Q4 2016 Earnings Call

Company Participants

- Carlos Alberto Bolina Lazar, Investor Relations Officer
- Frederico do Casal Ribeiro Brito e Abreu, Chief Financial Officer
- Rodrigo Calvo Galindo, Chief Executive Officer

Other Participants

- Ricardo N. Rezende, Analyst
- Rodrigo Gastim, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Kroton Educacional's Fourth Quarter 2016 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 completed, there will be a question-and-answer session. At that time, further instructions will be given.

Also, today's live webcast, both audio and slideshow, may be accessed through Kroton Educacional's Investor Relations website at www.kroton.com.br/ir by clicking on the banner 4Q16 Webcast. The following presentation is also available to download on the webcast platform. The following information is available in Brazilian reais in accordance with Brazilian Corporate Law and Generally Accepted Accounting Principles, BRGAAP, which now conforms 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, 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 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 your conference.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Good morning, everyone, and welcome to the earnings conference call of Kroton Educacional for the fourth quarter and year of 2016. With me today, our IRO, Carlos Lazar; and our CFO, Frederico Abreu.

During today's presentation, we will provide details on the results of our various businesses which were made possible by the capture of efficient and synergies gains and austerity in costs and expenses. In parallel, we will continue promoting significant improvements for our students, always focusing in the front on the employability as our most important value proposition for our students. These allowed us to deliver value in short-term while also ensuring sustainability and growth in the long-term.

Let's start the presentation on slide 4, which compares the actual results we delivered in 2016 with the guidance that we announced in May of 2016. Once again, we ended the year surpassing our targets. The targets were challenging, especially considering the highly challenging environment for the economy in general and for our industry in specific.

Kroton posted net revenue of BRL 5.2 billion, beating by 3% our guidance of BRL 5.1 billion. Adjusted EBITDA was BRL 2.3 billion, 3.7 points (sic) [3.7%] (00:04:01) above guidance, with EBITDA margin of 43.9% or 0.4 percentage points above our guidance. Adjusted net income in the year reached BRL 2 billion, beating our guidance by 8.9%, while net margin was 38.3% or 206 basis points above our guidance. Finally, the company's total investment including special products corresponded to 8% of net revenue, which is in line with our guidance. The number shows that 2016 results were extremely solid, demonstrated the success of our strategy and our efforts to ensure the efficiency of our operations.

Let's go now to the analysis of our operation indicators and financial performance in each segment and to continue the presentation for now, I invite our IRO, Carlos Lazar.

Carlos Alberto Bolina Lazar {BIO 17238206 <GO>}

Well, thank you, Rodrigo. Let's turn now to slide 5, which shows the analysis of our operating indicators in the quarter, mainly dropouts in delinquency rate. On the On-Campus dropout rate, which is a one-off increase or 40 basis points due to the significant change in the profile of our freshmen students since last year with a lower share of failed students. It is important to note that the Retention Program (00:05:22) projects for early 2017 since the results obtained it up to now really demonstrates the benefits, obtain and in terms of improving control and our dropout rates.

Meanwhile, in our Anhanguera Distance Learning business, the dropout rate remain exclusively stable even with the deterioration of the market scenario. And last on this slide, in our provision of doubtful accounts, as we know, here we adopt a very conservative practice for both revenue recognition and provision. And because of this, our provision has suffered with life and recurring adjustments since the start of the year – since last year in light of the market conditions and service given the tougher microeconomic scenario that the country is facing. In this context, PDA ex-FIES and ex-PEP has encountered business increases from 7.2% to 7.4% in the fourth quarter, while in the business line, business PDA – the PDA increases from 7.8% to 8.1%. While later on the call, Frederico Abreu will talk more detail in terms of receivable delinquency and also provision.

On slide 6, we present the evolution in the quarter for our net average tickets. Once again, the numbers confirms that success of our strategy of prioritizing the PEP students instead of granting scholarships and discounts with the average ticket of the On-Campus business in the quarter increased by about 10.4% year-over-year from BRL 734 to BRL 811. The increase also reflects again our tuition increases and improvement that we could achieve which also increased of share from improvements that have higher average ticket like engineering and health. As I already pointed out, we adopted a series of conservative practice for the recognition of revenues from PEP students, and making the business to the present value in the financial portion of the net value and consider also the bad debt of the 50% which is about seven times higher than the PDA for the out of pocket students. The PEP, despite the lack of the relevant historical database, the initial results for PEP dropout and delinquency rates are consistent with our model with our projections.

Furthermore, it is important to remember that the NPV of our PEP students is very close to the NPV of our pocket students, reinforcing to believe that the PEP strategy is reflective in increased value for our company in a sustainable manner. Meanwhile, the average ticket in the Distance Learning business increased 11.1% in the fourth quarter year-over-year from BRL 246 to more than BRL 270, reflecting the annual tuition increase in the On-Campus and also the effects of the premium distance learning programs that we are launching since last year, but especially this year, basically this kind of courses have a higher average ticket than the other DL programs.

Let's go now to our consolidated financial performance on slide 8, a summary of our main P&L lines in the fourth quarter and also for the year of 2016. Remembering that for a better comparison between the periods, we exclude here the results of Uniasselvi in 2015 and 2016. In the case of the fourth quarter 2016 specifically, the financial performance is presented in a pro forma basis due to the delay in the operating of the SisFIES system, the system coming from the SisFIES program in the third quarter we mentioned back there.

Note that the company has not changed any criteria or policy of revenue recognition, and so this is basically just a pro forma adjustment. The results for both quarter and year was very, very positive, net revenue grew 7% in the quarter and 5% in year supported to a better product mix and the resulting of a higher average ticket, as I just mentioned. In addition to these improvements in our topline, we also captured efficiency in synergy gains. And as a result of that, our EBITDA grew by 5% in the quarter and 10% in the year. The margins compressed by 100 basis points in the quarter, but will expand meanwhile in the year about more than 200 basis points. Net income and net margin also improved. The chart in the lower left shows that net income grew by 23% in the quarter (00:10:21), the net margin expanding almost more than 400 basis points in both comparisons.

Lastly, the charts in the lower right shows operating cash flow after CapEx. Note here that for comparison purpose we excluded from the fourth quarter the 2016 – we excluded from the fourth quarter 2016 the receipt of one additional month of FIES credits relating to the November receivables of around BRL 192 million because this is normally paid in January, so just for comparison we did this adjustment. We also adjusted the current EBITDA (00:11:03) to exclude capital gains related to Uniasselvi, so the numbers are more proper to compare and better show the company's performance.

In the quarter, cash generation considering (00:11:15) 114% represent an EBITDA-to-cash conversion of more than 61%, which also reflects the normalization of tuition – the receivables of this FIES cycle started back in the beginning of 2016 and also the strong result delivered over the course of the year. In the year, the cash generation after CapEx grew by 94% for an EBITDA-to-cash conversion of 60 – almost 63%. Our focus as we mentioned of course continues on capital efficiency and synergy gains and on taking advantage of new opportunities to continue brining value for all stakeholders as clearly demonstrated by these results, that I'm glad to start to deprive and show per business in slide 10, where we see the financial performance of our On-Campus Postsecondary business. Here, in this business, net revenue grew 6% year-over-year, driven by higher average ticket, which turns to us – also supported by better program mix.

The launch of new programs and (00:12:28), and also primarily by the positive impact from the recent intake in new enrollment cycles. Meanwhile, the gross income was BRL 679.2 million, with the gross margin of 65.7%, representing increases of 6 basis points and 22 basis points which benefit from the ongoing capital of efficiency gains in our units, especially through the rollout of our operational research software, which combines our (00:13:00) volume has led to important gains in the ratio of classroom hours for students, one of the segments highest cost.

Other highlights include the (00:13:12) since the beginning of the merger, and the restructuring of units to optimize the levels and the (00:13:21) gains captured by the strategic sourcing of projects.

In the year, the expansion in gross margin was even stronger moving up by 256 basis points. With the results, operating results of the On-Campus business with our market expense was BRL 480 million, with operating margin of 47.2%, representing a growth of 3%. In the year, operating margins stood at 52.2%, also higher than 2016, almost 250 basis points due to segment's continuous capture of efficiency and synergy gains.

Turning to the slide 11, we can see the performance of the Distance Learning business. While here the net revenue was BRL 263 million including 8% driven by the positive effects from the intake in new enrollment process and also by the higher average ticket periods, which was held by the annual increase and also the Premium Distance Learning business that have higher ticket (00:14:32).

Meanwhile, the gross income in the quarter grew by 7% to BRL 219 million with gross margin compressing by 82 basis points to 83.1%, reflecting a very similar effect year one-off increase in the cost and expense in the quarter. In 2016, however, the gross margins stood at 85.2%, expanding more than 300 basis points from 2015, due to the capture of efficiency and synergy gains with the special highlights through actions focused on optimizing the DL's performance of Anhanguera including migrating of the teaching model from (00:15:14) as well as the restructuring of the commercial model and reducing – the reducing of costs from leases and materials.

The operating results before our marketing was BRL 168 million, it's stable in revenue. Meanwhile, the operating results stood at 63.7%, declining a little bit less than 500 basis points. In addition, the one-off costs we mentioned before with expenses incurred to support the growth of the centers network, also contributed for this reduction. But in the year, however, the operating margin improved a little bit to achieving 69.6%, we expect to see all the benefits from the scale and the capture of efficiency gains.

Going to slide 12, you can see the financial performance of our (00:16:10) business, the primary and secondary education. And as I mentioned in previous quarters, Kroton has promoted an anticipation of the delivery of textbooks to even numbered quarters, which means that revenue that was recognized in odd numbered quarters will now be recognized in prior quarters. This effect however recorded in the fourth quarter 2015 that was even more significant in the first quarter of 2016 which impacts all the P&L lines of this business. So considering this new dynamic, the net revenue of the Kroton business was 6% higher year-over-year and achieving BRL 64 million, the gross margin grew in the same line and 54% to BRL 36 million and the margin which is 56.6% also up compared to last year.

Lastly, the operating results grew 68% to BRL 30 million with operating margin expanding by 500 basis points to a little bit over 46%, reflecting a greater anticipation of the revenue, as well as the capture of the efficiency gains with a very rigid controlling costs and expenses in the specific segment.

Going to slide 13, you can see the variation in corporation and selling expenses. And starting, talking about the corporate expenses, which stood at BRL 93 million, corresponding to 6.8% of net revenue or 17 basis points lower than the year before, supported also by the gains in the adjustment of the number of the corporate stuff and expenses, because of the payment for the strategic sourcing process that we are implementing in several ways here in the company.

Meanwhile, the selling and market expenses decreased 85 basis point as a ratio of net revenue, mainly due to the anticipation of part of the marketing campaign in the first semester of last year, in line with the (00:18:20) and also as a part of the strategic sourcing project.

On slide 14, you can see the growth of adjusted EBITDA in the fourth quarter and the fiscal year of 2016. The EBITDA – the adjusted EBITDA grew 5% to more than BRL 529 million, with adjusted margins compared to be about 85 basis points, almost stable. So, in the year, the adjusted EBITDA ex-Uniasselvi grew 10% to BRL 2.2 billion with the margin expanding more than 200 basis points to almost 44%.

Here, it's very important to note the prudent capability in such a high-challenged economic scenario and we have negative pressures into top line such as, for example, the lower prototype revenue and also the lower number of FIES students (00:19:19). Now, the next two important signs are to demonstrate the quarter's resilience and the execution capacity. Bear in mind that EBITDA is adjusted by non-recurring items that amounted to BRL 80 million in the quarter, especially related to some integration expenses already from the (00:19:38), but not only, and also some reduction in the number of units that causes some severance charge for the company in this specific quarter.

Finally, we had a capital gain. It's a non-recurring item also from the Uniasselvi divestment, which has a positive - which had a positive impact of BRL 12 million in this line.

Net income on slide 15. Here, we see that beside the adjustment from the non-recurring losses, adjusted by the amortization of intangible and effects on the payments for income and social contribution related to the Uniasselvi disposal. In the fourth quarter, the adjusted net income grew 23% to BRL 488 million with some of margin expanding 450 basis points to 35.8%. In the year, our (00:20:39) was even stronger or it's stronger. The adjusted net income grew 17% to BRL 2 billion and the net margins grew more than 400 basis points. So, that was basically the more important financial comments that I have to give you.

And now, I'll invite our CFO, Frederico Abreu, to continue the presentation.

Frederico do Casal Ribeiro Brito e Abreu {BIO 16674822 <GO>}

Thank you, Carlos. Good afternoon to everyone. I invite you to move to page 16. And before getting into the numbers, I'll present the accounts receivable, the PDA and the average receivable term. Before getting into the numbers, I would like to reinforce some important messages this quarter. But first and an important message is that the type of the two main indicators that we analyze monthly related to provisioning, they remained very robust despite an extremely challenging macroeconomic scenario that we had in 2016. And we believe it's very comfortable, which - on which regard, the adequacy of our provision.

So, the first indicator that we analyze is the accounts receivable coverage ratio, which is basically how much PDA we have for the total accounts receivable we have. So if you look at our coverage receivables ratio, there's an increase compared to last year and not only that mainly explained by an increase in PAT, and PAT as you know has a provisioning of 50% on all the balance that we do. So an increase in the coverage ratio.

The second indicator is increase in the PDA. So, in line with our budget and in line with what we've been telling you over the last quarter, we've seen a worse macroeconomic scenario in 2016. And therefore, we've increased marginally and gradually our PDA both on On-Campus and on Distance Learning and this is mainly the reflect of two things.

The first, we have an increase in the number of agreements during the reenrollment. So our graduates when they are reenrolling to the next semester, they have higher debts and here we have a clear tradeoff between reenrolling them and therefore providing them better financing conditions, so that they continue to study and therefore they optimize and maximize the probability of payment or we may not reenroll them. They will leave our schools and therefore it's going to be - it will be much more difficult to collect these debts. So we are using the first approach, which is based on the scoring of our students we are reenrolling the students that we consider that could pay on more flexible conditions and therefore, we are increasing our PDA given this increase in the receivables that we have for these students that we are reloading.

And the second effect, we have a lower rate of receivables paid on time. So the lower number of students pay on time and therefore we have an increase in the average receivable term and therefore we also increase our PDA based on that.

So basically, we are keeping our provisioning methodology or provisioning policy, there is conservative and we've been adopting a conservative approach over the year and therefore increasing our PDA. What we expect is that the macroeconomic situation improves in 2017. And if we have room to reduce the PDA, we will reduce. If we do not see an improvement in our macroeconomic scenario in 2017, we will not reduce them, we may even increase further our PDA. So, the message I want to give you on this second indicator is, we are conservative on PDA and the PDA reflect our debt assessment of default in the future and today we are properly covered.

And the third indicator is the average receivable term. It increased even actually on the next indicator, and again, this is the reflection of higher volume of renegotiations, mainly in our Distance Learning and face to face students in primary and secondary, this is a reflect of an anticipation of our sales of the collection of 2007, we have a higher anticipation of course, which is good for 2016 and therefore the average receivable term also increased.

So in other words, in general, we have a temporary worsening of all PDA and our average receivable term, which is really reflected in a higher PDA and an increase in our coverage ratio, which we expect to have improvement starting on 2017.

So moving now to slide 17, you can see the PDA as a ratio of net revenue. So starting with the On-Campus, you can see 6.5% PDA, which is an increase of about 2.2 percentage points year-over-year. And the main reason for this increase is a higher proportion of PEP, our private financing students on our mix. So considering only out-of-pocket students, you can see a PDA of 7.4%, this is an increase of 1 percentage point. And again, this is the reflect of what I've just mentioned, which is higher receivable terms given the renegotiations with our veteran students.

Now, looking at PEP, we will continue with a 50% provisioning in the balance accounts receivable that we have for the students. So we did not change anything about this methodology and we will continue provisioning the 50% until we have more statistical analysis that leads us to reduce or to increase. So far, we are comfortable with the 50%.

And moving to the Distance Learning, on the middle of the page, you can see 8.1% provisioning. This is an increase of 0.7 percentage points year-over-year and this is the same reason as I mentioned on face-to-face. So high volume of renegotiations with our veterans in order to maximize the lifetime value of our students.

And finally, on PDA, we have a stable PDA for primary and secondary business on 0.8% of our net revenues. So I'd like to highlight, before moving to the next page, our conservative approach of all of our provisioning in revenue recognition policy, we are conservative of - on recognition - on recognizing who is the student and which revenue to bring to our results and if you notice a deterioration in our portfolio, we will further increase provisioning levels. On the other hand, if macroeconomic scenario improves and the recoverability of our portfolio improves more than what we've anticipated in our PDA, we will certainly reduce the provisioning level.

So moving to page 18, you can see the accounts receivable net of PDA and adjusted for present value. We have a total of BRL 1.6 billion in accounts receivable, BRL 1.3 million refers to On-Campus, BRL 250 million to Distance Learning and BRL 65 million to primary and secondary. It's important to mention that on the BRL 1.3 million in face-to-face, 35% is related to out-of-pocket students and 65% is related to students supported by any types of funding or financing solutions (00:28:58) tax or FIES. And looking specifically at FIES, which accounted for BRL 794 million, which is almost half of our accounts receivable, we have here three important messages. The first is that the repurchase payments flow was completely normalized in 2016 and we've received for the 25% that was used related to Normative Rule 23. We've received one more payment than what we were expected related to November, typically the November payment is paid on January and this year was paid in December and this represents at about BRL 192 million. And so, mainly the main message in terms of FIES is that everything is normalized, and therefore we really see a reduction, a significant reduction in our balance sheet on FIES, which is almost 50% of our accounts receivable.

And so, on next slide, moving now to page 19, you can see how these accounts receivables translate in average receivables term. So, starting on the top in green, you can see the average receivable terms on face-to-face Postsecondary business. Looking at the whole, all students from Postsecondary On-Campus, we can see a reduction of six days. So, year-over-year, we have a positive improvement. Looking only at ex-FIES students, so all of our out-of-pocket PEP and Pronatec students, the average term increased by 43 days and this is mainly the consequence of two things that I've already mentioned and I emphasize here again.

The first is the higher number of agreements with our senior students aiming at optimizing the lifetime value of our season, which of course reduces dropout rates, but increases the average term in our PDA. We think this generates value over the long-term. And the second is reduction in the long time payments of our students, and so mainly so that you have an idea, this increase from 68 days to 84 days, mainly 16 days of increase two-thirds of this increase are related with the first thing that I mentioned the higher number of agreements and one-third of this increase is related with the reduction of one-time payments, so two-thirds and one-thirds of the increase.

FIES stood at 117 days, which is 29 days down year-over-year, as I mentioned, with the normalization of the FIES payment. And the Distance Learning had an increase in 13 days from 73 - 14 days from 73 days to 87 days, and this is the consequence of two things. First, an average volume of - an increase in the volume of agreement similar to the one on On-Campus, and also an average receivable term for (00:32:17), which is our proprietary course business that also increased. So, the same thing that we're doing in face-to-face, we're doing in Distance Learning, and therefore we have this increase of 14 days year-over-year.

And on primary and secondary education, we have an increase of 35 days and this is exclusively the anticipation of sales of collections of book 1 from 2017 to December (00:32:42), which is positive so this average receivable accounts be reached in the course of the first quarter 2017. So, what I want to emphasize here is that the substantial part of the annual increase in our average receivable term is due to a tradeoff between reducing dropouts and consequently reducing our future revenue generation capacity from our students or which is what we are doing, lengthening our payments conditions with rigor, with accuracy and according to the students credit score, which in term causes our average receivable term in PDA to increase in the short-term, but in the long-term, we believe that the payment capacity of these students will increase further and we will be able to generate future revenue that if we (00:33:35). So we have here a tradeoff and we are comfortable with the option that we are following.

So, moving to page 21, we have here the CapEx. So all the capital expenditures, in the first quarter CapEx represented BRL 128 million, which is 9.4% of net revenue. This is mainly related with projects involving content development, systems, software, expansion and improvement in our existing units to prepare the units for the 2017 academic year. In 2016, as a whole we've invested BRL 357 million which is 6.8% of our net revenue. This include also cash flow and greenfield special projects in greenfield. Our CapEx in the quarter was BRL 149 million and our CapEx in the year was BRL 419 million which is 8% of net revenues. And here I want to notice that despite our focus on efficiency and controlling cost and et cetera, we continue to make all strategic investments to support increase in academic quality and portability, technological development and innovation, and the growth of our operations on the short- and on the long-term which includes new courses and new degrees and also new (00:35:08) in the Distance Learning center.

Moving to page 22, you can see our net debt. Very important information here, we ended the quarter and the year with cash or cash equivalents of BRL 1.3 billion, this is almost three times higher than last year and this is basically the consequence of higher than last year cash generation and also the normalization of our FIES payment.

Considering only financial debt, our net debt is actually positive, so we have a cash positive (00:35:54) financial debt of BRL 806 million. And if we add that also the short-term and long-term obligations related to taxes and M&A. we ended-up with a net cash position of BRL 606 million, and remind that last year we ended with a net debt of BRL 634 million. So a significant improvement in our cash position compared to last year.

And also keep in mind that we have some short- and long-term receivables with our liquids and certain receivables. The first is, 75% of well-balanced of FIES that was not paid in 2015, so 75% EBITDA is in 2017 and 2018. And the second is the price that will be paid for the remaining part of Uniasselvi that will be paid in five installments between 2018 and 2022. So, we see these two short- and long-term obligations, we would end up the year with a net cash position of almost BRL 1.7 billion which is, I mean, very strong especially in the year that was so challenged.

Moving to page 24, we present here the cash generation, the operational cash generation and the, net cash generation. So, basically what we did here to make sure that the comparison was fair, we've excluded the capital gains related to the Uniasselvi divestment, we've excluded that and we've also excluded the amount of FIES related to November that we were expected to be paid in January 2017. So we've excluded from this comparison BRL 190 million that we will include when we present the first quarter results in 2017.

So, having the better comparison basis, our operational cash flow increased to BRL 405 million and this was mainly boosted by cost control and the normalization of FIES. If we look at the cash generation before CapEx in the year was BRL 1.7 billion, which is 81% EBITDA-to-cash, which is much higher than last year. If we exclude CapEx, cash flow was positive in BRL 275 million in the quarter and BRL 1.3 billion in the year. And if we also exclude special projects and also greenfield, our operating cash flow after all CapEx in the year was BRL 1.3 billion which is 60.1% EBITDA to cash. If you compare to last year, this was only 31.9%. So, a significant improvement our EBITDA-to-cash, so this is one of the main highlights of the year.

And finally looking at the free cash flow, so already discounting that and we still holding a part of the price of Uniasselvi, we've generated BRL 754 million in the year, and this is already excluding the debt repayments and dividends that we made in this year. So, a very positive message is also on operating and free cash flow.

I end up my presentation here and I will pass back over to Rodrigo.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Frederic. Going to slide 26, I will also present our regulatory indicators for 2015 that was just announced by Minister of Education. Kroton's results in terms of Regulatory Indicators were very solid. Even on the (00:39:46) exams where there are opportunities for improvement, the 2015 indicators were much higher than the first prior year. It is important to note that most of these students firstly started their studies in 2011 and 2012, which are long before the implementation of our KLS, Kroton Learning System 2.0 that was launched in the second semester of 2015, that means that the students have concluded their studies in 2014 and 2015 didn't experiment the KLS 2.0 that have much better quality than the other academic models, the previews academic models.

The General Program Score (sic) [General Program Index] (00:40:27) or IGC, once again, came in very strong, with 95% of our institutions receiving satisfactory scores. These compares to an average of 85% of Private Institutions and 87% for Public Institutions, so it's higher than the average for public and private institutions. For the Preliminary Program Score or CPC, Kroton received 87% of satisfactory scores. If we exclude Anhanguera and consider only the brands adopting KLS 1.0 for their students that means the other brands [indiscernible] (00:41:05) Anhanguera. The percentage of satisfactory CPC score is 94%, exceeding the average of 89% for the Private Institutions and 92% for Public Institutions. So once again in CPC excluding Anhanguera, we were better than the average of private and public institutions.

Looking now to the IDD, which is the difference between the (00:41:31) and the main exams, that means the exam on the end of secondary and the end of the higher education exams, we once again made progress, which 81% of our problems registering satisfactory scores, which becomes even more relevant when we compare to the score of 78% for public institutions.

So, in IDD, once again, the numbers – the Kroton numbers are higher than the public institutions, 81 against 78 of the public institutions. And this indication is extremely important, because it represents the value added by the institution and its contribution to student learning. They continued IDD for 2015 of 2.38 is the highest in Kroton's history and fastest to our students capacity to cooperate extensively through our student's education and development.

On the lower part of the slide, you can see they (00:42:30) results of the private institutional scores, which 99% of our problems and 99% of private institutions, which is in satisfactory (00:42:41) scores, reinforcing our commitment to teaching quality in all of our educational services.

We also want to highlight that Kroton have been implementing various actions to continue to improve academic quality. In the last two years alone, we have invested approximately BRL 400 million in products related to educational excellence, innovation and improving student experience. We remain focused in currently improving our regulatory indicators by delivering a value proposition to our students that combine scale, educational quality, and service excellence in our overall

Turning to slide 27, I want to update you on the progress we made in our academic model KLS 2.0 or Kroton Learning System 2.0 that was launched in the second semester of 2015. Today 81% of our On-Campus students already studied content from the new academic model in at least one subject. Plus Kroton KLS 2.0 is also present in 100% of our premium distance learning students. These are passes to our commitment to pursue the highest level of academic quality by investing in the continued improvement of academics quality.

Another important level for creating value for our company is the progress we've made in the interactive subjects, which are the digital subjects operating our On-Campus programs. We have opportunity to offer 20% – until 20% of the digital content in the On-Campus business. In the first semester of 2016, interactive digital subjects accounted for 12% of the total subjects offered in the On-Campus business, with this figure increasing to 14% in the second semester. So first semester 12% of digital content in the On-Campus business, second semester 14% of digital content, and we still have a big opportunity to achieve 20% that is the maximum that the law allows us.

The expectation is that the number of interactive subjects continue to rise over the coming years in the academic materials for the new interactive subjects is based on KLS 2.0, therefore a very high quality. This interactive subjects product is able to simultaneously increase efficiency and quality. We are focused on producing KLS 2.0 content and of this 282 new courses originally planned for 2017, we have increased our production target 499 courses. That means, our premium expectation we will produce

282 new courses and we concluded 499 courses, so we increased a lot in number of courses that we produced in 2016, 2017, in almost 80%, it is important to ensure that our students have a more complete and high-quality academic periods.

All KLS 2.0 content is free for the students and is available online through app SABER which allows the students to study anytime and anywhere, subject also have a vast digital delivery and in just two months of library and in just two months of 2017, we already registered almost 14 million pages read, considerably higher compared to 4 million pages read in whole 2016. So in all 2016 year period the students read 4 million pages, only two months of 2017, 14 million pages. This demonstrate that our students are playing a leading role in their on education and development by taking advantage as much as possible of the facilities that Kroton offers.

Turning now to slide 28, I want to comment again on the effectiveness of our employee affiliate channel or Conecta channel through with thousands of students have already found their jobs. Conecta is a free and easy accessible platform, has a national life for all the more than 900,000 students – Kroton students with an average of 3,400 daily access, the platform has over 4,700, partners, companies advertising more than 28,000 job opportunities. So more than 28,000 job opportunities available for our students in the channel Conecta. Note that the tool also retrofits our academic model, which means that as partners advertise jobs on the channel, (00:47:34) with the required competencies that job done easy.

Conecta also has a mobile app to meet the needs of our digital students who can access too many times anywhere and use the platform geolocation feature to look for jobs in their desired locations. The platform is trends in its activeness becomes resident with by the fact that for every three students interviewed, one is hired, which optimizes the time spent by companies on recruiting process and expands the opportunity available to our students. The average wage increase for students hired via Conecta is 69%, that means 69% increase in their salaries. Specifically, it's a very important specifically when we considered the recovery market economic and this is our value propositions for our students in coactivity and channel Conecta Channel is helping us to giving for our students that is our value proposition.

Moving out to slide 29, we want to comment on some of Kroton fulfill actions. Personally we do a lot of social actions and we done – did so many color for this social actions and we will start to talk a little bit more about the social actions that we do in . We do this for a long time and in a very strong way and we'll show for the marking that some products that we are developing. We have the social actions and projects, is divided into four main lines. The first one, social projects developed by Kroton units to provide services free of charge to underprivileged communities, to low income people. They are services in health, like dentistry, and nursery, and psychology, physiotherapy, and legal advisory for low income people. This is the first block.

The second block is that projects carried out by the Pitágoras Foundation. The third block is a State of Minas Gerais' Conspiracy for Education, a group that are trying to improve the quality of the school – the public school in Minas Gerais, and fourth is the Brazilian

Alliance for Education, with the same strategy for the State of Minas Gerais, but for whole country. So let's talk a little bit about these four blocks.

The first main line consistent of the social action developed by our units and the numbers are really important. With more than 2,300 social initiatives and projects, including medical, physiotherapy, psychological, dental, and veterinary care and judicial assistance, we have benefited over 2.3 million people via also contributing to local communities.

The second main line of social action is a product development by the Pitágoras Foundation, which is Kroton's social arm. The Pitágoras Foundation's mission is to help improve public education in Brazil, especially municipality school system by applying advanced management methodologies, and it was created in 1994. The foundation already has benefited from 29,000 educators and more than 1 million students in 12 Brazilian states and has demonstrated effectiveness by substantial improvement in the official (00:51:08) in Brazil.

The third main line is the State of Minas Gerais' Conspiracy for Education, a movement led by Kroton created in 2016, with actions that are widely regarded in the developments of public education. The Minas Gerais' Conspiracy holds regular forms with the schools' principals to share experiences and best practice (00:51:34) by the principals themselves, as the major issues of critical importance to improve education quality. And (00:51:41) are, first, participation; second, student motivation; third, future motivation; four, family school integration; and five, improving official learning indicators. That movement has already benefited along the 1,000 municipal and state unity schools, equivalent to a long one medium student beneficiary.

Last year – and lastly, in the Brazilian Alliance, the last one, the Brazilian Alliance for Education had the same target, the third item that the projects that we develop in Minas Gerais', but we are doing this outside Minas Gerais' in all other states in Brazil. We start in a pilot project in São Paulo, and building some 300 state building schools of approximately 350,000 students in addition to acquisitions of operating quality education (00:52:39) developments of the societies as a whole, by supporting projects which – with the capacity to transform people's lives in various areas. These products are developed by Kroton free of charge for schools and (00:52:56) Kroton's contributions to the improvement of public education.

Let's go now to the last part of today's presentation from my closing remarks in slide 30. First, we will not disclose any quantitative guidance, I want to reaffirm that we remain confident in meeting our targets for the intake and reenrollment process for the first semester of 2017, which ends in April. Our two segments On-Campus and Distance Learning are registering a solid performance, leaving us comfortable that we will start 2017 in a well situation. In relation to the special transaction, the process is currently being analyzed by Brazil's antitrust, the CADE (00:53:46) July 27 to issue a final ruling of the case – on the case.

Conversations with the court are in the initial phase and we are confident that we have (00:54:01) to deal with all the competition issues arising (00:54:07). We continue to work on planning and integration and we are very optimistic about the capital opportunities and all the benefits we will be able to deliver for all the stakeholders involved especially (00:54:19) of both institutions.

The second item we approved the distribution of dividend of BRL 125.6 million based on adjusted net income in the fourth quarter of 2016 which corresponds to BRL 0.08 per share. This means that we maintain our payout ratio of 35% of distributable net income.

Now, the third item of the final remarks, I want to really inform that, we are doing very well in the day by day challenges, the company is not – the company is running very well. In our day to day operations, entrepreneurship in the operational areas remains very strong.

This year alone we have 192 projects already being amended to improve quality, to capture efficiency gains and to grow organically in this year and long-term. So, we are running, in 2017, 192 projects, they are already on place that are being running at this time and they're doing very well. These projects include expanding the operating of the On-Campus programs at existing units, especially in the fields of healthcare and engineering, both of which are lacking qualified professionals in Brazil and which includes the value proposition of our brands among both the students and in the market.

Our program portfolio grew on average by 12% per year between 2014 and 2017 and we are pleased to report that in 2016, 66% of the applications filed received scores of four or five, therefore they are considered as excellent scores This project is a joint effort by various areas of the company that has very strong potential to create value and with the construction greenfield, brings more opportunities for new programs will emerge.

In relation to our greenfield projects that it is one of the other 192 projects in place in the company, the greenfields we launched at one unit in the second semester of 2016 (00:56:44) the first semester of 2017 in the series (00:56:51), actually they are doing very, very well in the intake process and we already have received the application for another unit in the (00:57:02). We have five applications for 47 of the 100 units planned and our target is to find another 27 in 2017, all in the markets where we do not operate or which offer growth potential.

In addition to these, we also are working on various other products that will transform our organization such as the retention product, optimizing interesting subjects, full integration of the models in Distance Learning business and (00:57:34) review of our graduates and non-regulated business.

In our – in other words, we have many opportunities on the table to increase efficiency, to increase quality, to grow and we will capture all of these opportunities through all the hard work carried on here in the company.

Once again, thank you for your participation in today's call and now we will begin the question-and-answer session.

Q&A

Operator

Ladies and gentlemen, we will now initiate the question-and-answer session. First question comes from Marcellus Atkins (00:58:42) from JPMorgan. You may proceed.

Hi. Good afternoon. Thanks for taking the question. In the Portuguese call, you commented a little bit about the outlook for the Distance Learning margins. So, I wondered if you could also provide some color for the campus operations or the consolidated operations, how do you see margins progress in 2017?

A - Frederico do Casal Ribeiro Brito e Abreu {BIO 16674822 <GO>}

Hello, Marcellus (00:59:06), this is Abreu speaking. We can't give guidance, because we will provide guidance in other opportunity, so we can't give numbers. The method – the qualitative method that we can provide is, we have no reason to assume a deterioration of margins in both, On-Campus or Distance Learning. We have some pressures for down in margins, but we have some opportunities for us. So we have no reason to believe in pressure on margins. That is the more detailed that we can provide before we announce the guidance.

Q - Operator

Okay, great. Thank you.

Our next question comes from Rodrigo Gastim. You may proceed.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Yeah. Thank you. Good afternoon, everyone. Talking about quality, I'd just like to delve a bit deeper here into the new results of Conecta, you've just showed us a couple of updated numbers, but how is the feedback that you've been receiving from the companies that are offering that position? How engaged they really are in providing feedback to you guys in order to improve the academic model and meet the right skills? So that's my question. If you could just elaborate a little bit more on that front, it would be highly appreciated. Thank you.

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

Hello, Rodrigo. This is Galindo speaking. Thank you for your question. What we did in Conecta channel is, we organized the feedback from the company. So, the feedback was not driven by a chat with the HR Manager of the company. How we received our feedback in a very (01:00:46) way, each job available in the seat that the company puts in the channels, more than just put the job available, they need to – the company needs to put all the technical excuse that their job demand and all this social emotional excuse that their job demand.

So, we have a big sample because we have more than 28,000 jobs, job markets and systems available. So, in all of these 28 (sic) [28,000] (01:01:21) jobs available, we have the competitive skills that they are demanding, and then we can analyze it with the more common competencies that we don't have in our academic model. And then, we analyze it to our students. If we realize that one student don't have some skill, probably it's a student problem. So, the plan [indiscernible] (01:01:43) for this student, one free course, for example, one students don't have English like a skill. So, the platform recommend English course for this student, but if we realize that a lot of our students don't have the [indiscernible] (01:01:59) that skills that the market is demanding, we know that we need to change our academic model. So, it's a very stressful way to understand the needs of the market.

And the second point is that, companies like this platform. The feedback that we are receiving from the companies are very, very positive and I believe that the number of job markets – jobs available, positions available that we have in our platform more than 48,000 seats available, and more than 4,700 companies and putting your system in the platform shows that they are liking and they are enjoying their (01:02:45).

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Yeah. Perfect. That's very clear. Just a quick follow up here, Rodrigo. The 69% salary increase that you mentioned in the presentation, I just would like to figure out how it's behaving over time, because I imagine or I suppose that this macro crisis in Brazil has been pressuring these numbers. So, do you have a study or database just could you give us some details on how this 69%, 70% salary increase behaves over time and if you do believe that this 70% salary boost could be better in the future from what we've been seeing lately? That's the follow-up. Thank you very much.

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

Okay, Rodrigo. I will provide two information that could be helpful. First one is not related by the increase of salary by channel Conecta, but it is related by our survey, our research that we know – that we do annually to understand the salary of our students. We do actually – we do this research biannual, we do it again this year. In the first survey that we did, the average of increase of income for our students is used to be 223%, the average. In the last survey that it was 1 1/2 year ago, this number reverses for 181%. That means the crisis affect the salary of our students.

We don't have – we still don't have the numbers of 2017 results, but probably we'll increase a little bit and we believe that will be a little bit higher than 181%. These are the numbers of the survey. When we analyze it, this Conecta channel, the situation is different. If we analyze the average – the increase in average since the beginning of the platform, the increase of salary is 60%. When we analyze it since 1st of January until now, the increase of salary is 69%. So that means that we are a little bit higher, a little bit better than when we did 1 1/2 period of time, more longer period of time. So, this is the information that we have about salary to provide for you.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Yeah, that is very clear. And if I may just one final follow-up here. Do you have any clue why the difference between the salary at Conecta is different from the survey that we developed? I believe that at some time in the future that will probably converge to a higher level or to the midpoint of the range that you've provided, do you know why that quite different at this point, is there a reason for that?

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

Rodrigo, we do have, but you need to understand that we are talking about two different analysis. One analysis is, the salary that the student have one year before entering the university and after the university, this is 181%. The order is increase of salary that the student that are already serving in the company have increase of salary, this is the increase of channel Conecta. And we can pick up one student in the first semester that increase the salary or one student that are in the last semester that increase the salary. So they are not comparable numbers, they're measuring different things.

A - Frederico do Casal Ribeiro Brito e Abreu {BIO 16674822 <GO>}

Rodrigo, just to complement, so the increase that we have in our overall survey is an increase over almost an eight-year cycle. So we see the student entry until four years after graduation, this is 181%. The Conecta is the delta before Conecta and after Conecta, so if a student makes BRL 1,000, he gets the job on Conecta, he earns now BRL 1,690, you have an average of 69%...

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

Immediate...

A - Frederico do Casal Ribeiro Brito e Abreu {BIO 16674822 <GO>}

The immediate increase that we have because of Conecta. The other reason, increase over an eight-year cycle.

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

That shows that Conecta is very, very strong.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Okay, okay. That's very clear. Thank you, Rodrigo. Thank you, Fred.

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

Thank you.

Operator

Our next question comes from Ricardo Rezende from HSBC. You may proceed.

Q - Ricardo N. Rezende {BIO 16469276 <GO>}

Good afternoon, gentlemen. Thanks for taking my question. So if I may, the first question is related to the Premium Distance Learning we've been talking about it in the potential that you see for this business, but if I'm no mistaken, during your Investor Day, you alluded two major challenges for the Premium Distance Learning related to the Distance Learning centers. The first one was on the real estate and the improvements that you got during the real estate to accommodate the new courses?

And the second one was related to that on the capital required to this improvement. So just I'd like to know how is that developing, how this relationship will get the operator from the Distance Learning centers?

And the second question is related to (01:08:08). If you could give us an update on how the development on this financial program going? Thank you.

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

Hello, Ricardo, it's Rodrigo speaking. For the investment that I needed to develop the Distance Learning Premium courses, our responsibility of the owner of the Distance Learning center, but they need to follow our projects and our demands, because we need to guarantee quality. So we have proved the (01:08:35) project, we have a list of equipments that they need to acquire and reality is they are acquiring or not the project. So it should be much easy to put engineering all our 910 Distance Learning centers is doing well, but doing this will destroy quality. So, we are not doing this. We have a lot of procedures that follow – needs to follow to be able to offer Distance Learning including investments in less (01:09:05) and we are very rigid and we just approved an offer – a new offer for Distance Learning Premium if the Distance Learning centers do their jobs. On the other hand, we have some ways to help some Distance Learning centers that wants to implement it, but don't have access to capital to do this, and Fred could comment a little bit about it.

A - Frederico do Casal Ribeiro Brito e Abreu {BIO 16674822 <GO>}

So, basically for the – because we have a large volume of Distance Learning centers that wants to offer the Distance Learning premium. Some Distance Learning centers do not have financial conditions and we have two – mainly two options to offer them some type of help – financial help. So, the first is with our own capital, we provide some financial help to fund not only real estate, but also what they need for labs and (01:09:56) and computers and, et cetera, and we do that over a 12- or 18-month installments, and we discount directly from the payments that we do monthly to these Distance Learning centers. We are talking about small amounts, but it's the amounts that help them a lot to make this initial investment. And we are working with some banks on the second option so that the Distance Learning center can contract directly with the bank at a reasonable interest rate. And we do not have yet these products developed, but there are some options that are on the table and we should have these projects concluded, I believe, in 2018, okay?

So, in terms of financial – the financial partnership that you mentioned, we are moving really well, all the negotiations with the bank are moving really well. We did not announce yet as soon as we conclude everything, we will announce. And we still have on the plan and we are working hard on our plan, so that we start the first pilot with the bank on the second semester of 2017.

So just to give you an idea, we already have a lot of IT developments concluded, we already have a lot of integration that we need with the bank concluded. So, we will not announce, but operationally we are moving really well, so that we have this pilot starting in the second semester of 2017. And on the first semester 2017, so right now, we are already testing in those three units, but without the bank. So we are testing everything, except the scoring from the banks. So we are testing the platform, we are testing the process, we are testing the income statement requirements and all the procedures that we will implement (01:11:53) we're already implementing, we're already testing in the first semester without the bank and with the bank in the second semester of 2017, okay?

Q - Ricardo N. Rezende {BIO 16469276 <GO>}

Okay. Great. Thank you.

Operator

No more questions. This concludes the question-and-answer session. At this time, I would like to turn the call back to Mr. Rodrigo Galindo for any closing remarks.

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

I'd like to thank you everybody for participating in this conference and our IR area is available for the information. Thank you very much.

Operator

Thank you. This does conclude today's presentation. You may disconnect your line at this time. Have a nice day.