in cash with the operations growth CapEx. And we consumed BRL427 million of our cash in 2018.

To give you better the cadence of the use of this cash, please turn to Slide 27, which starts with the generation of operational cash flows CapEx is BRL994 million in 2018. In the first block, we had BRL342.5 million, BRL206 million of which were debt into the Organic Expansion with the opening up 25 new on-Campus units, 600 million were invested in digital transformation processes, and also BRL76.5 million were geared to the acquisition cost controlled company. In the second graph, we see value generation to shareholders totaling BRL833 million in which we had BRL194 million of dividends and of repurchase of shares along the year. It's important -- and BRL639 million of dividends. We maintain a payout of 40% along the year in spite of our new projects. We also have -- we reduced growth debt representing BRL234 million in debt amortization. This takes us to the BRL427 million of free cash that was used in the year.

Now moving to Slide 29, let's talk about the net debt considering and consolidating the Kroton platform because we believe this is the more adequate way of interpreting our cash and debt position. At the end of the year, we have cash availability of BRL2.6 billion representing 50% growth in comparison to 4Q17. This is due mainly to the increase in gross debt of BRL5 billion as compared to BRL4.1 billion used at the moment of the acquisition of Somas. So if we add up all the financial debt and our short and long-term liabilities, we have net debt of BRL5.1 billion in 4Q '18 this is explained also by the initiation of debenture and sub base [ph] in total amount of BRL5.5 billion and also the Somas impact.

We also have receivables short and long-term with certain parts of the payment for the payoff Uniasselvi adjusted to net present value in this quarter, we received the first of the five annual installments and also the payment for the sale of FAIR, FAC and FAMAT concluded in August 2017, considering our receivables, our net debt was BRL5 billion on December 31, 2018.

With this, I close the session of the presentation, I would like to invite Rodrigo for his final remarks.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Jamil. Slide 31 for final considerations. We continue in an accelerated phase of organic expansion, we're doing really well and now that can be implemented throughout in the first half of 2019 as approved by the organization. We are very happy about the results. We continue to offer capillarity, quality services in the marketplaces where we work. As I said, we've implemented 12 new campaign in the first half of 2019 with -- for on campus learning and we expect to open another 12 in the second half, closing the year with 167 campaign, growing 17% compared to 143% campaign we had at the end of 2018. The project is doing well. We are happy and probably the breakeven curve and also the cross of the line when we begin to have positive cash generation will be before plan. In addition to 100 new education centers, we will open another 100 in the second half of 2019. So we will have 1,510 centers at the end of 2019 growing 15% vis-a-vis 2018. We are increasing our capacity and also we are improving the program mix with the new on campaign unit. We now offer healthcare, engineering and we have premium distance learning that shall gain market share in the processes of student recruitment this year.

So we gain more relevant in student recruitment and this is key for us to meet market demand, and to protect the average ticket due to the more fierce competition we're facing now. Now in the middle of the slide, you have an update of student recruitment process for the first half of 2019. We still have a month to conclude this process, the scenario is competitive and macroeconomically, we see challenges, we are confident in the evolution and we're happy with the results. We want to protect average ticket both on-campus and distance learning.

In distance learning recruitment, we will have approximately the same volume and average ticket. Now on campus the volume will be similar to last year, but the average ticket has a positive trend in on campus, so this is our strategy to prioritize average ticket and in distance learning, we have a more competitive position. So we wanted to improve our ticket on campus, and of volume, it isn't better than the expectation we had, and we will talk about the final results of student recruitment up until the end of April as we've been doing in previous year.

Next point, let me highlight our main deliverables in the context of the digital transformation projects. First, we implemented and improved our project execution methodology. We now have a methodology that combines traditional portfolio management and software development by agile methodology. We're using the Scaled Agile Framework (SAFe) with more than 550 people involved for 11 months more than 640 features and 10,000 stories delivered. This a very tangible proof that we are making significant process in the quality of our technology deliverables, we see a drop by expectant in the volume of incidents and problems in all projects that involve our systems migration which brings cost efficiency, efficiency in CapEx -- but we no longer see a difference between technology and business, it's part of the same deliverable.

So we prioritize agile deliveries and we are building a new organizational culture which had shown results in the short term and will be a great asset for the Company in the long run. It's difficult to make a tangible but those who know can feel the difference after the implementation of this methodology. We have talked to other companies to exchange information about how we obtained results with agile deliveries and we're very happy about the change we are going through in the Company. It means, we will need less investment, we will have better cost control and more stability in the operation, which contribute for a better experience for our students. We already see a significant evolution in our NPS [ph] both on premise and also Distance Learning.

We had some objectives deliverables -- concussion of candidate, already had a great improvement. We've also increased the number of student request. We in the past, we had 7% of all services in digital. We now have 50% of all services being digital and we want to attain 100% service requests we met digitally, which will improve student satisfaction and it will also bring cost reduction. We now have a new technological platform which is extremely scalable on the cloud for data treatment and analysis and we are using it more and more to make decisions. We have more data classes or analytics, more granularity. We're improving our algorithm for predictions, bringing more information on academic issues and also analysis of student drop out for example. So we are becoming increasingly more sophisticated, and this is possible because of all the decisions we made in the digital transformation and because of the digital mindset we took on. Finally, ever since we took this role of curators on the education vertical of Itau Cubo, we came to know 2,390 start-ups, we had almost -- we had more than 2000 visits at Cubo, we had 145 connections with Kroton ambassadors, who are our leaders responsible for identifying technology solutions for their areas. Eight experiments have been conducted to find solutions at Cubo to solve Kroton issues that might be solved by these start-ups. At the same time, we are conducting other experiments with Cubo [ph] companies, we've signed two contracts with these companies that have a potential of transformation or simplification of our administrative and I think the admin processes. So internally, the implementation of SAFe and systems in the company and also in terms of open innovation in our relationship with the start-up, so the whole ecosystem we're building at Cubo, we're really happy about the results of our digital transformation which is revolutionizing all areas of the organization and there is no way back. This will be our great differentiator in the next few years.

The final call in talking about dividend payout, BRL43 million or BRL0.03 per share keeping our payout at 40% and dividends will be paid on April 15, 2019.

To conclude today's presentation, I'd like to remind you that despite the difficulties faced in 2018, again, we delivered the guidance. Our commitment to the market, we took on in May last year. 2018, we had the largest number of FIES students graduating. In '19, the macro scenario will still be unfavorable, but we are certain we will deliver more sound results in 2019, especially in cash generation. In terms of K-12 and basic education, we're going through a revolution on the commercial area, that will bring great opportunities and more synergies. In higher education, we are at full steam with our expansion -- organic expansion project and also sustainable growth, to provide quality education and ensure the success of our students. 2019 will be another year of achievement for Kroton. Thank you very much for participating. I now invite you for the Q&A session.

Questions And Answers

Operator

Thank you very much. Ladies and gentlemen, we will now initiate the Q&A session. (Operator Instructions) Our first question is from Susana Salaru, Itau. You may proceed.

Q - Susana Salaru {BIO 16170633 <GO>}

Good morning, everyone. Thank you very much for the opportunity to ask questions, I have two questions in fact. A question to Ghio in relation to the acquisition of synergies. In which synergy blocks, is it going to have revenue, CapEx, and also what was the main reason for this revision? This is my first question.

And secondly, this year, we see graduation of FIES students starting at low level initially, but we would like to know what will be the impact of -- rather in terms of financing. Do you see graduation still starting to be up this year?

A - Mario Ghio {BIO 17352490 <GO>}

Thank you very much, Susana. I think I'll start with good thing actually, we have this upwards revision because after a few months with the company we have now become much more familiar about the scenario. So this synergies are in OpEx. So the BRL15 million in addition to what we have recorded before are completely in OpEx.

A - Jamil Saud Marques {BIO 21416820 <GO>}

Susana, and this is Jamil, in relation to the question about the graduating FIES students, we still have a very small level, 1,500 students graduated in December, we have been tracking this very closely. In terms of the influence of this, it's too early to tell, but we have observed that in terms of the behavior of payments in the last six months, it's very similar to out-of-pocket.

So, it was a very marginal decrease in collection and up to now, we continue to believe that the guidance we gave is adequate. Sorry, Susana, did you say that the -- no, there was a marginal decrease, this is what I meant -- we have been expecting 80% for the graduating students and if you compare this with out-of-pocket today with a decrease of 8%, we're still collecting 92% but the behavior of students after December, their payments from January to March is very similar with a marginal decrease and this of course puts us within the expectations we have for this type of students.

Q - Susana Salaru {BIO 16170633 <GO>}

Thank you very much. Now very clear.

Operator

Our next question is from with Rodrigo Gastim, BTG Pactual. You may proceed.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Good morning. I have two questions, the first one in relation to the contingency provision for Somos. Let me try to understand what's behind the numbers because you wrote about this under Louise but there is a number of things in the middle high especially when you compare it to the net worth BRL290 million in the last report. So can you give me some indication of the level of conservatism in the Company because were you expecting possible losses -- remote losses, did you bring this into the balance sheet as likely or probable loss. So how conservative were you and how much can you lose in relation to the BRL1.2 billion that was provisioned for Somos. This is the first question and I'll go into distance learning, there were efficiency gains and costs that were relevant, especially in relation to the teacher cost. If you consider personnel cost with a drop of 45% year-on-year. This is quite a sharp drop considering the Company has also high margins on business learning. So what's behind this reduction of 40% also in DL. Thank you very much.

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Hi, this is Galindo. About the acquisition. When you have an M&A exclusivity, the law defines you have an opportunity to pause against the opening balance sheet probable and possible contingency provisions and because of transparency, we posted all probable and possible provisions. when we say they are possible. We believe we will come out as winners and they will not materialize. Even probable, we believe that many events shall not materialize, but even with that because of transparency, we wanted to post them. So the market knows they exist. They are there. But of the BRL2.6 billion, which is the total amount of guarantees whether we have them positioned or not, of the BRL2.6 billion, BRL1.3 billion is premium and we are convinced that we will come out winners. And this amounts to BRL1.3 billion, BRL6 million we have collaterals or guarantees. So what is left BRL600 million which is the overall amount of possible labor suit. Many of them are highly convinced that we may come out winners or that these contingencies will not materialize. And if they do materialize, we believe we have enough arguments and elements to come out winners, but we wanted to provide maximum transparency.

So everything we found that could become a possible or probable contingency. As the lawyer said, it was possible or probable that we may have a contingency there. We posted it in the opening balance sheet because we want to be transparent with the market. So this was the rationale behind the contingency provisions.

Let me give the floor to Roberto for the second question.

A - Roberto Valerio Neto {BIO 2243533 <GO>}

Good morning, Gastim. How are you? In relation to the efficiency in real, of course three important pillars that explain the reduction. First of all, the synergies between professors of similar disciplines, especially as we expand the range of premium programs, there is more sharing. For example before we could have two professors teaching two different disciplines and with the synergies, we have just one. So this of course is a good synergy we captured.

Secondly, we have the tuition fee in the tutorship program, we've talked about in the past, maybe you remember, we have tutors that have active tools and that support students more closely. And like this, there is an improvement in productivity. They actually are able to anticipate questions, and we also have student supporting the tutorship program with peer review and peer support system.

And we have 100% online penetration in DL with lower tutor costs in those programs because we got -- need a tutor to be in the room like we have in the once a week model. This represents also better cost efficiency gains.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Thank you very much, very clear. Thank you, Valerio. Rodrigo, could you please go back to the contingency issues, just to make sure it's clear. You are looking at the Somos scope 100%, there is nothing more relating to Kroton. So it's exclusively everything that you have on Somos in terms of probable and possible contingencies that what you have brought into the balance sheet?

A - Roberto Valerio Neto {BIO 2243533 <GO>}

Correct. We will have with zero contingency provision from Kroton and subsidiary, all of them are related to Somos.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Thank you.

Operator

Our next question is from JPMorgan. Marcelo, you may proceed.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you very much for taking my question. Could you talk about the duplicate if you mentioned and what is the driver for the increase in on-campus -- with on-campus increasing the average ticket, or is it the time of financing and also in relation to distance learning, what are the pressure points since you are also increasing the premium distance learning programs.

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Hi, Marcelo. I will start with, then Marcelo -- will give you the -- his comments in relation to on campus. I don't see a relevant increase in the ticket or change in the ticket in DL. However, the digital, we have a flat or a level similar to that is because we have more pressure on the web products and once a week with higher pressure on the web products and once a week. And also a high participation of premium DL that does not suffer with the competition. So in relation to this, we see prices that are in line with inflation or very similarly -- with very similar to that. We have higher pressure in the distance learning ticket and in -- on-campus, we don't see there is movement, we see the FIES students leaving the higher cost -- higher prices in the program but at the same time, this is offset by the pricing strategy. We don't have a change in mix, that's really relevant between the two. So this increase in ticket and on-campus related to two points, the commercial strategies we are implementing with fewer discounts and scholarships, we couldn't given more emphasis on volume, for us this is not the way we chose to do. We gave more emphasis to ticket in comparison to volume and this is how we chose to operate.

And secondly, we have a pricing strategy and a pricing methodology that we have talked about in several other events that is being discussed and becoming more sophisticated today. We can use dynamic pricing very accurately among the thousands of products and the many locations we can understand every single day, what's the behavior among competitors and we can react much more quickly. This helps us define the strategy we want for each product in each location. Why it is important for pricing because when you're seeing a competitor that is more aggressive in terms of pricing, you don't have to review the entire portfolio for that location, you can go and change just the specific price and this granularity reduces the number of discounts we have to give while preserving our assertiveness. So putting together this strategy, we ended up with results that are in line with last year and also with a trend of prices diving and going up.

Q - Marcelo Santos {BIO 20444938 <GO>}

With the question about the dynamic pricing, what was the pricing before for example in the last six months, what did you implement in the system that wasn't available before just to get a clear picture.

A - Roberto Valerio Neto {BIO 2243533 <GO>}

This is Roberto speaking. This sophistication comes from the monitoring of the competition that we are now monitoring much more closely, even when it's a regional competitor and before the frequency of information was on a cycle of 15 days or more and now we have got that online, we also use verification through a call center with ever dedicated tools -- where people who are dedicated to calling their competitors every day. Just to make sure that the prices we see online are valid. And then we also have the mystery shopper program that goes and visits and to check whether the prices on the record, the ones that are really are being practiced, we don't do this on a very large scale, but it's -- yet another validation set. So as a result, we get more accurate information on a more regular basis than on more competitors and we monitor, we have actually more than 4,000 on campus programs on offer and 70,000 DL program and basically is of course considering the centers in all.

So if you compare this due to competition, you can make the necessary adjustments on a daily basis in the -- and I think -- as far as -- as often as daily but maybe on a weekly basis and as a result, we also have more people on the team, I think we have quite a large team as before working on this.

Operator

Our next question is from Mr. Roberto Otero, Bank of America. You may proceed.

Q - Unidentified Participant

Hello. In fact, this is Pedro. Thanks for taking my question. I have a question on out-of-pocket receivables. What's the dynamics you expect for the future in terms of this line.

And another question, looking to FIES students and contracts that is only negative, do they remain on the pipeline even if the agreement is active or are they moved to out-of-pocket. We want to know whether the increase that we saw in receivables in out-of-pocket is because when FIES contract is canceled, you change this person into an out-of-pocket since the contracts no longer exist, or if they remain in the pipeline. Thank you.

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Hello, beginning from the last question, no, we don't do this migration. Inactive FIES balance remains there, whether it's still active or inactive. About receivables, yes, we will have a natural increase because we have a growing out-of-pocket revenue, but in 2018, we had a deterioration of average time of receivables.

This is on campus because of this strategy that had more charges and interest.

Q - Unidentified Participant

It's important to mention the strategy matured in the second half of the year, what does that mean?

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

We expected some deterioration because of FIES but we -- all the impact, I think has already been posted. So we have seen neutrality in terms of default actually -- a slightly positive trend, but still gallop a little high and considering all of that and the initiatives we had to improve collection efficiency, our expectation is that these receivables will not grow more than the revenue than the out-of-pocket revenue. So we will have stability in average time of receivables.

Q - Unidentified Participant

Okay. It's clear. Thank you.

Operator

(Operator Instructions) Our next question comes from Mr. Leandro Bastos, Citibank. You can begin.

Q - Leandro Bastos {BIO 21416405 <GO>}

Hello, good morning. I have a question about the integration of Somos. So I would like to understand if you could mention what is your expectation in regards to tax gains becasue of the premium that was generated with the acquisition. I've seen in the explanation notes, you have a goodwill of about BRL4 billion, so it makes sense to think about 34% of those amount. So BRL1.4 billion, so I think that my question would be that if this would be reasonable assumption. So as we can try to calculate these gains, would you have more concrete numbers to convey at this time

A - Jamil Saud Marques {BIO 21416820 <GO>}

Hello Leandro, this is Jamil. We cannot really have the exact number but yes, it's approximately as you said with this tax credits to be recovered looking at the ownership structure. So we believe this would be the order of magnitude.

Q - Leandro Bastos {BIO 21416405 <GO>}

Okay, thank you.

Operator

Our next question comes from Mr. Luiz Mauricio from Bradesco Bank, Luiz you can begin.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Two questions, first, going back to the Somos opening balance sheet and contingency provisions. We have seen, I mean, as we look at previous editions and while as you mentioned, you have included all probable and possible contingencies to calculate the provisions. But in time because of your conservatism, we believe some of that will be reverted, but not all of that was treated as non-recurrent. So in the future this reversal if shifting up and will you isolate them as a non-recurring effect or is that included in your guidance for Somos. I mean, I wanted to understand how you're going to deal with that ? Nothing only in Somos, but also in other cases, you know, in the purchase of da Vinci score, and this is the first question. And the second question is about receivables. When we look on Page 16, the portfolio leaped to BRL97 million for a revenue of 70 in digital segment. When we look at the portfolio which is growing about 60%. If we consider the write-offs mentioned. So it's a very strong pace of growth. How do you view the future, I mean do you think we can project the same rate into the future. These two questions please.

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Hello, Mauricio. This is Rodrigo Galindo. I will answer the first question. Jamil will answer the second. About the contingency provisions, there are some comments I want to make. First, in the first year after the opening balance sheet, we can still make adjustment in the line posted in the opening balance sheet. So if we have a range of adjustments that we may identify in the first year, we can still do that. This is the first message. Second message, in all previous acquisitions even if it affected results, we always provided all the necessary disclosure, whether the adjustments were to revert contingencies or not even when that affected results, it was always clear if it was a contingency reversal or not.

Now, an important message. The guidance of BRL670 million for Somos has zero real of contingency reversal and this is important, even if we may have these reversal of contingencies and even if they affect the result, they can only affect positively. This guidance of BRL670 million, but my main message is that contingency reversals does not impact cash, and we look at cash. That's why we have this cash guidance and in May, we will also give you a cash guidance for Kroton regardless of how we treat contingency reversal. The cash will be there and tracking cash, we will feel comfortable to say that even if we have contingency reversal, this is not going to impact cash, obviously if we have a process of goodwill BRL200 million if we may an awareness, we are not going to include BRL300 million on results because this would just start our analysis, this would harm the comparison of results but it's now labor suite, may be included in results. Now a large tax suite we may win as a different treatment. So we must look at this case by case, what comes to recurring results or non-recurring results, it helps to reanalyze case by case, but in the first year, not only can we decide what will be recurrent or non-recurrent. If we had something really the exception of , we can simply adjust the opening balance sheet. But regardless of what we decide to do, our financial statements will always show contingency reversals in a very concurrent way. And cash, cash is cash. It is always going to be transparent, telling you how the company soundness is.

A - Jamil Saud Marques {BIO 21416820 <GO>}

Now the second question. This is Jamil. Let me understand. Let me see if I understand your question. What we expect from the receivables portfolio, because again it's grown this year, is that the question?

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Yes. We could see that even in the 4Q, you had another growth in receivables. But even when you look at the breakdown, you see a lot of pressure not only because of the reduction of FIES student.

A - Jamil Saud Marques {BIO 21416820 <GO>}

Well the FIES tap and the NTS still not in our base at least not as phase out of FIES students is not yet concluded. 2018 was a very relevant year, we had a drop in the penetration of FIES almost 20% was the drop in the on-campus space and that was offset by out-of-pocket. That for 2019, we will have another drop from 24%, 25% down to 13%, 14% of the base of our student base at the end of the year. So we will continue to see a growth in the PEP and out-of-pocket portfolio less than in 2018, but still a high growth. It's important to say, that in our recruitment process, we have limited the penetration of PEP up to 25% of the on-campus portfolio and in fact this level has not yet been attained. So for PEP, we continue expecting growth in 2019. But with smaller growth than in 2018, so the portfolio would stabilize around BRL2 billion. Of the other items, I think I've mentioned the portfolio of receivables of out-of-pocket students grown also in '18. In '19, we expect that to grow, but not more than net revenue or not more than the proportion of net revenue. In 2018, was when we received these payment.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Now, let me just follow up on a question that is already been answered , you talk about the average ticket. On Page 13, you spoke about pricing tools. But when we look at the table the average ticket increase was because of a 35% increase in the average ticket of FIES. Can you please talk about that because when you spoke about average ticket, you didn't mention specifically the FIES students, so if you could please comment?

A - Jamil Saud Marques {BIO 21416820 <GO>}

Yes, the comment we made about ticket was related to 2019, it was the strategy on ticket for 2019. But it's okay, I can talk about the FIES ticket which is related to the cycle time and characteristics of program. We have a large number of students graduating in FIES, students that graduate before the time are usually short duration program. And the average ticket is usually lower.

So now we have a larger base of higher average ticket, they pay more because they study engineering, medicine, and healthcare because these are long-lasting programs, they last longer. So now we have a bigger base in programs that have a higher payment. So that is why we have an increase in the average ticket.

But what we said about average ticket was from 2019, so the increases will be equal for the whole base on the same unit, in the same program, it is all going to do the same increase.

Q - Luiz Mauricio Garcia {BIO 17432519 <GO>}

Okay, thank you. Now it's clear. Thank you.

Operator

Our next question comes from Maria Tereza Azevedo from UBS Bank.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Good afternoon. Well, some of my questions have been answered. But going back to the 25% gap for PEP, can be a little more flexible in that ? And what would be the optimal mix in the long-term thinking of the financing and also cash to EBITDA conversion?

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Hello, Maria Tereza Azevedo, Galindo talking and Roberto may pitch in. We always have 25% as the gap, but we could have a go-to-market that could cause this to differ. For example, we can use scholarships sooner or later, and this has an impact on PEP in the different municipalities. In our gap in the regional office for example principal could request more PEP, but this has to be approved by the higher education unit.

And of course we deal with this on a case by case basis, this happened two semesters ago. We have just a few cases on this semester, but usually per unit, the limit is 25%. In this semester, we should be below 25%, we shouldn't reached 25% of PEP, we didn't have to use all 25% to deliver on the recruitment goals. In the long-term for us the optimal mix is one where 25% is not exceeded and in fact what we see that it's not necessary the results and the quarter show this, there are proof of this. You don't need more than 25%, so between 20% to 25% this is the adequate range I believe.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Thank you very much Galindo. And I also have a question about the learnings distance market. What growth do you expect? What contracts are in the pipeline for 2019 and do you continue to pursue the key initiative?

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you very much Maria Tereza. The learning systems market continues to grow, it's actually more focused on scores than the textbook in the figures for and you see this market growing in terms of the competition. I don't think we have more or fewer competitors, it is the different type of competition, which is in fact more for confidence, because it's more success dictated, it's more quality-driven. The players, we see operating in this field, have a policy of avoiding discount and charging higher fees. So our positioning, which is to offer a very diverse portfolio to the market and with our technology differentiators and the brand reputation. And I think, it's really adequate considering the current market dynamic.

Sorry, I just couldn't hear the second part of your question, you mentioned and I couldn't hear.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

What about selling other systems, back office services.

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Yes, this is something that is proceeding at full steam. We are now trying to understand the school needs using our own schools as a model. In '19, well we won't have the go-to-market gap of what we call the allied schools. It's still a year for modeling and private, but by 2020, it should come online and we are working with partner -- partner schooling has many of them and their effectiveness and their willingness to act as volunteers in our pilot is remarkable. So we -- schools are now aware that they should focus on their core business which is education and leave the task of managements to another partner.

Q - Maria Tereza Azevedo {BIO 16178885 <GO>}

Thank you very much.

Operator

Now, I'd like to turn the floor to Kroton for the final remarks.

A - Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Well, I'd like to thank you all for participating in this earnings call. Thank you all very much.

Operator

Kroton earnings call is now closed. We want to thank you all for your participation. Have a nice day.