Q3 2018 Earnings Call

Company Participants

- Carlos Alberto Lazar, Investor Relations Officer
- Jamil Saud Marques, Vice President, Finance
- Rodrigo Calvo Galindo, Chief Executive Officer

Other Participants

- Joao Noronha, Analyst
- Marcelo Santos, Analyst
- Rodrigo Gastim, Analyst
- Thiago Bortoluci, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Kroton Educacional Third Quarter 2018 Earnings Conference Call. We would like to inform you that this event is being recorded and that all participants will be in listen-only mode during the company's presentation. After the company's remarks are completed, there will be a Q&A session for investors. And at this time further instructions will be given. (Operator Instructions)

Also today's live webcast both audio and slide show maybe accessed through Kroton Educational's Investor Relations website at www.kroton.com.br/ir by clicking on the banner 3Q '18 Webcast. The presentation will also be available to download at the company's website. The following information is available in Brazilian reais in accordance with Brazilian corporate law and generally accepted accounting principles, BRGAAP, which now conform with International Financial Reporting Standards, IFRS, except where otherwise indicated.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Kroton management and on information currently available to the company. They involve risks and 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 to all and welcome to Kroton Educacional earnings conference call for the third quarter of 2018. With us in this call, we have our IR Officer, Mr. Carlos Lazar; our Vice President of Finance, Mr. Jamil Marques; and the heads of our two most important business areas, our Higher Education Head, Roberto Valerio; and our K-12 Head, Mr. Mario Ghio.

This third quarter of 2018 represents an important milestone for Kroton with the closing of the acquisition of Somos on October 11. For us that transaction is a strategic, that opens our access to the entire K-12 market in Brazil, where there are many relevant opportunities to be captured. In a way, it's also coming back to our origins since Kroton was born as a K-12 institution in the '60s, and up to the year 2000, we operated exclusively in K-12, and we're feeling very excited and hope to discuss at the end of the presentation the status of the integration and the next steps of the integration with Somos.

As the closing of the transaction took place recently on October 10th or in other terms in the fourth quarter, the disclosure of third quarter results does not include any consolidation of results or operating data relating to Somos. Therefore, we'll start today's presentation with our main operating and financial highlights in the quarter.

Please let's turn to slide four with key operating indicators of our undergraduate programs. Beginning with the left side of the slide, we see the results of new students and re-enrollments in the second half of 2018 with very strong numbers even considering all the pressure we've been under, in terms of the political scenario, sluggish economy with high levels of unemployment and a very challenging competitive environment as well.

But thanks to our assertive commercial strategy, this standing and also the strength of our brands and the portfolio of programs that is aligned to demands of the current market, we secured a 2.6 increase in the number of new students, adding 183,000 freshmen to our base, despite the lower availability of FIES financing in the period.

All the contributing factors were -- we believe that we know we have a very balanced offered on installment plan products, and also our job referrals channel connected, which have been shown to be a very important advantage and a positive transformation agent for our students, it's also a magnet to attract more students.

Along this year, we saw a substantial increase in the number of students graduating. This is a reflection of the strong enrollments we had in 2013 and 2014 years-on-years we had a 8.3 increase in the volume of graduation, which in turn reduces the universe of re-enrolling students and makes our total re-enrollments fall to 4.2% in 3Q '18 for having 688,000 students. As a consequence, our total undergraduate base closed the quarter with 871,000 students down 2.8% compared to the same period of the previous year.

Looking only at the on-campus segment we recorded growth of 5.3% in the number of new students and, but still this is something that was affected by the higher number of graduation. So, as I was saying, we recorded growth of 5.3% in the number of new students with the admission of over 60,000 students in this period, and beyond the factors mentioned previously another important driver were the 25 new units launched in 2018, 10 in the first half and 15 in the second half of the year.

This greenfields admitted 3,300 new students is still a very small number, but it's a number that exceeds the business plan and that strengthens our trust in our organic growth plans. So, we're feeling very confident about the growth strategies we have been using, and our associates strategy both in the locations where the campus are open.

We are also seeing new students enrolling and we believe that we have been really right on track. After we add up the 301,000 on-campus re-enrollments we have in 3Q '18, we closed the period with 369,000 students studying in our on-campus programs.

And as a consequence of the increase in the student graduation and partly offset by a reduction in dropout rates and all of this has been offset, as I said, with a very positive new enrollments that's up 5.3%, and we see also growth in same-store and a reduction in dropout rates.

And, as I said, this is something we had predicted before because they enrolled four years ago, so it was only to be expected that we would see a lot of students graduating at this point. So, nothing is really new.

Now moving to our distance learning undergraduate programs. We reported once again, growth of 1.1% in 3Q '18, in this very challenging competitive scenario, so we believe this is a very positive number and, by the way, we didn't see growth in the number of distance learning centers as fast as in our competitors. This represents 115,000 freshmen and despite the higher number of competitors caused by the change in the regulatory framework in mid-2017.

We believe this is very positive. We have around 10,000 new students that comes from the 400 new DL centers we launched in 2017. So, that solid performance reflects our efforts to build a very complete platform, which is always based on consistent quality indicators that has highly committed partner centers, and something we often emphasize in our calls is that we have been accredited by the Ministry of Education in our DL centers, and we always hire the best managers with the best education and work on this partnership structure, and this is what we'll ensure the sustainability of this project.

We often say that, in the past, we have an entrance barrier that was created by regulation, but we have several other barriers by to overcome and the strength of our brand, the strength of our partner network would make the difference in this scenario and in a scenario with less regulation. This is what we have been witnessing, we see how important it is to have a solid robust partner network.

Even in this very competitive scenario, we've been able to report good numbers in new enrollments and we continue to grow in distance learning. We know that the strength in our network is really going to make the difference. In terms of re-enrollment levels in DL, we had a 387,000 students taking our undergraduate DL base to 502,000 students at the end of the quarter, very similar to the comparison to the previous year.

Now let's look at the dropout rates. Starting on on-campus, we are very pleased to report an improvement of 70 basis points in the quarter, reversing the negative trend of the prior quarter, and in spite of all setbacks, we have, for example, our student profile now is more likely to dropout, as a result of the reduction of FIES funded students, and we are adopting several projects and initiatives to increase retention.

We have also increased the academic model and the student experience at every touch points, both on-campus and in distance learning, and our students have reacted very positively to the investments we have been making. And turning to DL, in addition to the issues concerning the macroeconomic environment. The increase in dropout rates occurs as a counterpoints to stronger wave of new enrollments.

We had a very solid wave of new enrollments and as a result the dropout rates have rised. And, once again, we saw a jump in the number of students in the 100% online program, which also contributes to the deterioration of that indicator.

That's why there was this small increase from 16 to 16.6. So, I think, that overall the numbers are very positive, considering the current competitive environment and the macroeconomic scenario. We're feeling very optimistic. I would like to talk a little bit about the new enrollments in 2019, and we'll leave that for the end of the presentation.

Now with the end of the first part of the presentation. I pass the floor to our Director of IR. Mr. Carlos Alberto, he can discuss the financial highlights of the quarter.

Carlos Alberto Lazar {BIO 17238206 <GO>}

So, before starting, let me underscore that this will be our last quarter without the incorporation of the Somos numbers.

As of 4Q18, our earnings conference call will include the results of Somos. But we are also working right now to develop a new form of disclosure for the first half of 2019. We hope that this will provide greater transparency on our K-12 business, which of course gained more relevance with the acquisition of Somos .

So, let's start with slide six, where we present the main lines of results of this quarter and also consolidated. I would like to start by saying that by September in the year-to-date analysis, we had achieved 76% of the net revenue, 79% of the adjusted EBITDA and 79% of the adjusted net income that we had informed you in our guidance.

This is a sign that we are right on track to deliver the goals we committed to this year and using the disclosure model we've been using since the beginning of the year, we would like to show you two views of the consolidated results.

On the top of the slide, we have the numbers excluding only the results of the assets sold in 2017. And in the bottom, we see the 2018 results not considering the impact of the new units lost this year. All of this, of course, for a greater clarity on the effects in our performance. So, starting with the ex-sold units consolidated vision, we recorded net revenues of 1.250 billion in 3Q '18, which represents a fall of 5.4% in the annual comparison, that was the effect of the following the basis of undergraduate students since many of them were graduating for programs as detailed by Mr. Galindo.

Additionally, there was an impact from the average ticket on both segments, but especially in DL as a consequence of an increase in the 100% online student base and also as a result of the fiercer competition among other factors.

Please note that we are being very judicious in the awarding of scholarships and discounts monitoring program prices in different markets, and that we are promoting a review of our mix of programs with the introduction of more premium profile also in DL program.

And also on-campus where we saw that 57% of our freshmen were going into health and engineering programs. And, in addition, these effects were partially offset by the robust enrollments we had in both segments, lower dropout rates and the incorporation of Leonardo Da Vinci, a premium K-12 school acquired in April.

Adjusted EBITDA reached 535 million in 3Q '18 with a margin of 42.8%, down 7% and 80 basis points in respect to the same period of the previous year, mainly due to the cost related to the opening of the new on-campus units almost 30 of them were open, and this is something we have discussed with you many times already.

I would like to remind you that even though it takes up to six years for new unit to mature, the new units are essential to guarantee robust growth in higher education both on-campus and in distance learning programs.

Finally, we observe that the net income, adjusted net income for the quarter totaled 440 million with a net margin of 35.2% down 16.7% and 480 basis points. This performance reflects the increase in cost related to the new greenfields and also an increase in the depreciation line, something we have been observing since the beginning of the year.

Now going to the analysis as greenfield impact, we see a contraction of 6.4% year-on-year in adjusted EBITDA we have 546 million, down 5.1%. However, with the margin gain of 60 basis points, which is very positive, considering the pressure and the changes in the profile of our student base, and the large number of graduations of FIES students and also the substitution of them by PEP and out-of-pocket students with higher PDAs.

Once again we are exercising cost discipline with the high level of authority since the beginning of the year, so that we can preserve our profitability at a very high level with our never compromising the quality of education and service we provide to our students. Finally, the adjusted net income ex-greenfield reached 453 million with a margin of 36.7%, down 14.3% and 330 basis points in relation to 3Q '17 owing to the reasons I have already explained.

With this I close the second part of the presentation I hand it over to our VP of Finance, Mr. Jamil Marques.

Jamil Saud Marques {BIO 21416820 <GO>}

Thank you very much. It's great to be with you once again. In the next two slides, I will talk about our provision for doubtful accounts and average receivables term.

I will break down the provisioning for losses per segment and per type of students just like we did in the previous quarters, excluding from this analysis of the units we sold in 2017 FAIR, FAC/FAMAT and NOVATEC that had only on-campus operations. Starting with on-campus, we see a PDA of 13.5% in 3Q '18 basically flat in the yearly comparison.

In relation to 2Q '18, there was an increase of 50 basis points related to this seasonality and the late enrollment installment trend. Analyzing the paying balance we have 30 basis points, 8% in the quarter, following the same trend that we saw in the 2Q '18 and also reflecting the impact of a more challenging macroeconomic scenario with high unemployment levels, which of course affects our delinquency rates.

Now going to the middle of the slide, we can see the evolution of losses indicators in distance learning, in 3Q '18 our DL PDA reached 9.9% in the quarter flat vis-a-vis with the previous quarters and with an increase of 70 basis points in the comparison with 3Q '17 also because of the increase of out-of-pocket students, considering only our out-of-pocket in the paying balance, there was an increase of 20 basis points in the comparison with 3Q '18 also as a consequence of a more challenging macroeconomic scenario and higher representativity or higher numbers of 100% online students that have less engagement and as such higher dropout rates and higher delinquency rates than other students.

Now, let's analyze the behavior of PDA in K-12 in 3Q '18. This indicator totaled 0.8% showing the stability in annual and quarterly comparisons and also confirming the soundness of the policies adopted by the company. Now let's turn to slide nine, where we see the average receivables terms, once again, excluding the impact of FAIR, FAC/FAMAT and NOVATEC in the on-campus segment.

In the on-campus segment, the total average term reached 157 days in the quarter up 29 days in relation to the comparison with 3Q '17 and in the quarterly comparison, we saw a reduction of 24 days because of the regularization of the average term for receivables of FIES.

And also because of the receiving of the final installments under PN23, breaking down the types of students the average out-of-pocket on-campus average terms totaled 107 days with the impact of the challenging economic scenario, and also with a higher number of negotiation or tuition in every year, with the incidence of late charges as well, which created a better result in our interest revenue lines.

By the way in FIES, the average term was 78 days in 3Q '18, down 29 days versus 3Q '17 because of the 50% remaining installments to be received under PN23 in August. Finally, the receivables terms for PEP and for the late enrollment plan totaled 489 days, an increase of 184 days in the comparison just 74 days in the quarterly comparison.

Now moving on to distance learning where the average out-of-pocket term was 85 days. We thought that this was three days smaller than 3Q '17 and 10 days below 2Q '18, reflecting the improving collection results we have obtained in spite of the challenging economic scenario. We were able to recover some of the debt. So, the average term in distance learning late-enrollment installment plan reached 556 days in this quarter.

As a consequence of the evolution we were expecting for this plan and also of the smaller revenues for this product in the quarter. Now going to K-12, the average term for receivables was 84 days as a result of the corporation of new schools in our balance sheet.

This otherwise the macroeconomic scenario and the high unemployment levels continue to put pressure on our performance, especially in terms of the provisioning for losses for office and also in the on-campus average term for receivables. In spite of this, we were able to get some achievement or an improvement in some indicators that are also impacted by this scenario.

For example, new enrollment improvement in dropout rates and reduction in the average DL term. And this, of course, is the result of our soundness in policies and collection practices. So, we're feeling very confident about the sustainability of our deliveries have resolved, and we are poised to continue searching for responsible in sustainable growth.

Now moving onto the next session, we will take a look at the CapEx cash generation and debt levels in the quarter. Considering, only recurring CapEx, we invested 121 million in the quarter. This represents 9.7% of our net revenues in the period growing 9% and 130 basis points in the annual comparison.

These investments were directed to the development of content and systems, expansions, and also renovations of our units considering how our program portfolio is becoming more premiums. This of course requires the installation of labs and also practical lesson for the health and engineering program.

With this CapEx reached 330 million year-to-date up to September up 8% or represented 8% of the net revenues and up 10% vis-a-vis the first nine months of 2017. Now turning to the right side of the slide, we see total CapEx recorded at 193 million, representing 15.4% of the net revenues and this of course led our total CapEx in the first nine months to 471 million. This amount represents a 11.4% of our net revenues and comes very close to our expectations of 13.5% for the year. These investments are driving organic growth projects and includes 86 million for that intention.

Now as for the cash generation in the quarter and year-to-date. In this quarter, as we have been talking about in the previous call, our operating cash generation was more robust with the receiving of the 50% of the FIES installments that are old under PN23 and total 400 million.

And in 3Q '17 we had received only 25% of the installments due. As a result of this, our operating cash generation reached 538 million with EBITDA to cash conversion of 114.2% up 30% and 34.5% in the annual comparison.

Year-to-date until September, our operating cash generation was at 731 million with EBITDA to cash of 45.5% down 21.2% and 730 basis points in the comparison with the previous year. This owing to the impact on working capital and the change in the profile of our students with high volume of graduating FIES students and their substitutions by out-of-pocket in PEP funded students.

In addition to this, we have invested more capital to fuel the organic growth projects we had mentioned, and in this year, they have used up 80 million of cash year-to-date until September and in operations with an impact, a negative impact of five percentage points in EBITDA to cash that we hope to reverse as the operations mature.

Finally, our free cash flow was favored by the first emission of debentures of Saber, our K-12 holding to finance the acquisition of Somos Educacao transaction that was completed on 11th October and as a result, our free cash flow was positive at 5.7 billion in 3Q '18 and 5.1 billion year-to-date.

The next slide, we see the bridge showing the evolution of our operating cash generation after CapEx to free cash flow in the first nine months of '18 to give you more transparency about the impact on our expansion and funding activities.

So, we turn to slide 13, where we see the operating cash generation after CapEx at 731 million year-to-date, and in the first block considering our projects we invested 262 million, of which 86 million were invested in our organic expansion including the opening of 25 new greenfields and 176 million were used to acquire on-campus higher education schools and two premium K-12 schools Leonardo Da Vinci and Lato Sensu.

Now moving to the next block value generation for shareholders we have 717 million, including 210 million in repurchase of shares and exercise of options and 570 million distributed in dividends, paid out in dividends in relating to the results of 4Q '17 maintaining a payout of 40% in spite of our growth projects

In our third cash block we had compensation of third parties. We paid also our interest totaling 500 million in the first nine months of '18. Other impacts use of 10 million of cash considering debt amortization and origination of 5.5 billion in the first emission of debentures for holding Saber that was used to finance the acquisition of control some of the cash balance. And this acquisition was completed in October 11, and the disbursement will be shown in our cash for the 4Q '18 and as such our free cash flow closed the first nine months of '18 positive at 5.1 billion.

Now moving to slide 14, we see our net debt for the period. We closed the quarter with the total cash equivalents of 6.8 billion up 313% in the annual comparison owing to two impact the receiving of the 50% remaining under PN23, I was talking about, representing BRL400 million and also relating to the emission of debentures, the Saber debentures at 5.5 billion.

If we add up our finance commitments and short and long-term liabilities, we have a net cash of 781 million in this quarter and its important to remember that we also have receivables. The second installment for the sale of Uniasselvi adjusted to the net present value that was to be received in five annual installments. So if we, and also the payment for the sale of FAIR and FAC/FAMAT concluded in August 2017.

So, with this, I close this section of the presentation, and I would like to hand it over to Rodrigo for his final remarks. Thank you very much. Rodrigo?

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

11 October is a milestone for Kroton. It's the start of a new phase of the fruit of a strategic discussion, we have been discussing for two years. Since 2017, we have been discussing, which would be the best path to follow.

And we took this decision to go into K-12. This is a very large market with opportunities for professional management, a very fragmented market and without major consolidators. And we saw that there were two opportunities in the Management of Schools, B2C, and by creating a service platform for schools in the B2B offerings.

So, we decided then to go into this market and we started negotiations with the one we consider the largest and the best K-12 education platform in Brazil. This is something that was very similar to what we did in 2012. We decided to work with distance learning, at this time, and we chose the best platform available in the country, Unopar.

So, once again, this is something that reminds us exactly of this period when we decided to go into distance learning and the more we get to know it's almost the more certain we are that we took just the right step and to make sure that all the opportunities are identified and kept.

We have implemented a very sound integration methodology with clear activities detailed timeline. We know that integration processes are all different from each other. But our track record that Kroton in integrating important assets has been fundamental for the success of this project.

In slide 16, we see some of the numbers that derived from the integration of the companies and that has been very positive. So far we have dedicated 1500 hours to the integration project. We have 12 committees involving the CEOs and other heads and VPs of the companies, we had five days in workshop, a key cost including 75 meetings and functional front with the participation of four external consultancies and we also got 12,000 responses on our climate survey, and on October 15 we had a meeting with 480, sorry, 148 leaders of the two companies and with the participation of 1400 employees always liked by the transparency.

And as I said we closed the deal on October 11, the following day was a holiday and on the Monday following the closing, we had this meeting with all leaders to communicate the changes and the different roles they would take on in the new organization.

And we had this meeting once again with 1400 employees and with the online broadcast of all employees in the Somos Groups. This, of course, marks the first day of the merged companies. All of this to give peace of mind and transparency to those affected by the integration process. We also had 87 individual meetings to communicate the cases when there were changes in the reporting lines and also a change in scope.

So all of this planning work was very beneficial for a smooth transition. In the next slide, we see some images that reinforce our sense of purpose and our ability to transform education. And, in the early release, the message of the administration is that we are feeling very happy with the technical quality the engagement and the sense of purpose we identify in this Somos thing.

This is going to make the integration much easier, and with this I would like to express my gratitude to all of the Somos employees together we are an even stronger company. Now I would like to go to slide 17 to discuss some of the next steps. On, October 11, we closed this process, but the new process started is the process that ensures the same rights to the controlling shareholders and the minority shareholders of Somos.

A few days after the closing on October 22, Somos held a shareholders' meeting to define who would be responsible for drafting devaluation opinion and as controlling shareholders at the time we abstained from voting. And among the shareholders, they elected Merrill Lynch and they have already started to work on this project, very soon we will be able to file with CVM and B3. We have application for the IPO and as soon as we get approval from the CVM, we'll be publishing the IPO standard clarifying terms and conditions for participation and counting 30-days after this publication and we'll have the auction at B3.

And if we get two-thirds of participation in the auction then we can close the transaction with Somos, and we'll be able to close the capital always keeping the market informed about any developments. So, in short, this is what I wanted to share with you. We are starting the closing of the capital with Tag-Along and this is just a little preview of the proposed timeline for this process.

Going to the final slide, I have some final remarks, we have already started our enrollment campaigns for the first quarter of 2019. We are feeling optimistic about it, even though it's a process that has just begun. We see some positive indications. We are feeling very confident about the strong brands we have and the improvement in the student experience we have created. Our capillarity of operations and also our program portfolio will ensure that we'll be able to deliver very solid earnings results.

And as we had mentioned in the previous call, we will have 19 new Campion [ph] 100 new distance learning centers that will be launched together with the first enrollment phase in 2019, demonstrating that our organic growth project continues to be implemented.

And, by the way, at the end of September, we acquired those second premium education, premium K-12 education brand Lato Sensu with four units in Manaus and one in Rio Branco and a total of 3,800 students in 2018. Lato Sensu has a very differentiated pedagogical proposition and focus greatly on education. It's ranked first and second in the ENEM test results in the state of Amazonas for the past 10 years

And all of this is consistent with our educations in K-12 we will be opening our first greenfield of this brand, still in 2019. Now about our acknowledgments we have some important recognitions. We were first place among the companies that best communicate with journalists in the category of education. We also got a prize in education as the most valuable company in education. We are now reaching 30,000 employees and all of this is motivating us to do our very best to transform the future of education.

And, once again, I would like to express my thanks to all of those who contributed to these achievements. And now our Board has approved a dividend payout of BRL132.2 million, which represents BRL0.08 per share maintaining the payout at 40% in spite of all the organic growth projects and also the inorganic growth projects, we are involved in.

And the dividends will be paid by November 27th, 2018. I would also like to invite to all to participate in our Kroton Day that will be held on November 26th. It's an opportunity for you to find out more about our strategy, integration and synergies in all projects and segments where we operate.

The Kroton Day will be held on Cubo Itau, as you know, we have a partnership with Cubo Itau, which is the largest ed-tech hub in Latin America. And in this event we will communicate our strategic vision for the field. This is very important for us and it's also a great chance for you investors to understand better our strategic view.

And, to conclude, I would like to say that in spite of all obstacles we saw in 2018, we're still making progress and delivering on our guidance honoring the commitments we made to the market. Our organic growth projects and digital transformation projects made great strides this year, and we also have the integration with Somos, which is a great driver for transformation in our history.

We're feeling really optimistic about the opportunities and the soundness of our history. We are certain that we are taking the right steps and that Kroton is just starting out on this journey. There's still a lot more to be done, and you're all invited to learn more about these opportunities on our Kroton Day.

Thank you very much. Let's move onto the Q&A.

Questions And Answers

Operator

Thank you. Now our Q&A session is open. (Operator Instructions) Our first question is from Mr. Marcelo Santos from JPMorgan.

Q - Marcelo Santos {BIO 20444938 <GO>}

Good morning, everyone. Thank you very much for accepting questions. I have a question about the distance learning opportunities. I know you talked about it more on Kroton Day, but do you see an opportunity for example in public education in the distance learning formats. We now have a new President in the country. What's your perspective on this issue. And a question about the late enrollment installment plan PMT used less this time. What were the lessons learned? What are you observing in this area?

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

Hi Marcelo. How are you? This is Rodrigo. Thank you very much for your question. I'll answer the first part and you Jamil will answer the second one. Well, considering distance learning for secondary education, we had a meeting with the Kroton Education and we are more than ready to support any policies, any new policies adopted by the federal government, and if the federal government approved these policies, we have the largest DL platform in Brazil and the best K-12 content platform in Brazil.

As such, we can add a lot of value to the country and also add value to the company. So, we are ready to take on this demand, but we are depending on the decisions in the area of public policies, but if this is the way to go, we are ready to serve.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you very much.

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

In relation to the late enrollment installment plan considering on-campus. We are very concerned with the timing of the offering. Volume was smaller in the fourth quarter, but in distance learning, this is linked to strategy because what we saw the ticket is smaller, so late enrollments have a lesser contribution in comparison to all this types of enrollment.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you very much.

Operator

Our next question is from Mr. Thiago Bortoluci, Goldman Sachs.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Hi, good afternoon. Thank you so much for taking the question. Let's talk about the organic margin ex-greenfield. For the third quarter you talked about an expansion 60 bps and it dropped 160 bps in the first semester. Could you give us a little guidance on the behavior of this margin on on-campus and DL and how do use view the like-for-like margin from now to the future. Even with smaller contribution of the FIES sort of could we expect organic margin to be regularized or could we see pressure still in 2019, these are my questions? Thank you.

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

This is Jamil. Thank you so much, Thiago, for your question. Starting with the question on our long-term margins, yes, we are expecting some pressure because of the organic initiatives, but it will be a lesser pressure, not as big as this year because we have some units that are now three and four semesters already. In the breakdown DL versus on-campus, used to be DL, that has more pressure than on-campus.

Also because we see that you know that there is a substitution of staff and out-of-pocket students. And in relation to what you were saying, I think, it really make sense to expect pressure on the fourth quarter again. Well, in relation to late enrollment in Somos Educacao, this will depend on the initiatives that are maturing in the fourth quarter.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Thank you very much. It's clear. Thanks.

Operator

Our next question is from Mr. Rodrigo Gastim, BTG Pactual.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Good morning. I have two questions. The first in relation to cash generation. I think that when you consider the FIES installments. This deteriorates the cash position and the conversion to EBITDA. Just like you said in the presentation, there is a worsening of receivables owing to the macroeconomic scenario. So, could you please tell me about the cash flow initiatives for the companies. This is something that you will look into, in the near future. What are you doing to give priority to cash generation and how much should we expect in terms of conversion. And secondly, I would like to talk more about on-campus out-of-pocket on-campus, this is something excluding late enrollments from this number because they diminish year-on-year and I know that this reduction was seen as something very positive for me. So, what is the strategy of the company. Are you focusing more on out-of-pockets because they have a better performance. Could you please explain what are the opportunities to improve the average ticket both on on-campus?

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

Well, I'll answer the first question. In relation to your first question, I think, that in '18-'19, there is an expectation of lower conversion. This is something we have been saying for a long time, it's very much to be expected, because of the change in profile and the change in the available financing.

As for post CapEx cash generation in the nine first months of '18 before the investments related to expansions, we were at 45.5%, but the negative cash generation, using up of cash that the greenfield use. Well, these are very initial operations, so they use that cash. This should bring back more than five percentage points in the conversion for the effective, conversion is closer to 51%, this improve the scenario.

And all of our efforts are geared to organic growth. We're investing in organic growth in higher education and we have two CapEx to -- the effect of CapEx and the negative impact on the cash operations in the first semester. However, we should take into account that the investments in organic growth has over 40% in perpetuity.

So from the shareholder point of view, this is a great business, it's something that add more value in the longer term. And all of the signs coming from the greenfields are above expectations, we're feeling very comfortable with this strategy.

As for operating cash, yes, we have some opportunities for optimization. We have two blocks of measures. The operational measures and the strategic measures that will cause an impact on cash generation in coming years. In terms of operational measures. In 2019, we will start keeping more focus to this management.

For example, we are reviewing our non-recurring concept, so in the new report results for 2019 that we'll see in the first semester of 2019. In addition to the consolidation and integration of Somos, there will be a new criteria for non-recurring expenses. We will have items related to growth as non-reccuring items, for example, organic expansion items and everything that relates to growth. We also have the operating management of cash through our improved collection practices, we have been obtaining good recovery levels with an -- even in this asset the macroeconomic scenario, but there's a lot of room for improvement. We can make great improvements.

Thirdly, we have been concentrating mostly on OpEx, but we're going to focus more on CapEx in the future, including recurring CapEx. Our investments will be submitted to a much more judicious analysis, they will be under the magnifying lenses. And we also have a review of our variable compensation programs in the company, and we'll put the emphasis on cash generation.

This is already one of the indicators that is linked to the compensation of our executive, but this will be reinforced to send out this sign that cash generation is the priority for the company in the next two years, because we know that cash generation will be a little tight and there will be some pressure on cash generation.

And we have two strategic issues to consider. As of 2021 we'll start receiving PEP installments and this will change our perspective on cash will grow not substantially, and it will start growing, and it will be much better upto 2021. This will create a structural change in our conversion profile and we also have the operation with Somos, structurally the conversion there is higher and this will also change our perspective.

So, cash generation is definitely at the center of our attention in the company, some growth decisions will have an impact on cash and the company believes that this is still the best option for the shareholders and to improve operating cash, we're taking a number of operational measures including some that we have already discussed. Thank you very much for your question.

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

Going to the first part of your question, about the behavior of the tickets and out-of-pocket, this is something that favoured by the mix of new students we have been investing and promoting those progress with higher average ticket is of course had a very strong impact in the new enrollment cycle. And as for your question about PEP, FIES finance. As we see the macroeconomic scenario improving, we'll see a trend for more students paying out-of-pocket and our strategy will be reducing PEP 30 and increasing margin at PEP 50. This, of course, increases the out-of-pocket participation.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Thank you very much, Rodrigo and Jamil for your answers.

Operator

(Operator Instructions) Our next question is from Mr. Joao Noronha, Santander.

Q - Joao Noronha {BIO 17451608 <GO>}

Thank you very much. Could you give us some more light on the collection initiatives and also about the growth in the interest line. Were there any significant changes in the collection and receivables policies?

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

Thank you very much, Joao. It's Jamil speaking. In relation to the collection initiatives, we discussed in the previous call, it's been implemented, 99% implemented and we saw some improvements both in terms of strategy and in performance.

We know that the macroeconomic scenario is still very complicated. So, these initiatives are helping us mitigate the asset conditions and in distance learning we see improvements in the receivables term with a better control of losses. And, on-campus, the scenario for trends is still challenging, but in interest lines and penalties, we see that there was a significant increase in this slide. In fact there are two impacts, we have the monetary adjustment on receivables and also the charges on late tuition.

What we can control is monetary adjustment, but if we compare it to the previous quarter, we will know that this impact on inflation, but the charges on tuitions increase both in DL and on-campus. This is the result of the collection strategies we have implemented with better control and more discipline. And specifically in the charges on arrears, the impact was over 50% in fact.

Q - Joao Noronha {BIO 17451608 <GO>}

Thank you very much.

Operator

We are now closing the Q&A session. We hand it over to Kroton for their final remarks.

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

Thank you very much. Once again, you're invited to participate in our Kroton Day in Cubo Itau, where we will talk about our strategies. Thank you very much, and we'll see you there.

Operator

The earnings conference call for Kroton Educational is now closed. We thank you all for your participation and wish you a great day.