

Q3 2013 Earnings Call

Company Participants

- Carlos Lazar, Investor Relation Officer
- Frederico Abreu, Chief Financial Officer
- Rodrigo Galindo, Chief Executive Officer

Other Participants

- Ian Simmons, Analyst
- Ruben Couto, Analyst
- Thiago Macruz, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Kroton Educacional's Third Quarter 2013 Earnings Conference Call. Today with us we have 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 plus audio and slide show may be accessed through Kroton Educacional's Investor Relation's website at www.kroton.com.br/ir by clicking on the banner 3Q 13 Webcast. The following presentation is also available to download on the webcast platform. The following information is available in accordance with Brazilian's Corporate Law and generally accepted accounting principles, BR GAAP, which now conform with International Financial Reporting Standards, IFRS, except for 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 the CEO, Mr. Rodrigo Galindo, who will begin the presentation. Mr. Rodrigo, you may begin your conference now.

Rodrigo Galindo {BIO 17238232 <GO>}

Good morning, and welcome to the earnings conference call of Kroton Educacional for the third quarter of 2013. With me today is our IRO, Carlos Lazar; our CFO, Frederico Abreu; our Operational VP, Igor Lima; and our On-Campus VP, Americo Matiello. I'd like to start the presentation on slide three with the highlights in the period.

The third quarter continued in a very positive pace in line with what we saw in the first half of the year. The main reason was the success of our admission and re-enrollment process for the second semester of 2013, in which we reached more than 534,000 postsecondary students. Another highlight was the launch of Pronatec where it's possible to offer vocational educational programs to the students.

It is important to highlight that this is the first semester offering this program and we could enroll 8,000 students, which reinforced the potential of these new business for next year. Between all the good results that we present in the quarter, the performance of Enade is the one that leaves us more satisfied. Enade is the official evaluation of the student performance in the country and is done by the Minister of Education. Kroton had the best grade between all publicly listed companies, education companies in Brazil. During the presentation, we will bring more details about these results.

This strong operating performance combined with the rigorous control of costs and expenses that we continued to implement at Kroton supported very strong financial performance as well. In the third quarter, EBITDA was R\$188 million with EBITDA margin of 36.4% and we saw the same behavior in the first nine months of the year when EBITDA grew 76%, achieving R\$555 million.

The adjusted net income growth was also strong, reaching R\$146 million in the quarter and R445 million in the first nine months or almost double the income in the same period last year.

Cash flow was very, very strong in both the third quarter and nine months. Considering the capital disbursement in the year, cash generation was R\$507 million for an EBITDA to cash conversion ratio of 94%. These indicators already show just how positive Kroton's performance was in the quarter and during today's presentation, we'll give more detail.

Let's go now to today's presentation. I invite our IRO, Carlos Lazarto present our operational and financial performance.

Carlos Lazar {BIO 17238206 <GO>}

Thank you, Rodrigo. I like to start on slide five. There you can see the new enrollments of undergraduate students for the second academic semester which is a very important event that's contributed significantly to the company's performance in the year. As

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mentioned before, with the process not even being concluded, we had already surpassed our internal targets and now with the admission process concluded, we obtain an even stronger growth in new enrollment that was 26% in the On-Campus business and 35% to 37% in the Distance Learning businesses. That led us for a total new enrollment growth of 33%.

On slide six, we show the growth in the student base which is the sum of the new enrollments and also the re-enrollments. As I mentioned, on the left slide, the new enrollment performance was very good, excellent, but the re-enrollment performance was also a very good figure. The re-enrollment totaled around 392,000 students and together with the new enrollment generate a growth of 32% in this total undergraduate student base when compared to the third quarter last year. With the campus, the highlights here, the On-Campus base growing 25% and the Distance Learning base growing 36%.

Going to the slide seven, please, we show the growth in the student base between the end of the second quarter and September 30. The third quarter, as I said, is an important period, because of this admission and re-enrollment process. And the success of this process was really important to help us close the quarter with over 534,000 students with all the teaching formats and products we offered registering the growth in the period, a very growth in the period.

The next slide provides more details on each business, the On-Campus and Distance Learning, on slide eight. So the table and charts on the left hand show the student growth in the On-Campus postsecondary business which recorded a growth of 5.9%, driving mainly by the growth of 7.3% in the On-campus undergraduate format. On the right hand side of this slide, you can see the student growth in the quarter's Distance Learning business. Well, the highlight here is that in the third quarter we reached a growth of 12,000 undergraduate students which more than offset the outflow due to dropouts or graduation of graduate students. So between the second and third quarter the overall base grew around 3.8%, beating even our internal estimates before.

Going to the slide nine, we show the number of students with FIES student financing and at the end of September, we have more than 83,000 students with FIES contracts or around 52% of the on-campus base which is close to the same number of last quarter, a drop of 0.9 percentage only. So we consider here, it's important to highlight that we only consider the students with signed contracts, but since we know that the signing deadline was extended to December, we really expect that this figure should increase by the year end or it means by the fourth quarter.

So we expect FIES loans to continue playing a very important role as we see from the student base figures as I just showed and especially in terms to helping to improve -- it's still helping and improving this in fact in terms of dropout rate. Lastly, we continue to have a very high percentage of students who are legible for FIES of around 99% even bigger than the -- higher than the last quarter, which also shows the high quality of our academic programs and institutions.

On slide 10, we present some information about Pronatec, the new business of Kroton. As we stated last quarter, the Minister of Education created the possibility to the postsecondary institutions to participate in Pronatec. And we joined the program in the Bolsa Formacao segment, which is a program of vocational programs that are fully subsidized by the federal enrollment.

We began to offer Pronatec at the beginning of the second academic semester, it means between August and September and reached around 8,000 students in our base distributed across 20 campuses and between 10 different programs. Note here that this is only the initial phase of this program and most of the students are studying in the morning and afternoon. They get advantage on the high idle capacities of our campuses during those periods. However, for the upcoming admission process, we do expect it to reinforce also the process of the evening period. And we are already preparing for this building and upgrading our facility. In general, we are well confident that the program will bring very positive returns to Kroton over the coming quarters, especially over next year. Last, please keep in mind that the revenue from these students from Pronatec students did not impact the results in the third quarter, as it will begin to be recorded only during the last quarter of this year.

Let's go now to the slide 12 which shows our performance in the regulatory concept. As Rodrigo mentioned before, it's really important and we were very glad to receive concession [ph] for Enade. As always said, Kroton's growth is guided by obtaining continuous improvement in the quality of the education and also these improvements is being very observed during the regulatory concept that we're receiving. Regarding that we are very satisfied with the results reported by Enade, the national exam for the students.

Enade is the official evaluation in the country and it's for the whole country and is done by the Ministry of Education. So 186 programs evaluated this time to Enade, approximately 80% of the courses from Kroton had grades equal or greater than three in a range that goes to one to five. So it's a satisfactory level. That means 10% percentage points above 2009 figure when we can compare the same programs that were analyzed at that time. And in additional to this, we also outperformed the average of the overall industry in Brazil, the average of the other private institutions and the average of the public listed companies. So Kroton had the best grades between all public listed educational companies in Brazil.

And now analyzing the results itself, we achieved in both institutional and program concepts a very good indicators as we are in the high ends of the matrix. And another point to be in mind is that the 2010 to 2012 was when we carried out various acquisitions, but even so we were able to maintain the academic quality and achieve good improvement in our evaluations. So today 96% of our institutions receive satisfactory grades with almost 100% of them have programs received in the satisfactory levels. So all these factors provide further indication that we are on the right path in relation to our academic position and strategy.

Now I'll begin the explanation of our financial performance on slide 14, which shows the company's net revenue by business segments. The performance of each of our business

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in this first nine months of the year was very strong. Net revenue in Postsecondary business grew 49% from the same period last year with strictly organic growth, in other words, eliminating the effects of Uniasselvi and Unirondon acquisition made last year in the periods that the growth would be 37% level given very high even considering that. So in the year to date, organic net revenue growth was 33% which further confirms the strength of our brands and the successful process of admissions and enrollments that we could carry.

Considering now only the On-Campus Postsecondary business on slide 15, we show the change in net revenue, gross income and operating results. Net revenue grew 34% from the same period last year, driving mainly by the student growth generated by our admission and enrollment process for the second semester and also the higher average ticket.

Gross income reached 141 million with gross margin of about 8.8 percentage points above from the year before, driving through the economical scales captured with the rollout of the current model at the acquired companies, especially here in Unopar, Uniasselvi and Unirondon by the continued improvement in the process of forming new classes and also the ramp up in distance learning courses in the curriculum matrix of the on-campus programs.

Well, all this was achieved while maintaining the really rigorous cost control we have been able to implement in our operations. Likewise operating results grew 69% from the same quarter last year with operating margin of 32%, which also reflects the tight control of the operating expenses.

Moving on to slide 16, we show the performance of the Distance Learning segment. We note here that this is the first quarter we completed the comparable base, since it marks the first time that a quarter of 2012 was fully impacted by the Uniasselvi operation. And thanks to be the efficiencies gained and the synergies captured between the two distance learning operations. We have seen the Kroton start upfront, we could post a net revenue growth of 37% and a gross income growth of 43% which supported the gross margin expansion of 3.1 percentage points, despite the fact that Uniasselvi was incorporated. We saw lower margin due to the difference in its delivery model from the past.

This makes it even clear just how consistent the results in the Distance Learning business and what reinforces the importance to our company, especially in terms of operating results with the business posting a margin of 66% and accounting for 48% of the company's business line.

Well, moving on to slide 17, we show the financial performance of the primary and secondary education business, the K-12 business. This business reported a very good performance in the quarter with improvement in our indicators whether they are nominal or absolute terms from the same period of last year. The results here were impacted by the sea of deflections for the second semester that was more intense this year and also

the renewal of the management contracts, the school contracts that we get with some companies of Brazil.

A highlight was the growth in operating results which more than doubled to R\$70 million with our margin improving 16.7% percentage point. This strong performance validates our strategy of focusing on this business, in this business especially what is regarding the learning systems in private schools.

On slide 18, we show the performance of the EBITDA of the company in the quarter and in the first nine months of the year. EBITDA in the quarter was R\$180 million with a margin expanding 6.3 percentage points from 2012. Note that EBITDA here was adjusted by the non-recurring items that totaled R\$7.1 million in the quarter and are basically related to the Unopar and Uniasselvi integration, but also to the Anhanguera merger already.

This growth reflects the solid performance of our businesses and also the continuous controlling of costs and expenses besides the excellent performance that we had in the enrollment process during the beginning and during the midyear of 2013. The results here in the first nine months followed a similar path with EBTDA achieving R\$555 million with our margin expanding 6.8 percentage points from the same period last year.

And on the slide 19, we show the net income of the quarter in the first nine months. In the quarter, it stood at R\$146 million with a net margin of 28.3%. Note here that besides the non-recurring costs and expenses, we also adjust for the amortization of intangible assets from the acquisitions that we had in the past. And in the first nine months, net income was R\$445 million or almost the double compared to same period last year with net margins achieving 29.7%.

So, please, I end my part of the presentation now and invite the CFO of the company, Frederico Abreu to continue. Thank you very much.

Frederico Abreu {BIO 16674822 <GO>}

Thank you, Carlos. Good morning, everyone. So moving to slide 21, we're going to present to the next four slides the performance of our working capital, accounts receivable and provision for doubtful accounts. So on slide 21, we analyze the performance of working capital in the quarter, which is composed by the difference between current assets, excluding the effects of cash in current liabilities, excluding financial balance.

So looking at working capital measured in days of net revenue or in percentage of net revenue, we can see a significant reduction of 70% compared to the same quarter of 2012 from 33 days to 10 days of net revenues or 45% when compared to the end of 2012 from 18 days to 10 days. This improvement is consistent across the last quarters and it is basically the result of our intense efforts on three fronts. The first, operational improvements in the FIES, the second is strong collection efforts, reducing the average Ex-FIES receivable term and third the continuing negotiation efforts with suppliers, increasing the average payment term.

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Now moving to slide 22 we analyze the provision for doubtful accounts, PDA. We measure this provisioning percentage of net revenues and you can see this provision for that postsecondary face to face, distance learning and basic education. I want to emphasize that PDA has been calculating using exactly the same methodology since 2010 and is based on a statistical analysis of historical collection data. All receivables up to 365 days are provisioned in accordance with this methodology and are written off after 365 days.

So the main message that we have here is the stability in our historical receivables curve, meaning that we have stability in terms of collection in all segments, which leaves us very comfortable with the levels of provisioning that we are adopting once again this quarter and therefore what you can see is the stability in terms of PDA across the board.

So, looking on the left hand side, on the green bar, we can see the postsecondary business and the PDA percentage of net revenue for the face to face as the whole including Ex-FIES and FIES student decreased from 4.2% to 3.8%. So we have a slight decrease compared to last quarter. Excluding the FIES students and looking only at Ex-FIES PDA, we have a stability of 6.4% compared to last quarter, and for FIES students we continue adopting the 2.25 provisioning for all students of FIES.

Just keep in mind that we have FIES with guarantor, FIES without guarantor. FIES with guarantor we have 15% co-share of risk and for FIES without guarantor with the absolute we have only 10% of 15%. So we have 1.5% co-sharing of risk which is much lower than the FIES students with guarantor. But still we have exactly the same provisioning level of 2.25 which is conservatively adopted since the beginning of the program.

Looking at Distance Learning, as we mentioned before, in order to view this, we expect this provisioning level to converge to the Ex-FIES on-campus portfolio, and this is what we see over the last two quarters. So we have, again, 6.5% of the net revenues, which is exactly the same level of last quarter. And finally, looking at PDA for primary and secondary business, K-12, we have a stability compared to last year and a slight decrease compared to last quarter.

Moving to page 23, we analyze the accounts receivable net of PDAs, so this is the balance that we have in our balance sheet net of the PDA, the balance of PDA. So we have a total of R\$279 million in net receivables, both from 183 million in postsecondary which is roughly 65% of total 60 million in Distance Learning, which is roughly 23% and the remaining in primary and secondary with a total of R\$36 million.

In the next slide on slide 24, we compare these accounts receivable with the net revenues of each of the businesses to see how the average receivable term is evolving. So, on page 24, we have the three segments. Starting on the top, we have a green, the postsecondary. Then it's red, the Distance Learning and that yellow basic education. Through various analyses, we show a higher cash generation capacity in a more effective collection and recovery action and we can see this is basically by the reduction in our average receivable terms in most of our businesses.

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So looking first at the On-Campus Postsecondary business we have four analyses. The first shows the postsecondary consolidated looking at FIES and non-FIES students. So here we see a reduction of 17 days from last year, so from 73 days to 56 days and a reduction of six days compared to the previous quarter. So this is a very strong message. We have our average receivables term reducing in the postsecondary,

Now, excluding the FIES effect, so looking only ex-FIES students, we have a reduction of 10 days in analyses number two and a reduction of 13 days compared to last year, or sorry zero days compared to last year or 13 days compared to last quarter in the criteria number three. So in all the analyses we have looking at ex-FIES we have a decrease or stability. In looking at FIES students, we have a decrease of 45 days compared to last year or a slight increase of two days compared to last quarter.

This seasonality we have in FIES is normal. Every odd quarters we have an increase in the average receivable terms from FIES and in all even quarters we have a reduction and this is mainly due to the regular re-enrollment process we have with FIES students. So we expect in fourth quarter this 57 day to decrease a bit converging to a level close to 50 to 55 days. Okay.

Now looking at Distance Learning, we have 38 days, which is small decrease from last quarter and the 13 days increase from last year. Again, this reflects the conversion of our collection practices in Distance Learning to the Postsecondary today. We have all of our students in Distance Learning on the same collection process we have in face to face and therefore, we expect the conversion in terms of collections period from the basics from the Distance Learning to the postsecondary.

And finally in the primary and secondary business, the average term increased from the same quarter last year and from the second quarter this year. This is mainly explained by the sell-off collection for the second academic semester which is going to be reduced again in fourth quarter.

Now moving to slide 26, we have investments, the CapEx of Kroton. We have mainly two types of investments. On the left hand side we have the CapEx, which we call recurring and expansion CapEx, which supports our short-term growth and this is the growth from one to three years. And on the right hand side we have the total of CapEx, including also the special projects which are projects that support our near term growth or a growth that is longer than three years.

But looking at the recurring and expansion CapEx on the left hand side, we have 20.5 million investment in the third quarter, and this is mainly investment in laboratory, IT, library and some small expansions in some of our units. This CapEx represented 4% of net revenues. If we look at the total year-to-date, we have 77.7 million, which represents 5.2% of net revenues in the period.

Now looking at only at special projects and these projects include expanding existing properties, building new properties or even buying lands for construction. And so these are projects that we have to support long-term growth. We've invested 15.4 million in the

quarter, which is in line with company's expectations for the year and as a result, if we look at total investments, including recurring and the special projects in the quarter, we have 35.9 million, which is 7% of net revenue and 105.3, which represents 7% of net revenue. So these investments are in line with company's expectations and they are enough and sufficient to allow and to permit that re-growth as we are growing organically in the last quarter.

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Moving now to slide 27, we have company's debt at the end of the quarter. So we end the quarter with 469.6 million in cash and marketable securities. So this is net cash that is available either in applications or in exclusive funds we have. And this is a high increase from the second quarter of this year, mainly driven by strong operation, operating cash flow that we'll see in the next pages.

In this balance, this cash balance that we present here is already net of all payment of dividends that we have throughout the year. Remember that we paid the 2012 dividend in April and also we paid two additional set of dividends related to the first and the second quarter of this year. So this balances is already net of those payments.

So now looking at net debt and considering only financial debt, our financial net debt was 94 million in the third quarter, which represents an extremely comfortable leverage level of 0.16 times projected EBITDA and if we include other short-term and long term liability that are related to payment of acquisition we had in the past, total net debt was 332 million or around 0.55 times projected EBITDA, so about half of the EBITDA we project for the year, which is an extremely conservative and extremely comfortable leverage position we have by the end of this quarter.

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Now moving to slide 29, we present the analysis of cash flow generation and this is operational cash. On the left hand side we have the quarter, on the right hand side we have the year-to-date. So we know in periods [ph] we look we can see a very strong cash flow generation, and this is consistent across the last the last quarters in 2013. So looking at the operating cash flow before CapEx, we have R\$191 million in the quarter, which is 106% EBITDA to cash. After recurring CapEx, we have 170 million or 38% higher than one year ago and represent an EBITDA to cash conversion of 94%. And if we consider CapEx for special projects, cash generation was 155 million or an EBITDA to cash of 86%.

If you look on the right hand side, on the year-to-date, after all disbursements, for both recurring and special projects CapEx so free cash flow, operational free cash flow after all CapEx cash generation was 480 million or 2.5 times higher than last year and representing an EBITDA to cash 89%. So it's a very strong performance, a very strong cash flow generation.

And in summary, we have some leverage for this strong cash flow position. The first is a higher EBITDA, so we grew our EBITDA in all businesses. Second, the continuous improvement in working capital management, including non-FIES and FIES students, a continuous renegotiation with suppliers, a strong efficiency in capital deployment through a rigorous CapEx expansion process. So all of that together led us to a very strong cash flow. I'll now hand the words to Rodrigo Galindo.

Rodrigo Galindo {BIO 17238232 <GO>}

Thank you, Frederico. Let's go please to the last slide in light of today's presentation for my closing remarks. The third quarter brought another round of strong results for Kroton with growth in all business lines in operational cash generation in the year-to-date of almost R\$500 million which leaves us more confident to develop our long-term strategy.

The results were only made possible by our rigorous control of costs and expenses and a highly structured admissions and re-enrollment process that has allowed us to surpass the march of 534,000 postsecondary students. Note that we have already begun the revision process for the first semester of 2014 and the initial signs are very positive for both the On-Campus and Distance Learning business.

And we had some important opportunities to sustain the growth in the following year. Pronatec is an important growth opportunity, greenfield are another opportunity. We are expecting to launch 20 greenfields in the next three years and we already have 184 new courses in process to be approval by Minister of Education in the actual units. And we have already asked for the Minister of Education 225 new distance learning centers for Unopar and 53 distance learning centers for Uniasselvi. So we had a lot of important opportunities to sustain this level of growth.

Yes, we are growing and should continue to grow but even more importance is the fact that this growth has been accompanied by improvement in the quality of the services that we offer. And this improvement was confirmed by the results of the Enade exams which 80% of our programs rated satisfactory.

In this evaluation cycle, Kroton had the best eight management program in Brazil, 10 of our programs were among the top 10% in Brazil and 50 of our programs were among of the top 25% in Brazil. It was the best result between all publicly listed educational companies in Brazil, the new and the old one. In other words, we are on the right path to creating value for our students over the long term and in a sustainable way.

Turning to the merger with Anhanguera, we are very confident in the progress being made in this process. We have hired a professional consulting firm to help us in the planning of the integration and it's going very well. All the necessary information was given to antitrust Brazilian agency Cade and we remain confident in the conclusion of the process.

In the capital markets, we approved a distribution of dividend of R\$30 million to be paid to our shareholders on November 20. And with our strong stock performance on recent months, we were included in the Ibovespa index, one of the main stock indexes in Brazil. At the end, we launched our level one ADR program which will improve our visibility with foreign investors.

As you know, we are very focused on improving our management tools and our relationship with the financial community. And on that note, I'd like to thank the recognition

we received from some of you with the award from Institutional Investors, it is one of the most important magazine for the financial markets in the world.

In closing, I'd like to invite all of you to participate in our Investor Day event which would be held in Sao Paulo on November 28 and for more information, please go to on our website. Once again, thank you for participation in today's call and we will now begin the question-and-answer session. Thank you.

Questions And Answers

Operator

Thank you. Ladies and gentlemen, we will now initiate the question-and-answer session. (Operator Instructions) Our first question is from Ruben Couto from Brasil Plural. Please go ahead.

Q - Ruben Couto {BIO 19172367 <GO>}

Good afternoon, guys. Thank you for taking the question. So, I wanted to hear a little bit more on Distance Learning's profitability, results continue to improve with integration and synergies from Unopar, Uniasselvi and Anhanguera including, but is it possible that once all the academic models are fully integrated, we could see gross margins on an annualized basis returning to the 80%, which was roughly what Unopar had on (inaudible) levels?

A - Rodrigo Galindo {BIO 17238232 <GO>}

Thank you for the question. No, we do not expect 80% of operational margin in Distance Learning. We believe we are running in the correct or adequate level of profitability in Distance Learning. But we will continue to improve our efficiency and benefit of this efficiency, we will return in the academic quality. We know we have a challenge in the long term to deliver the quality education, so all efficiency that we can capture in the Distance Learning business we will return for academic improvement in the model. Further, there is a little bit space for improve of margins, but not at this level.

Q - Ruben Couto {BIO 19172367 <GO>}

Great. Makes sense. Thank you. And could you talk a little bit more on the K-12 business, why it was so strong and if this collection process improvement that you mentioned in the release even the recurring, could we see and expect a gradual profitability increase going forward?

A - Rodrigo Galindo {BIO 17238232 <GO>}

Ruben, it's Frederico. So, first, I'm going to give an answer on the nine months of the year, so taking out the quarter. So what we have in basic education is two things. The first is, Rodrigo mentioned in other calls, we have a restructuring in the commercial area of basic education. So we are growing and we are showing a good growth, both in the total of basic education and also in what we call strategic businesses in basic education which is

mainly collections for the private segment. So this is the first important thing we are growing.

The second we are running since the beginning of the year a restructuring process also in logistics. And logistics mainly includes paper, graphics and all the distribution that we have of our collection. So we are in the middle of this process and we already have some benefit from the beginning of the year. I'm going to mention four benefits. The first is the better stock management.

What does this mean? In the last years, I mean in 2012 in particular, we had some write-off of stocks, so collections that were not sold and we had to written them off from our balance. This year we had a very small percentage of collections that were not sold. This means that we are improving our prediction in terms of how much we are going to sell and therefore we are keeping less inventory in our inventory and therefore we have less risk of written off stocks. So this is the first thing.

The second, we are centralizing the logistic operation for the whole company. We have a logistic, a different logistic operations in basic education and in this we are centralizing logistics and we already are seeing some benefits in basic education. To give you an example, we reduced extra time basic education in logistic by 50%.

The third, we have got negotiations with graphics with companies that produce our materials and the third we had reached last real reduction compared to last year. And finally, we had also a reduction in paper cost, also showing a real reduction. So these are some examples of things that we've done throughout the year. These results are shown in the margin.

And now talking about third quarter in particular, we've registered one important contract. It was a very difficult renegotiation that we have over the year. And all the revenues of these contracts, which represented about R\$7 million were recorded in the third quarter, but third quarter this year compared to third quarter last year has part of this is related to these contracts. But if you look the nine months of the year compared to the nine months of last year, this contract is a recurring contract and therefore is considered recurring. So, in general, high growth of revenues and also restructuring costs, which we consider recurring.

Q - Ruben Couto {BIO 19172367 <GO>}

Yes, very clear. Thank you.

Operator

(Operator Instructions) Our next question is Thiago Macruz from Itau. Please go ahead.

Q - Thiago Macruz {BIO 16404924 <GO>}

Good afternoon. My question is actually regarding Pronatec. I was wondering if you could give us more color on what sort of profitability you expect to generate in that specific

operation, as well as to give us a color on how the payment flow from the government to you will take place? Will this be monthly, quarterly, is the government using the same (inaudible) as it uses in the FIES perhaps the FIES bonds? Any color on that matter would be helpful, guys. Thank you.

A - Rodrigo Galindo {BIO 17238232 <GO>}

Thank you, Thiago. Very good question. First, about Pronatec and the profitability of Pronatec. In our models, we expect a similar, a little bit of higher profitability than the postsecondary on-campus business. We are talking about 40%, 45% of operational margins in the first semester. And the average, let's remember the average ticket is around R\$500 million in Pronatec. And Frederico will answer the second part of the question.

A - Frederico Abreu {BIO 16674822 <GO>}

Thiago, in terms of the way we are going to receive from Pronatec students are going to be conceptually the same, in the same way as we receive from FIES students. We have different systems, but (inaudible) same thing. So we are going to be paid monthly. We are going to be paid based on the actual number of students that are actually on our classroom, so attrition is going to be taken out of the payment. So all students that are at the classrooms, they are assets and we receive based on those students that are effectively studying in (inaudible).

Our first payment is scheduled for 18th November. So in this month we are going to receive the first payment which is going to be related to the September, so from students who studied in September. In December we should receive the payment of students from October and we expect this to be continuously happening monthly.

Operator

(Operator Instructions) Our next question is Ian Simmons from Charlemagne. Please go ahead.

Q - Ian Simmons {BIO 6360521 <GO>}

Hello. I just wondered, do you have any update on negotiations with governments over the ProUni tax breaks after we saw the headlines a couple of weeks ago?

A - Frederico Abreu {BIO 16674822 <GO>}

Hi, hello. It's Frederico. So just to give a context of ProUni, so we have a law. This law is from 2005, is valid for 10 years and what we had in the news for the last month was normal, giving instruction which is an instruction from federal receipt from IRS to try to change what the law, what your regional law was setting. So the advisory we got from our legal advisors and we have these advisory on an entity level and also on an association level is that this management or this attempt of a management on the original law is anti-constitutional. So these amendments would not change the original law. And therefore we are not conducting any type of negotiation on that front.

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What we have is a legal opinion, so that's why the trials amendment will not impact the original law. And therefore we are not considering any change on this law. After the original law is valid, so after the 10 years of original law nobody knows what will happen in the original law. We are not expecting as a company any change in the law. We are not expecting any change in the incentives of this law. Just keep in mind that today in Brazil you have 1.2 million ProUni students. 1.12 million ProUni students represent about 15% of total students in Brazil and we do not expect that this incentive change at least in the near future.

A - Rodrigo Galindo {BIO 17238232 <GO>}

It's Rodrigo Galindo. Just complementing, in the Ministry of Education, the perception we are not talking about -- we are not hearing nothing about changing of the conditions of the law. So it was particular interpretation of the law by the IRS and in the Ministry of Education we are very comfortable that they will keep the same conditions and we believe they can keep the same condition in ProUni.

When we analyze it, the reason the ProUni was created -- the reason there are few happening in Brazil. The lower penetration rate in Brazil it was the most important reason to create ProUni and we still have the lower penetration rate. So we don't believe that government will implement any structural changing in the ProUni that could be a problem for increasing this penetration rate.

So we are confident and besides all of this, we have a lot of goodwill to amortization in the taxes that we need to pay. So if we need to have any change, the impact for our operation it would be lower because we have a lot of goodwill to amortize the tax rate.

A - Frederico Abreu {BIO 16674822 <GO>}

And it's very important to understand this that the way the incentive for ProUni for the institution is not to pay federal taxes. If you change the incentives, the institutions may also change the focus and what you may do is you reduce the offer to ProUni student and you bring paying students, so you bring more FIES students. So there is a trade-off here as you can have less ProUni students, but you will have more paying students. And besides that we have a goodwill, we have net debt, the lot of potential to offset any potential increase in the effective tax rate. That's today's law. If anything increase we can offset it.

Q - Ian Simmons {BIO 6360521 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Having no further 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.

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A - Rodrigo Galindo {BIO 17238232 <GO>}

I would like just to reinforce that our Kroton Day, our Investor Day, it will be on November 28 in Sao Paulo. And once again, I would like to thank you for participation in today's call and have a nice day, everybody.

Operator

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

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