Q2 2012 Earnings Call

Company Participants

- Carlos Lazar, IRO
- Frederico Abreu, CFO
- Rodrigo Galindo, CEO

Other Participants

- Bruno Giardino, Analyst
- Luiz Cesta, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen. and thank you for waiting. At this time, we would like to welcome everyone to Kroton Educacional's Second Quarter 2012 Earnings Conference Call.

Today we have with us, Mr. Rodrigo Galindo, Kroton's CEO. 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. (Operator Instructions)

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, 2Q12 Webcast. The following presentation is also available to download on the webcast platform. The following information is available in Brazilian reals in accordance with Brazilian's corporate law and generally accepted accounting principles, BR GAAP, which now conforms with International Financial Report Standards, 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 risk, 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 if 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 the CEO, Mr. Rodrigo Galindo, who will begin the presentation. Mr. Rodrigo, you may begin your conference call, sir.

Rodrigo Galindo {BIO 17238232 <GO>}

Good afternoon, everyone. Welcome to the quarterly earnings conference call of Kroton Educacional for the Second Quarter of 2012. With me today are our IRO, Carlos Lazar, our CFO, Frederico Abreu and our COO Igor Lima.

I'd like to start today's presentation on slide three with the highlights in the quarter. This quarter we made important progress in our integration process. The Unopar process is well advanced and all students that started the second semester are already using Kroton's academic model. At Uniasselvi the process begun immediately after the acquisition and is advancing on schedule.

And lastly, at Unirondon the process is faster and has already been concluded with significant savings captured.

In July we solved the pending issue of debt clearance certificates our CNDs and we are able to already participated in the government's monthly credited (inaudible) process. This provided a cash inflow of BRL103 million of which BRL80 million were related exclusively to the CND related blocked amounts. These reduced significantly both our balance of accounts receivable and our average receivables term.

In the year, through July, we have already received over BRL200 million through FIES credits repurchase and tax offsets. Another highlight in terms of number of students was the excellent performance so far in our midyear new enrollment and reenrollment process. The admissions process isn't yet over, but by the results already achieved, we are fairly confident that we will meet all of our targets.

In terms of our financial performance in the Second Quarter, EBITDA was BRL72.4 million with EBITDA margin expanding 17percentage points from the same quarter last year to 24.1% while our net income was BRL49.2 million. Operating cash flow before CapEx was BRL92 million and after recurring CapEx was BRL73.8 million.

We will provide more details during the presentation, but these figures already give you an idea of the evolution in the Company's results. Given the good results so far this year and the strong midyear admissions process we are experiencing, the Company has decided to revise this guidance for this year which I will comment in more detail later on.

So let's go straight to today's presentation, starting with the Company's operating performance.

I'll now invite our relation -- our investor relation officer, Carlos Lazar to present our operational and financial performance.

Carlos Lazar {BIO 17238206 <GO>}

Thank you, Rodrigo. So let's begin with slide five that shows the growth in the number of students between the end of the First Quarter and the situation in June 30th of 2012. The First Quarter is the most important period for new enrollment for the year, which led us to the -- by the end of the quarter with a student base above 325,000 students.

In terms of organic growth, until the end of the Second Quarter, we observed a reduction of 1% due to drop outs. However, considering Uniasselvi and Unirondon acquisitions, the growth in the quarter was 27%.

The next slide provides details about the student based growth in each of our businesses. So on slide six, we show the student growth on the left hand side of the on campus post secondary business and this business excluding the acquisitions, the base remained stable at the end of the Second Quarter with the highlight the number of the new enrollments, including the acquisitions in the period, the base grew by 14%, due especially to students for Uniasselvi.

On the right hand side of this slide, you can see student growth in Kroton's distance learning business, between March and June and excluding the acquisitions, it decreased by 2% due to drop outs during the period and as in the on campus business, after include Uniasselvi position, the distance learning base also grew by 34% in the period.

The slide shows the evaluation in the number of students with FIES. At the end of the first semester we had about 43,000 FIES students, more than twice the number at the end of 2011. This means that in June, around 34% of our student base in the on campus undergrad business were FIES students with the figure already including Uniasselvi and Unirondon acquisitions. If we exclude these acquisitions, more than 37% of our base would be FIES students.

As mentioned before, FIES performance id driven by two main factors. The first one is our capacity to execute a series of actions to convert students to FIES financing, and second, the high rate at which our students quality for FIES financing. In this sense, at the end of the Second Quarter 97.4% of our student base were qualified for these FIES programs, considering both Kroton and Unopar.

This strong growth from 2011 is due to the improvement in the evaluation of our academic programs which have passed the quality of our educational census.

Moving to slide eight, we preset the figures for our new enrollment and reenrollment process that has been running. For new enrollments, the Company's targets to grow by 20% in relations to the second semester of 2011. This growth is strictly organic since the figures in the second semester of 2011 are pro forma and already considered the new students from Unopar and Uniasselvi for example.

As of today, August 8th, we have already surpassed the number of new enrollments that we registered in the second half of last year and we are very confident that we will be reaching the new enrollment target by the end of September.

For reenrollments, the target is also to grow by 20% in relation to the second semester of 2012 and once again, we are talking about organic growth since the figure for the later -- the half and last year are pro forma.

This strong growth also in reenrollment is explained by two main factors. First, the lower dropout rate which is mainly due to FIES whose relevance is in our base growth average semester. And the second affect is the lower average maturity of our portfolio. This is because in 2012 we implement many new programs at our unit, especially engineering programs which will have a positive effect in new enrollments until the first class graduates.

And for our reenrollment, we also have already surpassed the number registered in the second half of last year and we are very confident here also that we'll be having a very good organic reenrollment growth in the targets will be met.

Based on the number of -- the outlook for our organic growth is very, very positive.

And moving on to slide nine. We present a summary of the integration process for the recently acquisitions that we did. Starting with Unopar process, the first second and third phases have already been concluded and we are now moving into the fourth phase of the integration. Note that the measures already completed in the Unopar process was one of the important accomplished was the implementations of Kroton's academic model for all freshmen and senior on campus students as of July 2012.

This new academic model has allowed for a reduction of 20% in the faculty costs and Unopar's on campus business. The fourth and last phase involved full integration and process assistance which should be finished by the end of this year.

Uniasselvi integration process is also advancing as planned. Phase one has been concluded and phase two is currently underway. There are 17 work fronts and 89 products which are monitored by an exclusive project management ops, a PMO and integration has also been divided in three different phase.

The first one which began in June were focused in the (continuance) and the stability of the operation as well as in the new enrollments and student retention. The phase one is already concluded and the phase two that we already begun has too many objectives.

The one -- the first one is on organizational restructuring and the second one is the initial integration of the process and systems. The phase three will focus the optimization of the academic model and should be concluded by early 2013. And finally, the fourth and last phase, we will ensure the full integration of the process and systems and should be finished by the mid next year.

And lastly, the Unirondon integration has already been concluded. Once again, Kroton used its methodology for integration is more on midsize assets to conclude the process within the 90 day timeframe. The ERP academic and payroll systems have already been integrated. We implemented also a new administrative structure in the Kroton's academic model, which resulted in a 30% reduction in professors working out.

With all these initiatives we expect to achieve higher levels of performance and with more efficient and streamlined operations. The integration of Unirondon confirms once again the efficiency of the methodology for integrating the small and mid companies which has been developed and successfully tested on several of the companies acquired.

The excellence results of Unopar integration show that Kroton has acquired the expertise not only integrations small and midsized companies, but also in developing very robust methodology for integrating larger assets. And this is one of our major competitive advantage of the Company.

I will now turn the call to our CFO, Frederico Abreu for him to present the financial performance.

Frederico Abreu {BIO 16674822 <GO>}

Hello. Good afternoon. Thank you, Carlos. So before beginning, I would like to remind you that the numbers do not include the results from Uniasselvi for June 2012, except when stated otherwise. So we will see the numbers for Kroton and Unopar.

I would like to begin my comments on the financial performance on slide 11. This slide shows the performance in net revenues, gross income and operating income in the on campus post secondary business. Net revenue grew 39% from the Second Quarter of last year, driven by expansion in the student base through both acquisitions and organic growth. Considering all the organic growth, or in other words, on a same unit basis, revenue posted a year-on-year growth of 23%.

Gross income grew by 50% with gross margin expanding 2.6percentage points from the Second Quarter last year driven by revenue growth and by the street budgeting process and cost controls we have in place at Kroton. Lastly, operating results grew by 54% on a yearly -- on a one year earlier with an operating margin of 21%, 2percentage points expansion from last year.

Moving to slide 12, we can see the performance of distance learning. There is no comparison base for the Second Quarter of 2011 since Unopar's results were consolidated into Kroton only as of December 2011. So we have included the results of the First Quarter of this year to provide a comparison between the periods.

We continue to see a very consistent results and a high performance of the distance learning segment during the Second Quarter of 2012, despite the seasonality form the first to the Second Quarter.

As an example, the operational margin remains at 65% during the period. And as also occurred in the First Quarter, you can see the importance of distance learning business to Kroton with net revenues already representing 26% of Kroton's total in the Second Quarter alone. This strong contribution becomes even clearer when we look at the gross income and operating income for which the distance learning business accounted for 45% and 66% -- 56% of the total respectively. And these contributions should grow even higher with the full contribution from distance learning operation of Uniasselvi as of the Third Quarter, 2012.

On slide 13, you can see the financial information on the primary and secondary education business. The growth in the number of students and associated schools was followed by growth in the volume of services provided, especially through corporate contracts with large corporations which help support net revenue growth of 29% in the quarter.

Following this trend, gross margin increased to 32% or to nearly doubling the last year's level. Despite the seasonality effect of Second Quarter, which is usually negative, we also saw significant improvement of 8.3percentage points in operating margin, resulting basically from a result of strict control of expenses.

On slide 14, we present the Company's consolidated performance. As showed in the last three slides, there is an improvement in the three businesses, both in top line and in margin improvement. Three mainly messages that I would like to convey. The first is the good performance on the on campus post secondary business, both by an increase in the student base in margin improvement.

The second, the growing importance of distance learning business on the Company's consolidated results that have higher margins and third the improvement in the primary and secondary business, both in revenues and in margins. This all adds to a consolidated net revenue growth of 85% in the Second Quarter. Gross margin expansion of 16.5percentage points, and operating margin expansion of 15.1percentage points.

On slide 15, we showed the nonrecurring items in the quarter which totaled BRL7.6 million and were basically related to the Unopar integration including the layoff costs in M&A activities, including the costs of auditing and due diligence. This auditing and due diligence, they include the recent acquisitions of Uniasselvi and Unirondon. So basically, these costs are related to the integration of Unopar and two acquisitions we concluded on the quarter.

Year to date, nonrecurring items already total BRL15 million, which is in line with our budget and in line with our previous communications to the market. Nonrecurring costs and expenses for the year should grow by another BRL10 million, that will still be recorded in the second half of the year, which represents expenses with Uniasselvi and Unirondon integration processes. Therefore, for 2012, we expect the total of BRL25 million in nonrecurring items.

On slide 16, we present the evolution of EBITDA in the quarter and in the first half of the year.

EBITDA in the Second Quarter was BRL72.4 million with EBITDA margin of 24.1% and expansion of 17.4percentage points from last year. This margin expansion is explained by solid performance in all businesses as well as rigorous control of cost and expenses and a successful integration process of the institutions acquired in 2011.

The first half results have a similar trend with EBITDA of BRL199 million, EBITDA margin of 31% and expansion of 13.4percentage points from first half of 2011.

Slide 17 shows net income in the quarter and in the first half of 2012. Net income in the Second Quarter was BRL49 million with net margin of 16.4%. Note that net income adjustments include both nonrecurring costs and expenses and the non cash effect of amortization of intangible assets from the acquisitions. Additionally, it is important to mention that these numbers include the effects from the BRL335 million cash disbursement from Uniasselvi acquisition which led to a lower financial result in the period.

During the semester, we achieved a net income of BRL148 million with net margin of 23.1%, which is 15percentage points above the previous year. Even if we exclude the two adjustments mentioned above, net income was BRL117.9 million in the first half, compared to BRL28.2 million in the first half of the year. So a significant increase from last year.

On slide 18, we present Kroton's managerial analysis. As we've already announced in the First Quarter, we will also report Kroton's 2012 results, excluding the effects form the most relevant acquisitions. We call this Kroton's stand alone, where we exclude the effects from Unopar in the first half of the year and as of the Third Quarter, we will exclude the effects from Uniasselvi. This will allow investors and analysts to clearly follow Kroton's evaluation independently from the contributions made by the most transformational acquisitions we made in the year.

On slide 18 we show the results in the first half of the year. The message is very strong. Kroton's stand alone net revenue grew by 29% to BRL459 million in the first half of the year. Considering only organic growth without the effects from 2011 acquisitions of FAMA, FAIS, and Uniao, Kroton's net revenue grew by 26% in the same period.

To assess EBITDA margin, we present three different scenarios for the allocation of corporate expenses. As you remember today, the corporate infrastructure serves all businesses at Kroton including Unopar and Uniasselvi.

So in the first, we allocate 100% of corporate expenses to Kroton. This results in EBITDA of BRL111 million with EBITDA margin of 24.1%. In the second scenario, we present all the corporate expenses pro rata according to net revenues. So we split corporate expenses as a percentage of net revenues based on the contribution of Kroton, standalone in total Kroton. In this scenario, EBITDA would be BRL121 million and an EBITDA margin of 26.4%.

Lastly, in the third scenario we restated corporate expenses in the first half of last year by IPCA inflation index to provide a better understanding of how EBITDA would behave if we wouldn't have made any acquisitions. In this scenario, EBITDA would be BRL119 million with EBITDA margin of 26%.

All scenarios show a very significant increase in EBITDA and EBITDA margin of Kroton stand alone, which confirms the operational improvement achieved during 2011 and the positive impacts from organic growth combined with our strict control of costs and expenses at Kroton standalone.

Moving to slide 20, we will start explaining provisioning and receivables. So on slide 20, and before starting, I just would like to give a context on how we make our provisions. So remember that our provisioning methodology is based on historical analysis and recovery rates over a period of 365 days after maturity. All accounts due more than 365 days are written off against the results. And note that this methodology is consistent and has been used since 2010.

So on slide 20, we show PDA as a percentage of net revenues for each of the Company's business.

In the post secondary business, PDA was 4.9% in the Second Quarter, down from 5.1% in the same quarter last year, which is basically due to the effects from the mix of FIES students which accounted for a higher share of our base. Analyzing ex-FIES portfolio, so excluding the FIES students, the level of provisioning was 6.7%, higher than a year ago, but in line with the level for the First Quarter, 2012, which was 6.5%.

This increase was mainly due to the conservative posture adopted to cover any increases in future default levels in line with the more negative expectations of the market. For the FIES portfolio, remember that since 2010 we have accrued a provision of 2.25% of all revenues to cover any future losses from studies in this program.

The level of provisioning for the distance learning business followed exactly the same methodology as in the on campus. Therefore we've adopted a provision of 6.4% of net revenues. As announced in the First Quarter, the provision for this segment should meet the levels -- should meet levels similar to those in on campus business.

Lastly, the increasing PDA level in the primary and secondary business is also aligned with a more conservative provisioning policy adopted by Kroton. This is due to more restrictive stance adopted with the associated schools during renegotiations and as well as reductions in the average payment terms.

Slide 21 shows the evaluation in accounts receivable net of provision for doubtful accounts, broken down for each of the three businesses. In the Second Quarter, Kroton's accounts receivable totaled BRL312.2 million, which with BRL255.2 million in post secondary business, BRL26 million in distance learning business and BRL31 million in primary and secondary business.

Before we analyze the results, note that the three businesses are significantly affected by seasonality. In the on campus post secondary and distance learning business, the second and the Fourth Quarters typically have higher accounts receivable when compared to the first and the Third Quarters. This is basically because on the first and the Third Quarter our reenrollment period ends subsequently there are a significant volume of renovations. So typically, the second and the Fourth Quarters we have an increase in the accounts receivable in post secondary.

In primary and secondary segments, on the other hand, the First Quarter typically has higher accounts receivables, which gradually decline during the Second Quarter. Since most of the collections are sold to the associated schools in the first half of the year and are paid over the subsequent months.

In the post secondary segment the 3% increase from the First Quarter 2012 reflects both seasonal factors and the higher FIES balance. In the ex FIES tuition and agreements portfolio, the increase is due to the seasonal effect as mentioned before. The FIES accounts receivable increase is basically explained by the higher number of FIES students.

Note that the first half of the year, the Company received BRL98.5 million in FIES credit repurchases, and in July alone, following the resolution of the debt clear and certificate issue, we were able to participate in the repurchase process of July and received additional BRL103.2 million, which totals around BRL201.7 million from January to July in repurchases from FIES.

The repurchases related to the unblocking of CNDs, the certificates of debt clearance will be recognized as cash in the Third Quarter and they represented around BRL80 million out of the BRL103 million. This should lead also to a significant reduction in accounts receivable and therefore in the average FIES receivables term.

Accounts receivable in distance learning were BRL26 million, increasing from the First Quarter, due to nature seasonality of the business. In the primary and secondary business, seasonality was also the reasons for the reduction of nearly 51% between the quarters.

If we move to slide 22, we can see the behavior of the average receivables term in each of our businesses. In the on campus post secondary business, we present three separate analysis. The first analysis considered the accounts receivable ex FIES, for which the reduction was caused by the higher percentage of IES students in Kroton's students mix.

In the second analysis, we exclude the balances of both FIES accounts receivable and then also FIES on revenues. In this scenario, the average are more stable compared to a year ago, and increased five days compared to the First Quarter, mainly due to seasonality.

In the third analysis, we present the FIES balance excluding the funds blocked due to the lack of clearance certificate, which shows a reduction in the number of days from the same period last year and also from the First Quarter of this year.

A large portion of this reduction is related to operational improvements in the FIES process as well as to the credit repurchases in the period. We have not met our target yet in terms of number of days, but we made a significant process over the last three months.

In the distance learning business, the average term of the quarter was 37 days, up from 24 days in the First Quarter, due to the same seasonality factors between the two quarters as I explained before.

And on the primary and secondary business, the average accounts receivable term decreased by a sharp 84 days from the First Quarter of this year, due once again to seasonality. And compared to the Second Quarter '11 improvement by 22 days was mainly due to a more restrictive practice for installment payments.

Moving to slide 24, can see the investments made by Kroton, which total BRL17.4 million. In the quarter, around 5.8% of net revenues was used for CapEx and 6.1% if we look at the semester. This shows that our level of investment is consistent and totally under control around 6% as we stated before in previous communications to the market.

Note that this level includes maintenance CapEx as well as CapEx used to support the Company's organic growth, which we call recurring CapEx. Kroton's M&A investments are not included in these amounts.

Kroton is also investing in what we call special projects which include brown fields and acquisition of properties and buildings that will support stronger growth in the coming years. The effects of these investments in terms of more students. They are expected to come only in the midterm, therefore we do not consider them as recurring investments and therefore we segregate them from the recurring CapEx.

In the Second Quarter, 2011 -- 2012, these investments totaled BRL30.3 million, from which BRL18 million were already dispersed, and they were basically related to the acquisition of the property at Timbiras in Belo Horizonte.

On slide 25, we show the Company's debt by the end of the quarter. We ended the quarter with a lower balance of cash in financial investments than I the First Quarter, due to the payments of BRL335 million from the Uniasselvi acquisition. When we analyze financial loans, the reduction is explained by the first payment of interest of about BRL35 million related to the debenture which totaled as you remember BRL550 million.

As a result, net debt, considering only bank debt, was BRL341 million, which represents an extremely comfortable level of leverage which is less than 1 time projected EBITDA for the year. If we include all the short term and long term liabilities related to the payment of deferred taxes and acquisitions, total net debt is BRL742 million or less than 2 times our projected EBITDA for the year.

Now moving to slide 27, we can see cash generation. In the quarter operating cash flow before CapEx was BRL92 million which corresponds to 142% of EBITDA in the period. In the first half of the year, operating cash flow was BRL144 million, increasing form the same period of 2011, driven by the Company's better results. It is important to note that this cash flow represents 78% of our accounting EBIDA, which indicates a significant increase in EBITDA conversion into cash.

After recurring CapEx, cash flow was BRL74 million in the quarter, compared to a negative cash flow of BRL3.1 million a year ago. In the first half of the year, we reached BRL107 million with 58% conversion of accounting EBITDA into cash.

Another analysis will be also considering the disbursements of CapEx for special projects. In this analysis, cash flow was BRL55.4 million in the quarter and BRL88.6 million in the year. This cash flow levels put the Company to an exceptional position and allow us to continue develop9ing our long term strategy.

So I'll now hand the call back over to Rodrigo Galindo.

Rodrigo Galindo {BIO 17238232 <GO>}

Thank you, Frederico. On slide 29, we present our revised guidance for 2012. Given the excellent result in the first half of the year and the strong figures for new enrollment and reenrollment, we believe the results of Kroton plus Unopar will exceed our initial expectations.

Therefore the EBITDA guidance for Kroton plus Unopar, that previously stood at BRL305 million was increased by BRL31 million or 10% to BRL336 million and with the expected EBITDA for Uniasselvi of BRL21 million and from Unirondon of BRL1 million, the total EBITDA projected for 2012 now increased to BRL358 million.

So the new guidance for 2012 is as follows. Net revenues of BRL1.351 billion, EBITDA of BRL358 million, and EBITDA margin increasing from 25% to 26%.

Considering the contributions from Uniasselvi and Unirondon in the last 12 months our EBITDA should reach BRL384 million.

For investments re maintain the previous forecast of 6.5% of the net revenue of BRL90 million in addition to the BRL60 million for special projects. Therefore, for 2012 we expect total CapEx of BRL150 million. We are very confident that we can deliver this result, which represents a high level of improvement and consolidate Kroton at a whole new level of performance.

Let's go please to the last slide of today's earning presentation for my closing remarks.

Once again, Kroton had a very positive quarter with growth in both absolute and relative terms and in all of our business and with significant expansion in margins. We also had strong cash generation in the quarter and in the first half which will allow us to continue implementing our long term strategy.

Another important factor is the strong new enrollment and reenrollment rate which indicate excellent potential for organic growth. And this will be complemented by the contributions from the recent acquisitions that are being rapidly, efficiently and safely integrated. We will also continue to focus on improving our management to and our relationship with the financial community.

And here, I'd like to express my appreciation for the recognition from a part of you that we received in the IR magazine awards, in which Kroton placed first in seven of the eight categories in which it competed.

In view of the excellence performance achieved in the first half of this year, we remain confident that 2012 will be a very positive year and that we are on the right track to continue growing in a very solid and structured way. Once again, thank you for participation today. And now, we will begin the question and answer session. Thank you.

Questions And Answers

Operator

Thank you, sir. (Operator Instructions) The first question we have comes from Bruno Giardino of Santander. Please go ahead.

Q - Bruno Giardino {BIO 15974970 <GO>}

Hi. Good afternoon everyone. Congratulations for the results. I have two questions. The first one, if you could please give us an update of the process of share issue for the payment of Unopar acquisition and also on the migration to the Novo Mercado?

And the second question, how do the Uniasselvi financials compare with Unopars? Specifically in terms of EBITDA margin and gross margin now you have adopted a different accounting process for this operation? That were my questions, thank you.

A - Carlos Lazar {BIO 17238206 <GO>}

Bruno, it's Carlos speaking. So regarding your first question. We are in process of issuing the shares regarding BRL206 million still the first -- the second installments of Unopar, so we are in process of doing that. We expect to conclude probably until the end of the Third Quarter. So and this is what we have in terms of news regarding that.

And after decisions we will be probably run with the migration of Novo Mercado, we are on process of talk with the stock exchange and everything else to do this migration until the end of the year. So we are working in the same schedule that we defined since the beginning -- since we announced it to the market and we expect to migrate by the end of the year.

Regarding your second questions, could you please repeat?

Q - Bruno Giardino {BIO 15974970 <GO>}

How are the margins of -- growth in EBITDA margins of Uniasselvi in the new accounting form that you released this -- for the month of June and how's this compare to the

Unopar existing base?

A - Rodrigo Galindo {BIO 17238232 <GO>}

Hold on one second.

We do have only June as let's say accounting number. So and this is not representative should tell you in terms of how is the margin and how is the performance of the Uniasselvi business because of the change, what we can consider is going to be an improvement on the margin of course, but we don't have, let's say, a closed quarter to analyze how it's going to be it.

Q - Bruno Giardino {BIO 15974970 <GO>}

I was just asking about your projections for the whole year for instance? In which kind of margin Uniasselvi should run?

A - Rodrigo Galindo {BIO 17238232 <GO>}

We don't disclose margin per -- let's say per -- for the business itself. Considering the EBITDA of Uniasselvi from the rest of the year's BRL21 million that we announced in terms of the guidance and the net revenues expected for the year for Uniasselvi was about BRL120 million -- but this is just to make sure this is the net revenue 100%? This 100%; considering 100% on net revenue is BRL120 million and discounting that the commissions is approximately 20% of it, then we're going to find out the margin.

A - Frederico Abreu {BIO 16674822 <GO>}

But Bruno, it's Frederico, let me just tell two things. The first -- what -- two things, the first -- the payments to the distance learning centers, the same practice that we have at Unopar we have at Uniasselvi, okay? So the contribution that we have to the distance learning center that at Unopar is around 36% and at Uniasselvi is around 20%. We discount both from net revenues. Okay? So we are doing this in both operations.

The second, in terms of relative margins, Unopar, because of the higher proportion of distance learning on the mix and because the distance learning of Unopar is more efficient already that Uniasselvi, we can expect better margins at Unopar than at Uniasselvi in 2012. Okay?

In 2013, those margins should converge to levels that will be close both in the phase two phase and on the distance learning between Uniasselvi and Unopar using exactly the same methodology which is excluding the payments to the distance learning centers from the net revenues.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay, so I think that at the end of the day, when you've truly integrated both operations you can make Uniasselvi's margin catch up with the higher margins of Unopar?

A - Frederico Abreu {BIO 16674822 <GO>}

Exactly. So in the phase two phase, there's no reason why the phase two phase operation of Uniasselvi would be different from Unopar phase two phase, or any other phase two phase operation at Kroton. So yes, in 2013 in distance learning we expect that to happen in 2013 and 2014, the distance learning operations to converge in terms of margins as well.

Q - Bruno Giardino {BIO 15974970 <GO>}

Okay, that's very clear, thank you very much.

A - Frederico Abreu {BIO 16674822 <GO>}

No problem.

Operator

The next question we have comes from Thiago Macruz of Itau BBA.

Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon, gentlemen. I actually have a couple of questions. The first one is on the PDA ex-FIES side, you had an increase this quarter to 6.7% but apparently this did not reflect any sort of deterioration but Kroton's conservative approach to the matter. My question is, what should we expect for the remaining of the year? Should we expect something closer to the 5.5% we used to see or levels similar to what we saw in the Second Quarter? That's my first question.

And my second question would be on FIES, if you could provide us with some sort of indication of what has happened to the average tuition of students that migrated to the program? If you could give us just a color if this average tuition is higher than the average ex FIES? Thank you.

A - Rodrigo Galindo {BIO 17238232 <GO>}

Okay, its Rodrigo speaking, Thiago. Good afternoon. I'll start you answering the second question about FIES. The numbers that we have is the average ticket from the student that are using FIES is around 38% higher than the average ticket versus in the student that are not using FIES, so 38% higher the average ticket that for the group of student that use FIES.

We expect this level of difference in this better performance for ticket in the FIES students will keep in the following -- in the following quarters and one of the most important reasons that it happens is because with FIES the students choose more expense problems, more expensive courses. So that's the reason that we assume that makes the FIES tickets higher than non FIES tickets. And Frederico will answer the first question.

A - Frederico Abreu {BIO 16674822 <GO>}

Hi, Thealgo. In terms of the PDA, this increased to 6.7%. So in the First Quarter, we have 6.5% and now 6.7%, which is structurally higher than 2011. It is not significantly higher, but it is above -- is around 1percentage point above.

We should continue see this type of level of PDA, so around 6.5%, 6.6%, 6.7%, around these levels over the year. Our recovery rates are pretty much in line with last year. It of course depends on the aging and on the type of balance but on overall they are more or less in line but this year, except if we see a clear improvement in the performance compared to last year we will not change this level. Okay, so stability in terms of 6.5% to 6.7% this year.

Q - Thiago Macruz {BIO 16404924 <GO>}

All right. Thank you.

Operator

(Operator Instructions) Our next question comes from Luiz Cesta of Votorantim. Please go ahead.

Q - Luiz Cesta {BIO 15223262 <GO>}

Good afternoon, everyone, well I have a question regarding drop out rates in this quarter. If you get only the on campus drop out for this quarter, it represents something around 3% of students in the quarter and in the second Q 2011, drop out represented something around 2%.

I was really not expecting this increase due to the fact that you are now running with the higher level of FIES students, so it just make me believe that drop out could be lower this year. So is there something that I'm missing or maybe something related to recent acquisitions? I don't know you ask. So if you could give me some color about that, why we had higher dropout rate in this quarter versus the same quarter last year? That would be very helpful for us.

A - Carlos Lazar {BIO 17238206 <GO>}

Thank you, Luis. This is Carlos speaking. So we believe that the best analysis that we can do regarding dropout would be between semesters, not between quarters during the beginning of the year or during the beginning of the second semester. But we might have a very clear view about how drop out is doing probably with the results of the reenrollments process that we are running at this time.

Regarding this specific point that you mentioned between the first and Second Quarter, what we believe is a -- it's a natural position that we had there, it's a natural drop out. We believe that we had a tremendous -- a fantastic process -- intake process during the beginning of the year, which sometimes points to a higher drop out just after it.

And also, we have different -- different institutions, different units in our base today considering the acquisitions that we did over this last 12 months. So all in all, I believe that this is not an issue for us. This amount of drop out. In the end we believe that the dropout rate would be -- would let's say go for a lower rate, a lower number because of the impacts of FIES and we believe to start you'll see that more clearly but the second semester now and going forward.

A - Rodrigo Galindo {BIO 17238232 <GO>}

It's Rodrigo speaking. Just to complete, the 20% of increase in reenrollment that we are targeting and we are -- you are assured that we can achieve it. This 20% of increase shows how dropout rate will be lower in this semester than in the last semester so we are confident that we will have in the first to second semester lower rates of drop out -- of drop out. Okay?

Q - Luiz Cesta {BIO 15223262 <GO>}

Okay. Great. Thank you very much.

Operator

(Operator Instructions) It appears that we have no further questions at this time. We will go ahead and conclude the question and answer session. At this time, I would like to turn the call back over to Mr. Rodrigo Galindo for any closing remarks. Sir?

A - Rodrigo Galindo {BIO 17238232 <GO>}

I just like to thank you everybody for participating and our IR area is available for further questions. Thank you.

Operator

And we thank you, sir for your time. This conference has now concluded. We thank you all for attending today's presentation. At this time you may disconnect your lines. Thank you. And have a good day.