Q1 2020 Earnings Call

Company Participants

- Bruno Giardino, Investor Relations Director
- Jamil Saud Marques, Chief Financial Officer
- Mario Ghio, Vasta Executive Officer
- Roberto Valerio Neto, Kroton Executive Officer
- Rodrigo Calvo Galindo, Chief Executive Officer
- Unidentified Speaker

Other Participants

- Irma Sgarz, Analyst
- Marcelo Santos, Analyst
- Susana Salaru, Analyst
- Unidentified Participant
- Yan Cesquim, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Cogna Educacao First Quarter 2020 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 (Technical Difficulty) Further instructions will be given. (Operator Instructions). Also today's live webcast, both audio and slide show, may be accessed through Cogna Educacao Investor Relations website at ir.cogna.com.br by kicking on the banner 1Q '20 Webcast. The presentation is also available to download on the Company's website.

The following information is available in Brazilian reais in accordance with the Brazilian corporate law and generally accepted accounting principles, BR GAAP, which now conform with International Financial Reporting Standards, IFRS, except when otherwise indicated. Before we proceed, we would like to clarify that any forward-looking statements are based on the beliefs and assumptions of Cogna 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 the 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 Cogna'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 conference call to discuss the earnings in the first quarter 2020. With me today Bruno Giardino, IR Officer; Jamil Marques, Finance VP; and the CEOs of each business unit: Paulo Valerio, Kroton; Paulo de Tarso, Platos; Paulo Serino, Saber; and Mario Ghio, Vasta.

This is the first time we will present our earnings breakdown by vertical units, and we are certain it will provide more transparency about performance challenges and opportunities in each operation. So on Slide 4, I'd like to speak about our current context to the pandemic that has affected our lives, the life of Company, and we see a big impact on our society.

As a Company, we have to react quickly and prepare for this moment. As soon as we heard about the first cases of COVID in Brazil, we set up a crisis management team and a reaction plan to deal with all the impacts. The plan is based on seven pillars. Our first concern was to ensure the protection of our students and employees. That is why we decided to close our units on March 16, and on the same week, all our employees were moved to home office. At the same time, we made available telemetric psychological help to our employees.

The second pillar, we talk about the continuity of academic services. We continued all our operations, mitigating impacts for students. We always see an impact, but the more we see migration of students from on-campus to the digital platform, then we would be able to reduce the impacts. We will be talking about the status of engagement and satisfaction of students in K-12, and also, in post-secondary, but the results were very well managed. We've been able to deliver very adequate academic services without any interruption of activity.

The third pillar focuses on liquidity, cash and financial soundness. And then the fourth pillar will ensure the financial stability in this scenario. Today's presentation will provide more details on pillars 2, academic services; pillar 3, financial soundness; and pillar 4, our strategy.

So pillars from 1 to 4 deal with a very punctual emergency issues. In addition, we have to strengthen the Company for the post-pandemic. So now we focus on pillars 1 to 4, after that, we began to look at more structural issues. The fifth pillar looks at the new organization we will build as of the second half of 2020. And the sixth pillar looks at all strategic possibilities that may come up.

Finally, we are also providing services in corporate responsibility, corporate social responsibility. So we provide content and classes free of charge so that people can study. Also, we provide a donation and donations of face masks, hand sanitizer, in addition to financing to our students because they were engaged but maybe they lost their income during the pandemic. There are many actions on each pillar. We could have a long meeting to talk about these pillars, but as I mentioned, we will focus on pillars 2, 3 and 4 of this presentation in the interest of time.

Now Slide 6, like to look at some highlights of new enrollments in the first half of 2020, which was impacted by the quarantine imposed by the COVID pandemic. We had to close our campy and distance-learning centers as of March 16. In the last call, we had 70% of our target already achieved. We continued with new enrollment, including the admission exam, 100% online, but we saw a reduction in the number of new entrants, especially on-campus students. Even with all the impact of closing our units, we closed the cycle with a growth of 8% in new enrollments, but a different mix. On-campus had a 23% decrease, but distance learning more than offset this drop. So finally, a growth of 8%.

Now, in distance learning, we had 255 new students. It's an increase of 33% if we compare to last year. We know that after the new legal framework for distance learning, we have much more competition as of 2018. As of the mid-point of 2018, we could see stabilization of the competition. And then, in 2019, the situation is more stable in terms of offerings, the growth of new offers and also prices, and now we have the opportunity to resume the market share we lost, continue to invest in our digital transformation, which has provided this readiness for this so we can begin to regain market share, although, we have fewer new entrants on campuses where students who were at the end of the cycle.

So now these were more aggressive commercial products and we analyzed the performance of these products, and we reached the conclusion that they generate less revenue and less cash. So therefore, it's important to keep in mind that the impact in volume was bigger, 3%. But the impact of revenue was less than that. And the impact on cash generation is even less, actually, minor because these were students that had a higher dropout trend and lower cash generation. So the first half of 2020 has a mix that is healthier with a lower dropout trend and a higher potential of cash generation. And it's important to highlight that, again, with all of this impact of the quarantine, we grew 8% in new enrollment with a different mix.

Now, on the right side of this slide, it's important to talk about the results by channel. So we see a more hybrid product. The division between on-campus and distance learning will become less relevant. We'll have to be looking at channels, so with our own unit and the partnership. And this view will gain more relevance in this process of more hybrid program, which was already a trend, but it was intensified by the pandemic. If we look at the analysis side, channel, we look at our own unit that grew 13% in new enrollment.

So this increase in distance learning more than offset the drop we had in on-campus. So the volume of new students had a growth of 4%, and it shows our commercial strategy. In the distance learning, they have a more advanced and anticipated calendar so we see the results earlier.

Distance learning shows that our own units are very relevant for distribution. It doesn't matter if we distribute on-campus products or distance learning products, it's important because they provide capillarity, which is an important asset today.

We see a strengthening of hybrid products as to break their prejudice against distance learning and they begin to value the convenience. So here, we're fully prepared to provide different levels of presence to use all the opportunities with robust platform.

Next, we were able to keep our graduation basis because distance learning grew by 12%, reaching 600,000 students. And if the world post COVID will be more digital, then the result of our new enrollment and the results we will soon present show that we're very well prepared for this new normal.

Now, Slide 6, where we're going to be talking about access and engagement rate. Post-secondary, on the left side, 100% of our on-campus students have access to AVA. The chart shows the average score in activities until week 13 last week. As we planned, we had an increase in the number of accesses and engagement, an increase of 25% compared to last year and an increase of 5% if we compare it to the last half year, that is the second half of 2019.

Engagement is one of the most relevant indicators because we know that lower engagement leads to higher dropout. If we have more engagement, then dropout should be lower. If everything continues smoothly as we talk about engagement, I mean, it's not just one variable, but this variable, engagement is much better than it was last year.

In the lower line, we look at the levels of satisfaction with our digital solution. The average content quality evaluation, looking at the content that was made available on the platform and the evaluation of the quality of classes, of digital classes, we had an average score of 9.39 out of 10 in the average content quality evaluation, and 4.78 out of 5 in the quality of live classes, showing we are delivering digital content with high quality to students who used to be on-campus students, and they still look at the content very positively and evaluate very positively.

On primary education, 100% of Saber and Vasta students are already on our digital platform. The number of students went up from 923,000 to 1.2 billion this month. Our app is the one that has the most downloads compared to all other closed educational apps. And the NPS is very high, 75%.

Out of every five Brazilian private students, one uses our platform. And the number may even go up to one out of every four if we exclude kindergarten. We are very close to the number of 1 million live classes since we closed our units, with daily average of 23,000 live classes growing every day. 1.4 billion activities conducted by our students, which is 1,100 average activities per student. That's why we feel comfortable, and we know about the success of our solutions.

They were on-campus students and now they migrated to digital platform and everything went smooth in this migration. So we were able to deliver this high quality because of our digital-transformation process, which is a differentiator that favors our Company.

On Slide 7, our leverage and debt. On the left, the chart shows we closed the first quarter with BRL3 billion in cash. Receiving the funds from our follow-on offering, we consider that our loans and other obligation receivables in the long and short term lead to a net debt of BRL5 billion.

In addition, we also announced an issuance of debentures. We actually issued last week BRL500 million, due date in three years, to strengthen our cash position and stretch the profile of our debt. We made the decision to issue debt given the attractive cost, 2.95%, and we can prepay if we think it is convenient. So we ensure a more comfortable cash position and a longer debt profile. On the right, our amortization schedule. The next payment of principal amount is in August 2021. So our cash position is very comfortable to face the current scenario.

Slide 8, important information. I'd like to give you some more qualitative information on receivables in April and May. Our due date receivables, students who pay on time, on-campus students had no impact, not in April, not in May. But the students, on-campus students who usually pay in a delay, we also had a small impact on these late receivables.

In distance learning, the impact was minor among all students, those who pay on due date and those who pay later. It is still early to evaluate the impact. We will still have more negative impact because of the crisis. But it's a good sign, actually better than the stress scenario we designed to make emergency decisions.

It is worth mentioning that even without great impact so far, even without seeing a higher default rate among on-campus or distance-learning students, we are conservative. So we increased our provisions by 7% already in the first quarter. And if possible, default, we are already -- we already have these higher provisions.

Now, let me talk about some emergency measures we're taking to mitigate the impact, and the results of these measures will be felt as of the second quarter, that is they have not yet been captured in the results of our first quarter. First, the main cost, favorable. We decided to push vacation forward, so many of our employees went on vacation.

And secondly, we had some temporary flexibilization of labor loss allowed by the interim -- federal interim measure 936, so that we have savings and, at the same time, we protect job. 90% of administrative employees had 25% reduction in workload and wages for 3 months. By doing that, we neutralized any impact of employees who received BRL3,000 or less per month. We suspended 5% of our administrative employees for 60 days.

So we had reduction of workload and also suspension of some employees for 60 days. And we reduced the pay of managers between 27% and 38%. That includes wages plus bonus. So the highest levels of the hierarchy had the highest reduction, between 27% and 38%. This was the premise, more reduction to those who have a higher rate. And those who have salaries up to BRL3,000 had no reduction.

Now the other emergency packages, we reviewed and negotiated all costs and expenses including rental, marketing expenses, utilities, technology, travel, third-party services, among others, always taking care not to cause any harm to our operations. We also reduced organic and expansion investments, except investments in digital transformation, which were protected because we believe that this is our great differentiator, and it will be even more relevant in the post-pandemic new normal.

Finally, we decided not to pay all dividends in 2020, but we will review this issue next month so that we can make recommendations for the 2021 shareholders' assembly. So even in the worst scenario designed, we can ensure there will be no cash consumption in 2020 and all covenants of our debt will be complied with.

With that, I'll close the first part of my presentation, and I'll give the floor to our IR Director, Bruno Giardino, to present the financial highlights in the first quarter 2020.

Bruno Giardino {BIO 21658408 <GO>}

Thank you very much, Rodrigo, and good morning to all. Moving on to Slide 11, I would like to explain the main changes that we have made in this release. The first in regard to the analysis of the 4 companies that make up Cogna. We hope that with this, we'll give the market a better understanding of the challenges and opportunities that each vertical offers.

Kroton concentrated on post-secondary graduation operations both in own units and partner schools; Platos, which is our educational services platform for post-secondary education; Saber, comprehending our own K-12 schools and those managed by contract; Vasta, our integrated education solutions platform for K 12 schools; and finally, other businesses, including the National Textbook Programs, SETS, LFG and other services.

A new development in this quarter is that we are making a more granular disclosure of our earnings with individual results of each company being presented net of opening balance sheet reversions, particularly in the case of Saber.

We also disclosed the detailed breakdown of accounts receivable with a focus on the Kroton operations. Therefore, we present to the market a diagnosis of accounts receivable and PEP provisioning, our payment plan product.

Let's go now to Slide 12 for the results of our vertical processes. For comparison purposes, we included in the 1Q '20 results the deferred revenue of BRL75 million relating to the delays in the renewal of FIES students, and we excluded the additional provision paid this quarter for losses related to COVID-19 impact.

In this scenario, net revenue showed a 23% drop caused by the reduction in the volume of new on-campus students since the quarantine began during the student recruitment base in addition to the reduction of the FIES student base. And these factors have been partially offset by the robust performance in DL recruitment, as Rodrigo mentioned.

Consequently, Kroton's EBITDA dropped 50% with the loss of efficiency and dilution of costs and expenses arising from the fall in revenue. Here is the process to underscore that the cost for the semester had already been contracted before the pandemic. Our teachers continue to give classes as usual, and we also made investments to guarantee the structure of our synchronous and asynchronous models on the same date as the closing of our units. Looking at the bottom slide for Platos, net revenue grew 16%, supported by an increase in the average ticket. While EBITDA grows 62% supported by efficiency gains captured in the quarter.

Proceeding to Slide 13, we see the figures related to our K-12 operations, starting with Vasta at the top of the slide, we present the 1Q '19 numbers classifying editorial expenses in cost of goods sold. Additionally, we exclude the PIS and COFINS tax credits that drove down Vasta's SG&A and expenditures in 1Q '19 for better comparison purposes.

Therefore, we see growth of 24% in the quarter's net revenue in line with the 25% increase in ACV we had already reported. EBITDA growth 26%, with a 60 basis point increase in the EBITDA margin as a result of the higher level of efficiency in the operation even considering the increase in marketing expenses. Saber, in turn, had an increase of 7% in net revenue with EBITDA up by 44%, reflecting the turnaround we implemented in the vertical with an expressive gain of EBITDA margin.

Finally, let's analyze the results of other business and Cogna consolidated results on Slide 14. In the other business segment, we classify statutory expenses so in 1Q '19 and disregard the revenue and expenses relating to 1Q '20 national tax book program, which normally have an impact in the third and fourth quarters.

As a result, the comparison between the segments will not be adequate because of the seasonality of each product. Therefore, Cogna's consolidated net revenue was BRL1.6 billion in the quarter, down 12%, with an EBITDA of BRL574 million, down 19%, impacted by Kroton's drop in revenue and EBITDA and partially mitigated by the improvement in revenue and EBITDA in Platos, Vasta and Saber.

With this, I finish this section and hand it over to our CFO, Jamil Marques, to proceed.

Jamil Saud Marques {BIO 21416820 <GO>}

Thank you very much, Bruno. Good morning to everyone. Moving on to Slide 16, I would like to detail the behavior of accounts receivable, our coverage index and the average time of receivables both in our companies and also on Cogna consolidated.

Looking to our coverage index, it's adequate, especially when we look at the annual comparison, but it's important to highlight that in the Cogna consolidated view, that includes other companies, we had an increase of 147 days to 175 days in the average term of receivables. This is a natural trend considering the maturing of our payment plan products.

If we analyze the average term of receivables of Cogna excluding payment plans, this is 120 days, which is the same as the five days that were reported in 1Q '19 and two days below what we saw in the fourth quarter '19. We also see that our accounts receivable, of course, has the impact of Kroton as the most relevant.

So let's turn now to Slide 17, where we will discuss those effects. Here, we have made a breakdown between the FIES students graduating and dropout. And all products had a change in the amount of comparison.

In the following slide, I will detail the payment plan products, but first of all, I would like to say that PDA is adequate for all products in line of our coverage index. When we look to our pocket, the level of coverage is consistent with our account receivables and with the level of uncertainty brought about by COVID-19.

On the right side of the slide, we see that the average term of receivables follows the maturing curve, and the out-of-pocket average term had an increase of 13 days. And this, of course, reflects the impact of COVID-19, but it has remained stable in the quarterly comparison, reaching the 114 days that we saw in the fourth quarter '19 and reaching 115 days. And finally, the average term for FIES show an expressive reduction as a result of the time line of the program reported at 35 days.

On Slide 18, considering that we are now breaking down information about PEP in more detail, let's discuss the level of provisioning for the product and how it compares to our initial estimate, which pointed to a level of 15% provisioning.

If we look to the middle of the column, here we notice that the revenue breakdown between graduating and dropout students, and it's slightly different with 54.7% of our revenue coming from dropouts and 45.3% from graduated students.

And from the credit perspective, the profile of the students has deteriorated in relation to what was planned or which was basically half and half. And this is because we have more participation of dropout students with the profile pointing to lower chances of receivables.

We also see that the expected losses are better than what we had anticipated. And the top part of the chart, we see that the graduating students are slightly better at 22.8% compared to 20%, but we see that the dropout rates are better than what we have predicted, two-thirds of recovering of those payments. As a result of this, and also considering the graduating and dropout students, the losses for PEP would be 46.8%.

In spite of this, considering the uncertainties we are experiencing because of COVID-19, and the potential impact that this will have on our collection rates, our expectation for recovery of PEP in the next 12 months would point to 40.3% in losses, still below the 50% we had predicted earlier. And this reinforces that our provisioning for PEP is adequate even considering deterioration caused by COVID-19.

Now, moving now to Slide 19, we will present CapEx developments, investments in expansion and cash generation. Starting with the left side of the slide, our CapEx, including investments in expansion, reached BRL119 million in 1Q '20, equivalent to 7.3% of net revenue, down 21% in the annual comparison once the Company finished its project for opening up new units. And what's missing now is only the expansion of current units.

With regard to cash generation, in the first quarter, as we know, cash consumption predominates. In 1Q '20, we had lower consumption of cash, mainly because of the lower working capital consumption in addition to the receivables related to PNLD 2020 that we had expected to receive in 2019. It's also important to highlight that with BRL2 billion cash generation positive as a result of follow on, we have a very solid cash position to face this time of hardship.

And with this, I turn it over now to Rodrigo for his final remarks.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Jamil. Now closing today's presentation, I'd like to speak about some relevant topics on Slide 21, please.

Beginning from academic activities and new enrollments for the second half of 2020. About academic activities, we already have all our teams and platforms ready even if the quarantine should persist until the next half year. So we want to neutralize the impact to our students.

In relation to new enrollments, we already started the new enrollments of the first half fully digital using our sites and platforms. The admission exams were 100% online. The teams have been trained and retrained to use our resources for new enrollment. As we said, we see an acceleration of student migration to hybrid formats or to purely digital formats.

In 2020, as most companies in this third block, we decided not to publish our guidance because of the high level of uncertainty. But what we can share with you is that even in the stress scenario that we designed, we will be able to ensure we will not consume cash, even in the stress scenario, we will not consume post-CapEx operating cash. We'll have a positive operating cash, and we will meet all covenants of our debt.

Now, also the impact of structural measures that I mentioned in details earlier on, so these emergency measures will begin to generate an impact as of Q2 2020, and also, in the second half of 2020, when we will be able to re-adapt our cost structure to this new reality, reducing pressure on our margin.

Now, the third block, we believe the current scenario will bring M&A opportunities. Our team is evaluating assets so that we can capture these opportunities when we have a more stable economic scenario. But now we will protect our cash of BRL3.5 billion, adding the cash from the debentures issue. So we will have financial soundness for the whole period.

About Vasta, the results show we have a unique combination of robust brand, high-growth, high-profitability and high-cash generation. We have already started our digital go-to-market for the 2021 annual contract value fully digital, providing digital school to prospect clients. So we see lots of efforts. We are still only just beginning these new enrollment, but we look at our daily performance, and we can see that it is higher than the receivables of 2020. So we are only just beginning, but the first signs are extremely positive. And our platforms are key as a competitive differential to help schools that did not have a digital solution so they can continue their academic activities.

As we mentioned in the material fact publication, on August 2 and November 21, we are preparing for future listing in the US so that we will have further inorganic growth.

These were the messages of today's presentation. I'd like to close saying, we are living in a new world. All organizations on the planet had an impact, smaller or bigger, and something we tried to do at Kroton was to react quickly and safely using the seven pillars plan. So we had a structured and quick reaction. The impact will be felt. Yes, the impact will be felt. However, it will be less intense. And the impact may also bring opportunities after the crisis. So that's how we are prepared.

Thank you very much for your participation today. I'd like to invite you now for the Q&A session.

Questions And Answers

Operator

Thank you very much. We now have the Q&A session. (Operator Instructions). Our first question is from Susana Salaru, Itau

Q - Susana Salaru {BIO 16170633 <GO>}

Good morning, everyone. Thank you very much for taking our questions. I think that there are two points that we would like you to elaborate. First of all, distance learning. You said that you would like to recover market share. What will be the strategy you'll use to recover market share? This is our first question. And secondly, in relation to the hybrid products that you mentioned a few times during the presentation, could you give us a few examples of those products and what you are already offering?

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

Hello, Susana. Thank you very much for your question. Rodrigo Galindo here, and then I'll start answering the question and Roberto Valerio will (Technical Difficulty) I think that process of regaining a growth curve of distance learning, we have already started that this year. And growth happened in a very accentuated way in distance learning premium, which are the hybrid programs. So answering your second question, when we talk about the hybrid program, this is a program with distance learning and on-campus components. And for us, it's indifferent. It doesn't matter for us whether it's distance learning or on-campus.

We believe that this difference will be less and less relevant in the future. And we also have distance learning programs with a high level of on-campus attendance. So hybrid programs are those that, regardless of the mode, they have both types of components -- on-campus and distance learning. Hybrid the hybrid that grows the most is the premium programs with the Company. And this is seen, especially on the campus. And Roberto, will give you more information about this.

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

Thank you very much, Susana, for this question. Okay. As Rodrigo was saying, he was talking about premium DL programs. Those are our hybrid programs. Just to give you a reference, it's growing 50% year-on-year in terms of student recruitment. And as such, it has a very important participation. Hybrid programs, especially on-campus, they are just the mirror of the on-campus programs, and they work very well. It's almost as if we're selling a nursing or engineering solution, and students can choose whether they wanted to take the program remotely or on-campus. So it's natural that at this time with the pandemic that these programs will become more attractive. The distance learning model is becoming more popular and better known.

In relation to your question, I think, that in addition to the full portfolio that we offer, we have almost all health care programs and engineering programs available in DL mode. So this is allowed by the regulation. As long as they are allowed by the regulation, they are offered in distance learning. And another front for growth is the repositioning of our 100% online programs.

For several moments, we discussed that our strategy, since we were market leaders, was not to compete on prices on the 100% online segments because we didn't want to launch a price war, and we didn't want the average ticket to shrink. So what we saw with time was the stabilization of online program prices. And when this happened, we set up our 100% online programs. So this is basically our strategy with growth of 100% online and also 100% with the premium programs being offered in distance learning.

I think just to add to this answer, Susana, I think it's important to say that we are now growing the number of centers as well in this cycle with what we call the lighter asset centers that meet all regulation requirements but that occupy less physical space. And there, we offer 100% online programs, our entire portfolio, and we believe that this will also be instrumental to recover market share from now on. By the way, market share, in terms of revenue, we have maintained our revenue share by focusing on the higher ticket programs and offerings as we have said before.

Q - Susana Salaru {BIO 16170633 <GO>}

Okay. Just a clarification, please. When you say that you're going to have more competitive pricing in DL, does it mean that you're going to be more aggressive in your commercial activities, offering more discounts for DL or is the ticket lower now?

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

Well, we have been more competitive in pricing for online programs because this is the more competitive product in the market. We were not focusing on this strategy because we didn't want to be the market leaders with lowest priced 100% online programs because this would drive down the program prices in the market at large. So we continued to try to preserve the average tickets in the market. But the fact is that we're using 100% online programs. And the recovery of market share volume is going to come because now everybody is sitting on this segment.

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

Just to add to what Roberto said, I think that from now on, there will be no changes in the policies we have adopted for the first half of the year. And this policy, even with the impact of COVID, grew volume by 26% and revenue by 12%. So this policy, with a more competitive policy in premium EAD, led to a 12% increase in revenue.

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

Yes, we haven't been growing in DL at those rates for a while. And we are now growing volumes once again. And as Rodrigo said, we grew 26% in volume and 12% in revenue because the average ticket is slightly lower because of the 100% online program.

Operator

Our next question comes from Yan Cesquim from BTG Pactual.

Q - Yan Cesquim

Two questions on our part. Like to know a bit more about average ticket on on-campus students and also distance learning. Second question, I'd like to know a bit more about the academic activities. You mentioned, you already see a trend of migration on-campus students migrating to distance learning, but I'd like to know if you have some more marginal data to help us understand. I mean do we already see renewals having this process of migration?

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

Hello, Andy, how are you. I will reply your second question, and then, I'll give the floor to Jamil or Roberto to talk about your first question. But basically, yes, we already see a migration towards hybrid program. When you look at this learning, Distance Learning grew 26%, whereas on-campus had a drop. So that's a clear trend. In distance learning, you have 100% digital programs and also, hybrid programs. For example, nursing where you have a lot of on-campus activities. However, when you look at the on-campus distribution channel, so we have to look at our campus as a distribution channel, as a store. And one of the products is on-campus program, but also all the other distance learning programs because we believe that more and more, this channel will see digital products, 100% digital or hybrid programs. And this is good because hybrid programs bring a higher margin even compared to on-campus students.

So we can even see a stabilization of revenue because of this. I mean, without growing volume, because the absolute EBITDA and cash generation from distance learning is significantly higher, so this trend is inevitable. It would happen anyway. It was, of course, accelerated by the pandemic, but it's favorable for companies who are ready. This is what we believe. So when we talk about digital transformation, there are many aspects to it. First, the Company is quicker, swifter. We changed the organizational culture. We changed our way of doing business, but we also changed the products that we offered. This was already going to happen, we believe, but it's been accelerated by the pandemic.

As you look at the growth of hybrid programs in our campy, this was a significant growth. And it was accelerated in the current scenario. We already saw that in the first half of the year, and we still don't have the full impact of the pandemic. So when you have top-quality digital programs, and this is what you can see if you look at our quality indicators, then this process can even be more accelerated as of the second half of 2020. So we may see more student migrating -- I mean on-campus students migrating to distance learning, and we're ready to deliver digital academic activity. We've already increased our offer of digital program. All of our units already have hybrid programs in addition to on-campus programs. This is what we call the process of migration to hybrid program. Students feel more comfortable to learn on digital platform, either 100% or in hybrid models.

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

Good morning, Yan. This is Jamil. Thank you for your question about the ticket I'll try to provide some details on what we've seen in this quarter, and especially, looking at on-campus because that's where we may see a delay in payment and an impact caused by the COVID cries. But for out of pocket students with the growth in enrollments, slightly better than the first half of 2019 and veteran students feel an impact. That's why we saw this drop, but most of it is only temporary, 5% of may be 10% minus 5% because of late renewals with a higher ticket and also seasonality of last year. That was a post. I mean the average ticket of the first quarter basically because of renewals but we will not see this effect any longer. So the average ticket of the second quarter will be very similar to that of the first quarter. Now in Distance Learning, that's where we see the impact of the 100% online programs, as Rodrigo mentioned. We are growing Distance Learning volumes. So we have now a greater penetration and a lower average ticket. But as you look at all the enrollments, we can see that Distance Learning is -- (Technical Difficulty)

Operator

Our next question is from Marcelo Santos, JP Morgan.

Q - Marcelo Santos {BIO 20444938 <GO>}

Good morning, everyone. Thank you very much for answering the questions. (Technical Difficulty)

A - Unidentified Speaker

So until the closing of the units, the recruitment has been growing a lot. So basically, the decrease in revenue in on-campus. And when we are reporting this because it's very important for us to make this message very clear. This decrease in volume and revenue in on-campus is relevant, but just feel free to understand the dynamic. Historically, after we create the classes, we are more aggressive in our commercial offers because the costs have already been established. So our offers are very aggressive to recruit more students because the revenue is marginal. And it seemed to make sense to offer this like this. We conducted a historical analysis of the student performance. And this analysis was concluded at the end of the year, and we came to the conclusion that the volume was very high, the revenue was average because the students had several discounts, and the cash generation was almost void. And also, there was a very high change in dropout.

And so these actions were all on increasing cash difference. And a large part of our strategy today is to offer at the end of this cycle, and that's why we say that the quality now is much higher. This is an element that would become a benefit in terms of PDA for the following semester. And with factors such as COVID, this is even more important. So we have less pressure on future PDA because we'll have more cash generation and lower dropout rates in the future. And on-campus had been doing very well before the advent of COVID. If we consider only growth, it's 5% that we have been growing at. So I think it's very important to make a deep analysis because the impact on cash generation is very low.

Now, conceptually, discussing the opportunities, we have several opportunities. We understand that there was some resistance coming from on-campus students in relation to the DL offering. Most of the education institutions in the country have not succeeded in implementing the 20% of digital content that was allowed by the law before because there was a negative reaction coming from students. So when they changed this, very few -- even with the change in recognition, very few institutions did it because of the negative reception coming from students. But now that students have access to 100% of digital content, they were able to see the good side of going digital, no need to attend classes on campus, several advantages they were not able to perceive before. So I believe that, yes, there will be some impact, for example, the use of digital content in a larger scale, including in on-campus activities because students now realize that you can have quality education through digital means.

Secondly, I believe that the channels will tend to offer digital products ever more. So when we're talking about making, for example, the analysis by product, DL or channel analysis, what really makes sense is the channel analysis. It doesn't really matter whether the volume is coming from DL or on-campus, what we need is the own units to grow. So that's why I think that channel-based analysis is more important. And the important thing, of course, is to offer digital products on-campus as well, whether partially or fully digital products.

I think that your explanation about the on-campus dynamics is perfect, as Rodrigo explained, especially small players, small competitors will be in difficulties in the new scenario. And so there is a trend of moving to DL in substitution of on-campus. And I would just like to add a little bit about the regional brand. Yes, we can use DL with regional brands. Those are opportunities that are really local opportunities. But we offer Pythagoras and DL Pythagoras in our campy. Those were the initial brands. And like we do with (inaudible), this is the process that has already been kicked off. It's not anything new. It's the second or third semester, which we did this and we now have the objective of creating new regional brands. We want to use our strength to launch those brands regionally, also because the volume is 26% up and revenue 12%, even with the impact, the adverse impact of the pandemic.

Q - Marcelo Santos {BIO 20444938 <GO>}

Well, going back to what Galindo was saying about the on-campus dynamic. This change of the reduction of end-of-cycle offers was something that was driven by COVID, but at the same time, it's something that was beneficial because those were students that did not contribute much to cash generation. But from now on, even without COVID, are you going to change your strategy for the end of the cycle? Are you going to try to finish with those offers earlier?

A - Unidentified Speaker

Yes. I think you're right. Yes, our studies had indicated that this was a positive move, stopping with the end-of-cycle offers. And now we'll use other strategies. We'll put more energy in the lower ticket products at the end of this -- instead of contaminating the higher ticket programs with aggressive offers, I think that we can use the lower ticket programs for that. But I agree with you, those offerings should be interrupted. And we're going to take the recruitment process to the end, to completion, but with less aggressiveness after the end of the cycle, maintaining the same balance of discount and product offering.

Operator

Our next question comes from Irma Sgarz from Goldman Sachs.

Q - Irma Sgarz {BIO 15190838 <GO>}

Hello. Good morning. Thank you for taking my question. We have two questions. First, do you see any impact in the ENEM delay? I know the date is still unknown, but where do you see an impact? In what parts of your business you see a potential impact? And also, if you have received any lawsuits or requests to reduce the monthly fees, especially from on-campus students? And how do you position yourselves before this risk?

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

Hello. This is Rodrigo. Let me just begin to answer because we're all remote. We're all in home office. So I'll begin, and then I'll give the floor to the person in charge. Now, the delay in ENEM has a low impact. If ENEM is conducted, still this year the impact is minor, and the impact becomes a little higher if ENEM migrates to 2021. The impact is only on Kroton. It's important to highlight that, first, not all students in our base who enroll -- not all of them bring their ENEM grade. And many already have an ENEM grade because our students not necessarily come straight from high school to our university. So there is an impact, but it's mitigated. It's less relevant for us than it is for public universities. But the more ENEM is delayed, the bigger the impact, but it's not really very relevant.

Sorry, the second question, about price reduction. Well, in Brazil today, we have more than 50 bills of law from the local level or state level requesting price reduction in K-12 or post-secondary. But we're very comfortable with our legal argument showing that this is not under the jurisdiction of local or state government to legislate on the price of private schools. Some mayors have already understood. I mean, even when there is an approved law, this is not enough. Some state assemblies have already realized and decided not to vote these bills of law. However, in cities or states where the law has been approved, we will go to court. We will discuss this judicially. I mean regardless of the legal issue, as I said, we feel very comfortable. This is a conceptual issue. This is not the best solution. I mean if we could reduce price, then we would have more people being laid off. That is, we would need fewer professionals. And so that would feed a vicious circle, which does not help the economy. And who would be benefited? Only students, but all students, those who need a price reduction and those who do not. So it's much more effective to solve this problem. And we do agree there is a problem. But why not solve that, providing a case-by-case solution for those who really need a solution, that is those who lost their jobs or those who had a reduction in their income.

So at Kroton, which is where we see the greatest impact of such demand, we now have a product, an installment product so students who are engaged or who were engaged before the pandemic and those who lost their jobs or who had income reduction, they will simply provide a declaration, a statement, not an official document, just a signed declaration. And for 12 months, if it is distance learning, they will have a reduction to pay only next year. And depending on their cases, they will repay only after graduation. The demand has not been very high so far, but we do have this installment product. And we still don't see a big demand. Also because our students are paying on due date in April and May. So a linear reduction of prices, we believe, it is not the right solution. It is a bad solution. And legally and I mean, judicially, we feel very comfortable that this is not in the jurisdiction of local or state government to legislate over the price of private institutions.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you. Very clear.

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

Roberto, would you like to add anything?

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

What I could say, Rodrigo, in relation to the tuition fees, we are trying to reduce our costs, and we use the provisional measure to reduce administrative costs. For example, the wages of our teachers are a sign of that. And just to add something else, reducing our tuition, this would create pressure on our entire network.

And also in relation to ENEM, 30% of our students or less than 30% of our students get into the programs using the ENEM score. So it's not insignificant, but it's not the majority of them that use the ENEM score. Of course, many of them wait for the ENEM results to make decisions about the schools they're going to. So if the scores come out in February, for example, the results will be minor, but if they come after, then the impact for the sector could be higher.

A - Unidentified Speaker

Yes. And I think this is a very good observation. By the way, even if the results come out by February, maybe the impact would not be so great, but there will be a delay in the recruitment curve because many of them will wait until they know for sure whether they can attend a public school or not. So this delay in the curve is something that I would rate as likely to occur.

Q - Irma Sgarz {BIO 15190838 <GO>}

Thank you. Very clear.

Operator

(Operator instructions) Our next question is from Alisha Decosto [ph], HSBC.

Q - Unidentified Participant

Thank you very much. Good morning to all. I have two questions. The first event in relation to the default rate, I would like to know if this is the number that is calculated before or after renegotiation? For example, if they need to pay in installments, the default that you calculate, does it take place after or before the negotiation? And as a follow-up to this question, how does the negotiation take place? For example, does this go into the interest expenses or discounts, where does it go into, in what line?

And also, in relation to the adjustment we're talking about on the second semester, I think that from now to June, nothing will happen, but as of July, probably we will change things around a little bit for the second half of the year. So what are the moves you're planning to adjust costs for the second half of the year? Are you going to tweak the campus that are on offer, what are you going to do on the second half in the year?

Thank you very much, Alisha. I'll answer the second part, and then Jamil will answer the first one. You are right. We are planning some adjustments between June and July. We have not ruled anything out in terms of the adjustments that we can make. We could have, for example, an integration of two campy in the same city or it could be a change in portfolio being offered in a certain campus or turning the portfolio more digital in a certain campus, with more centralization of activities. So it's, in fact, a large set of activities that we are discussing. They are very comprehensive, and they could include everything you have mentioned.

Okay. But just to add, what is the information you're going to base your decisions on? You already have it at hand, I imagine. So it would be something based on the data we already have, right?

A - Unidentified Speaker

I think that, depending or as we go into the student recruitment phase in the second half of the year, we could adjust the intensity of the different measures, basically.

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

Alisha, good morning. Jamil speaking here.Jamil speaking here. In relation to the default where we have the active students in that figure, basically and with the active students, Rodrigo broke down this figure in two. When we look at the timely payments, the figure is actually slightly better, as you can see on Slide 8 of the PowerPoint. But with late payments, we saw a deterioration because either the student pays on time or they ask for payment installments of the amounts they owe.

Q - Unidentified Participant

No,. Just to understand I mean, the rate, do you calculate it based on whether it's a late payment or not?

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

Yes. This is the cut off. For example, those who have paid on the right date divided by the amount. And in relation to how we report this, we don't make any discounts on the principal. What we do is charge interests -- interest in charges in the receiving and we have the coverage rates that have been mentioned in our release. I'm not sure if your question comes from this. In the specific installments that we are offering, this is something that we deal with directly with PAC and with a coverage of 50%.

Q - Unidentified Participant

Do you think that this limit of BRL50 million would be increased?

Yes. So far, we don't see a lot of people picking up on this, but we don't see that happening right now.

Operator

Our next question is from Marcelo Santos, JPMorgan.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you. Thank you for this follow-up question. I'd like to speak about Vasta. First, could you give us some more color on the impact of COVID and the operation, receivable of materials, the budget of schools, the situation of due date payment in the schools? And maybe talk a bit about opportunities for next year. And also a second question about M&A. I mean, what do you see as the potential for M&A?

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

Thank you, Marcelo. I'll give you a general overview, and then Ghio can provide more color. Vasta has shown to be very resilient, perhaps the most resilient of all our business lines even in a crisis such as now. So the first message is that, we see a solid Company keeping growth margins into the future. We see lots of opportunities. We already saw opportunities before. The IPO, we are now preparing, which we announced late last year, and then, we'll be waiting for the right market moment to do that. That is to finance inorganic growth. We see lots of opportunities of acquisitions in our segment, in core content, complementary content, digital solutions. And this is the beauty of our platform concept at Vasta, because this is a platform that relates to more than 4,000 schools, providing services to them. So we can develop services and make them available on the platform. We can buy companies and plug them into the platform or we can partner with companies and plug them into the platform. The platform concept is beautiful because it generates lots of possibilities of growth. So acquisitions, we see it as a great opportunity for growth for Vasta.

And the IPO will finance M&A activities. This was already an opportunity but now with a crisis, we will see many more assets which were not available in the past, and they now may potentially be available. So we believe the opportunities will be very relevant. However, we have high-margin assets, high-growth assets and high cash generation assets. And so therefore, we know the share value of our assets. Our offer will wait for the market to be willing to pay a fair value for our assets. As soon as the market understands the characteristics of our assets and is willing to pay fair price, that will be the right moment for the IPO. And so that will finance our inorganic growth. Now, Ghio will talk about your first question.

A - Mario Ghio {BIO 17352490 <GO>}

Thank you, Rodrigo. Marcelo, thank you. Good morning, everyone. I think, first, I'd like to mention, Marcelo, that when the crisis broke, this is when the impact on primary education was already minor because all schools had ended their enrollment processes. The schools already had all the materials, those who use textbooks had already received all the textbooks for the whole year. So this resilience was because of the timing that was perhaps more favorable for primary education than it was for post-secondary education. It's always important to mention that in K-12, a head of a family cannot simply take his son or daughter out of the school because it's an obligation. They may, of course, change schools, even go to the public system, but not simply stop the contract in the middle of the year. And families, I mean, households, they leave that kind of savings for last. I mean, this is perhaps the anchor of this resilience. Now, about default that you mentioned -- Marcelo, can you hear me?

Q - Marcelo Santos {BIO 20444938 <GO>}

I can hear you. We had a moment when it was mute our.

A - Mario Ghio {BIO 17352490 <GO>}

Okay. Good, Marcelo. Yes, we had a problem here. But about defaults, in the first quarter, we did not see anything different from usual. And the second quarter I mean we still don't see anything different from previous years. However, if we see that payments are late, then, well, that will be offset along the year, because the schools, they're using our platform, I mean and so if there is one bill they will not stop paying is the digital platform because that's the only thing they have to continue to receive payment from the families. And so we talk to schools every day. We're connected to them all the time and we always say that our default should not grow. Schools that have any difficulties will come and talk to us. We will negotiate, but that will be offset in the second or third quarters.

About opportunities, they're very clear. I'm not even going to mention the opportunities of M&A because Rodrigo has already talked about this. But the opportunities we have, schools who are not our clients, but still they have to continue operating, and so therefore, they want to join our platform to continue to do business. And this is very clear. We have 350 contracts, trial contracts of our platform for these schools to be able to continue their operations on a digital platform. And we believe that they will become subscribers. There is a big probability they become subscribers.

Now, the other opportunity, and Rodrigo spoke about consolidation via M&As, and that's applicable to core content, and also, applicable to complementary content. I mean if you look at our platform, many partners, including international companies, come and talk to us because they know our platform is fully connected to private schools. And so they want to build revenue sharing partnerships. It's a very interesting way to bring innovative products quickly, simply, without any additional CapEx. So we take care of the platform, the partner takes care of the services and the content. So that's a great opportunity we see every day.

So I mean in closing this reply, we were lucky because the timing of the crisis did not really impact primary education. I mean, if you look at our business, schools need us, that's why we're so resilient. And because we have the digital platforms, we have a bigger possibility to convert schools. Schools that would require a long negotiation now need our platform. And we also have an opportunity for innovation on our platform even though we may not have to invest to build new services.

Q - Marcelo Santos {BIO 20444938 <GO>}

Okay. Perfect. Thank you.

Operator

As there are no additional questions, I would like to hand it over to Cogna for their final remarks.

A - Unidentified Speaker

I would like to thank you all for participating in this earnings conference call. I wish you all great health and that we are able to find new ways for the future. Take care.

Operator

Cogna Educacao conference call is now closed. Thank you very much. Have a great day.