Q2 2015 Earnings Call

Company Participants

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

Other Participants

- Ian Simmons, Analyst
- Rodrigo Gastim, Analyst
- Ruben Couto, 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 Second Quarter 2015 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 slide show, may be accessed through Kroton Educacional's Investor Relations website at www.kroton.com.br/ir by clicking on the banner 2Q15 Webcast. The following presentation is also available to download on the webcast platform.

The following information is available in Brazilian reis in accordance with Brazilian Corporate Law and Generally Accepted Accounting Principles, 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 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. Please go ahead.

Rodrigo Galindo {BIO 17238232 <GO>}

Good morning everyone and welcome to the quarterly earnings conference call of Kroton Educacional for the second quarter of 2015. With me today is our IRO, Carlos Lazar; and our CFO, Frederico Abreu. I would like to begin today's presentation by touching on the current scenario, outlook and how Kroton is approaching important topics such as margins, cash flow, PDA and results.

Slide 4 shows the company's financial performance in the first six months of the last five years. The company has involved [ph] significantly in 2015 as well. Between the first six months of this year and the same period of last year, EBITDA margin expanded 580 basis points while net margin advanced 600 basis points. This performance is a result of the successful integration of Anhanguera, strict control of costs and expenses, (inaudible) and greater efficiency in our operations.

Furthermore, the majority of synergies and efficiency gains are [ph] yet to be captured. Another important topic is Kroton's cash flow in the second quarter. Despite regulatory changes to FIES, Kroton generated R$209 million in cash, reflecting higher receipts from FIES in the quarter and a strong cash flow from the Distance Learning segment. I will now hand over to Carlos Lazar for his presentation.

Carlos Lazar {BIO 17238206 <GO>}

Thank you, Rodrigo. Following you with the comments, the scenario -- and the current scenario and also the outlook. So, another aspect that we should look at more closely in the current scenario is provisioning. Slide 5 shows that despite a deterioration in the macroeconomic scenario, provisioning remained stable in the On-Campus segment for both students, with FIES and for those without FIES or the PEP financing, as well in the Distance Learning segment.

It is important to emphasize that we are exactly in the same provisioning policy based on the analysis of the historic data since 2010. So we didn't change at all, all our policies. Additionally, we are working on various initiatives to further strengthen our collections and recovery practice to mitigate any signs of deterioration in delinquency levels.

During this conference call, I will comment much in details these numbers, but the general message here of stability is very positive. Moving to slide 6, we think all are in the same part of the presentation. We will -- let's comment briefly on the new enrollment and re-enrollment process for the second semester of the year. As was the case in the student recruiting process at the start of the year, we are prepared to offer alternative payment methods giving to the restrictions on the number of FIES openings.

For the second semester, we will offer the Private Special Installment Plan, the PEP, but this time in the version of the PEP 50 in which the student is responsible for 50% of the monthly tuitions over the course and also the PEP 30, which the students will pay 30% of the tuition in the first year, 50% in the second year and 55% in the third year going forward.

So, in partnership with Ideal Invest, we are also offering Pravaler, which is a long-term financing facility in the versions of Pravaler Easy and Pravaler Interest Free. Finally, we received nearly 11,000 new FIES openings from the government. This number is significantly lower than the number of students that we had last year at nearly 35,000, but also in line with our current expectations.

So we've been considering the challenging nature of the second semester cycle especially in the On-Campus business. We believe that we have been able to create the tools needed to deliver very satisfactory results by the end of the process, which should be announced by early October.

On the next slide, slide 7, we present the dropout rate over recent years. In the On-Campus business, dropout rate fell slightly between the first quarters of 2014 and 2015 from 12.1% to 11.6% and the second quarters also dropped, 2014 and 2015, from 4.5% to 3.6%.

So, dropouts in Distance Learning increased between the second quarters of the same years, but when analyzing the first and second quarters of the year as a whole, so the combination of these two periods which provides a better analysis of dropouts in the semester, the rates remain roughly stable from 2014 despite an increase in the share of the 100% online students and also a more strict renegotiation policy.

These results from both the On-Campus and Distance Learning businesses are even more important considering that the last two years new enrollments have grown, creating a larger base of students enrolled in initial semester of the programs, which is the period that most dropouts occur. While despite fairly positive dropout numbers, we saw room for improvement and greater efficiency, and to capture this opportunity we created a Retention Program, which -- with more than 20 different projects related to dropout management and increased student retention that we are implementing over the course of the second semester of 2015 and also into 2016.

We believe that it should contribute positively for the results of the dropout rates over the coming years. Initial message demonstrates that despite the current macroeconomic conditions and the regulatory changes, the company has shown excellent results in highly relevant areas, including margins, cash flow and dropout. And besides that, we are implementing a range of actions to weather this challenging scenario by capturing short-term results while maintaining the long-term sustainability.

Financial performance in the second quarter of 2015 serves to reaffirm our view that this was the best quarter of Kroton's history. So, let's begin to analyze the financial performance on slide 9. Here we can see the financial performance of the On-Campus Postsecondary business (inaudible) from analysis, so there is a less profit. Revenue increased 7% driven by the student base, (inaudible) by our new enrollment and re-enrollment process and also by the Anhanguera merger.

Compared to the first quarter of this year, net revenues grew 20% mainly to the recognition of revenue from around 48,000 students who concluded their enrollment and re-enrollment process after the end of the first quarter 2015. So the impact here in revenues was something around R$160 million that worked of payments from the first three months of the year that was booked in the second quarter. Gross income was R$711 million, increasing 123% over the same period last year. The gross margin compression of 1.1 percentage points is due to the merger of Anhanguera which has still a slightly higher cost structure compared to the company's other business.

However, like the previous quarter, it is also important here to note the strong gross margin expansion compared to the last two quarters of last year, of 2014, which appears that already incorporated the figures of Anhanguera and demonstrating. So, the continuous capture of efficiency gains in both existing and acquired institutions. Operating income before marketing expenses increased 113% year-over-year with operating margin of 50.3% in the first six months of this year. Operating income was almost R$909 million with a margin of 50%. Also here demonstrating the significant improvement compared to the second half of last year, which posted a margin of 45%; also the period there considered the consolidated basis of Anhanguera figures.

So turning to slide 10, we can see the performance now of the Distance Learning. And here the revenue in the quarter was R$292 million, growing 40% year-over-year, pretty much in line with what happened in the On-Campus business because of the student base growth, also up because of incorporation of the students from Anhanguera.

The gross income grew 27% year-over-year to now 74%, almost down 7 percentage points also due to the consolidation of Anhanguera figures. Compared to the previous quarter, gross margin fell about 6.5 percentage points due to seasonality especially regarding the cost of teachers and tutors; that is more relevant in the second part of the semester.

Operating income before marketing expenses in the Distance Learning business grew 24% year-over-year with margin of 60.8%, falling 7.7% in the same line what I just mentioned about the gross margin. However, in the year-to-date, the operating result was almost R$400 million with a margin of 65%, well above the margin of the second half of 2014 which was 56.5%.

Turning now to slide 11, we can see the financial performance of the K-12 business, the primary and secondary business. And here the net revenue rose 1% year-over-year to R$41 million mainly to the good performance of the management contracts and own operations. Note also that the performance could even be better since the second quarter of last year was positively impacted by the anticipation of the calendar due to the World Cup and also because the segment's revenue this year is impacted by the recession of the contracts from a part of the Sesi Network which we were attending until last year.

Gross income in the quarter was R$21.2 million with gross margin of 51.8%, down 10 percentage points year-over-year due to the reasons mentioned before and also because of the seasonality in the period. In the same way, the operating results came 14.1% with operating margin of 34.3%.

On slide 12, we can see our corporate and marketing expenses. And first, in the corporate expenses line, we had R$65.5 million or 4.6% as a ratio of net revenue, so down 2.3 percentage points year-over-year, mainly due to the post merger synergies capturing the administrative structures and also due to the higher cost efficiency achieved through contract renegotiations. Selling and marketing expenses as a ratio of net revenue remaining practically stable in relation to the same period of last year and compared with the previous quarter, the first quarter expenses fell 2.1 percentage points, which demonstrated also the Company's rigorous control even in the more challenging commercial environments observed this year.

On slide 13, we can see the performance of EBITDA and net income in the quarter. Adjusted EBITDA in the quarter was R$600 million, increasing 84% year-over-year with EBITDA margin of 42.6%. In the year-to-date, adjusted EBITDA was R$1.1 billion, up 75% year-over-year with the margins falling 4.3 percentage points to almost the same margin over the second quarter 42.7%.

Here the better performance confirms that the ongoing efforts should capture all the synergies and also the efficiency gains and besides the readers [ph], the really important cost control are keeping the EBITDA improvement (inaudible) is adjusted by non-recurring items which came about R$53.6 million in the quarter were mainly related to the expenses with the Anhanguera merger and also with the expenses related to personnel and severance payments, especially impacted this year because of also the reorganization that we conducted in the Company. For coming quarters, we do expect a sharper reduction, let's say, in the non-recurring expenses.

Going forward, I am turning to slide 14, we can see the performance of the net income in the periods and net income adjusted by not only the non-recurring that I mentioned before, but also by the amortization of intangible related to acquisitions and this number posted in the second quarter was R$514 million, with a net margin of more than 36% in the period expanding from the periods before. And in the first half, net income was almost R$1 billion with a net margin of 35.9%, also a very important trends here.

Looking at the last part -- last slide of this part of the presentation. Here we'd like to show only the four [ph] managerial analysis here the evolution in the Company's result in a pro forma basis, using the combined figures for Kroton and Anhanguera for the second quarter last year as reported for the market. In these analysis, we can see a solid and a consistent performance delivered, even if we take in account that the first half of 2014, Anhanguera had a still different practice in terms of accounting procedures from prior to the Kroton wins [ph].

The highlights were for sure the growth, we have 15% in top line, 44% in EBITDA and 53% in the net income. We also observed that our robust margin expansion both in EBITDA of 8.7 percentage points and also in the net income 9.1 percentage points, even considering the scenario that we are facing now. We are able to present, again, excellent results and over-deliver even with the market expectations.

Well, I now would like to invite our CFO, Frederico Abreu to continue the presentation.

Frederico Abreu {BIO 16674822 <GO>}

The second very important factor is PEP kit. As we mentioned in previous quarter, we are conservative in terms of positioning the accounts receivable for PEP. We are using 50% provisioning for all revenue of PEP students, which is a level that is much higher than what we use for a typical paying student. Thank you, Carlos. Good afternoon, everyone. I would like to invite you to move to page 17 and on the next three slides we will analyze our provision for doubtful accounts, our accounts receivable and our average receivable term. We will present several analysis here that will detail the behavior of our collections, the behavior of our accounts receivable term and also what's behind and also what we are seeing for the future, given this more challenging macroeconomic scenario.

So on page 17, we show PDA as a percentage of net revenues and before starting, I would like to emphasize that we are using the same methodology to calculate PDA over 2010, so for the last five years we are using exactly the same methodology. We are using the same methodology also for Anhanguera since the second semester of 2014 and this methodology is very consistent and is based on our statistical analysis of all of our historical billing data. And we think this methodology captures more recent or more structural movements in terms of delinquency and therefore we are keeping and maintaining this methodology.

So looking out on the On-Campus Postsecondary business and considering all On-Campus students, paying students, FIES students and also our PEP students, our PDA stood at 5%, which is stable in relation to the previous quarter and increasing its higher levels when we compare to last year. There are basically three factors; one is structural, which is related to Anhanguera's operations, our PDA for Anhanguera is still higher. The delinquency levels at Anhanguera are high, we are converging the delinquency levels of Anhanguera to the ones of Kroton. So this is one factor.

And the third factor is related with FIES. We are having, since the beginning of the year, a discussion over a potential cap, a potential limitations in terms of price adjustments in FIES students, the negotiations with the Ministry of Education are evolving, but nevertheless we are provisioning with a higher provision than we use for FIES, the difference between the cap that is being discussed and our price adjustment, again we are using a conservative approach, we don't know what will be the result of these price cap negotiations, but we decided to be conservative and provision apart of that difference.

And if we exclude and if we analyze only the paying students, so excluding FIES students and excluding PEP students, you can look on the right side on the green bars, you can see that our PDA for paying students is stable, it's stable over last year and it's stable over last quarter and this is basically the result of our good results in terms of collection practices, despite the macroeconomic environment that is more challenging, we are comfortable to maintain our PDA level for paying students and I'll comment later on the call about what we are doing on those fronts.

And on the middle of the page in red, we can see the Distance Learning business. Again the main message is that -- our PDA is basically flat at 7.4% is higher than last year, again where it has a high PDA, but it's stable compared to last quarter and again, I'll comment later on the call what we are doing on this front.

And last Primary and Secondary education, we have a decrease in 2.6 percentage points year-over-year and this is basically the result of two things. The first, last year we had a notion of (inaudible) and increased our -- last year of the (technical difficulty) practices towards our associated schools, okay.

Now, commenting on the more challenging macroeconomic environments, we were -- several of you asked us what's our vision in terms of macroeconomic scenario. And if we are seeing a deterioration or not in our accounts receivable, I think two things are important. First, we are not seeing a deterioration in terms of the performance of our accounts receivable or in the performance of our receivables. And second, we are doing everything we can that is under our control to prevent for a potential deterioration of the accounts receivable in the future. So everything that is under our control we are doing, and I'm going to comment on some of the things that we are doing over the last 12 months after the merger with Anhanguera.

We've hired a consultancy company and I'm going to comment on five things that we are doing that are structural and are allowing us to capture more efficiency gains and synergies in the collections to mitigate any potential worse [ph] in terms of macroeconomic scenario.

The first, we have today our collection teams unified and our process, our collection process is unified. Second, we have and we are improving our preventive collection procedures. The third is we are unifying our operations for collections for inactive and active students. Today, we outsource the collection of these and active students and we've unified our billing activities in the most, in the high performing collection offices.

The fourth, we are converging our collection model in our operations also for active students. And the fifth, we are extending our payments means and including remote channels such as web, so today our students can renegotiate remotely towards our web channels. So these five things are five examples of what we are doing there, things that are under our control and they are generating efficiency gains and we expect the efficiency gains to be captured also in the next two quarters.

So now moving to page 18, we can see our accounts receivable, already net of PDA. And before going to the numbers, I would like to emphasize some points in terms of FIES. The first thing, we've received 100% of the value of the FIES repurchases that were expected for this quarter. And also, we received what was pending from the first quarter. So today, we do not have any pending receivables from FIES. Also, we've cleared the pending balances from Pronatec. We've received also, in the beginning of August, the repurchases of FIES related to March that were supposed to be paid in the beginning of August and they were paid on schedule, so no pending payments on the third quarter as well.

And the last, we are able to offset all factors using FIES sophisticated [ph] month after month. So we are not accumulating any pending balances also on that front. So this contributed to, despite the (inaudible) number 23, which impacted significantly in 2015. The government is meeting this (inaudible), so we're not reporting any delays in terms of what was expected in terms of FIES and Pronatec.

So looking at the numbers, you can see that our accounts receivable stood at R$1.4 billion approximately, which R$1.173 million related to On-Campus, R$220 million related to Distance Learning and R$36 million related to Primary and Secondary and from the total of R$1.4 billion around R$874 million or 61% of the total are related to FIES and this is a much higher volume that's what we had last year.

And here you'll see on the next page, the impact in average receivables term and this is basically the reflect of total year Administrative Rule number 23. So moving to next page, page 19. We can see how these balances translates into average receivable term. So, on the first -- in the On-Campus, starting from the On-Campus, the first analysis looks at the whole balance for On-Campus including FIES, non-FIES and PEP students. So you can see an increase in 35 days year-over-year and 24 days from the previous quarter and (inaudible) of the impact in these accounts receivable term is related to PEP.

The analysis number two. You can look separately at ex-FIES. So, excluding all FIES students, but including the PEP students. So here is ex-FIES and PEP students, we can see an increase and mainly this increase in eight days compared to last year is related to PEP. As you know, PEP is a special payment scheme that we've implemented to some of our students, where the student pays only 10% and he pays the remaining 90% over the course. And therefore the average receivable term of PEP is much higher and this explains most of the increase in eight days.

If you look separately, only the paying students, excluding PEP, the average receivable term is stable, which reinforces the adequacy of our provisioning policies for paying and non-paying students. And looking at the analysis number three, we isolate the FIES students and here is where you can see the highest increase, and this is basically what explains our -- increase in our receivables term.

So you can see that we've moved from 82 days last year to 124 days this year. This was already expected and is basically the result of Normative Rule number 23. We expect this term to continue to increase until the end of the year. And in 2016, this term should start decreasing as the government starts paying the four payments that were not paid this year. These payments will be paid in 2016, 2017, 2018 and 2019.

In Distance Learning you can see an increase in 12 days from last year and nine days from the previous quarter. There are two things that explains this increase, the first is the merger with Anhanguera and Anhanguera is a high receivable firm. And again we are converging the terms, the average receivable term of Anhanguera to the ones of Unopar and Uniasselvi. This is one of the things that explains a higher receivable term compared to last year.

And the second is the convergence of billing and renegotiation practices between Distance Learning and face to face. As you remember, we've integrated Unopar and

Uniasselvi starting in 2012 and 2013. We've integrated the collection and renegotiation practices similar to the ones we have on On-Campus and this increase in average receivable terms is the reflection of this integration. We are generating an important revenue from interest and fines on this delay of average receivable term, which is positive also for our results.

And looking at the Primary and Secondary business, you can see a decrease of 39 days and again, this is the result of the anticipation of good collection sale of last year due to the World Cup and also a better collection practices that we've implemented and we are implementing on our Associated Schools. There is a decrease in the average receivable term. It was positive to our cash flow generation.

So, just to finalize in terms of accounts receivable, I want to reinforce that we are doing everything that is under our control to improve collection performance. We know that the macroeconomic scenario tends to be worse and we are doing everything that is under our control to mitigate negative impact.

The first thing, we are also very strict and we have the same methodology for revenue recognition, this is very important, so our revenue recognition policies are same and is very conservative. The second, we have a very high and stable coverage ratio. So if you look at our balance sheet and if you look at our quarterly reports, you can see that our coverage ratio is high and it's higher than our peers and this gives us a lot of comfort that we have a level of provisioning that is adequate. And the third, the structural initiatives and projects that I've mentioned before that we are doing to continue improving the efficiency of our collection at Kroton.

Now, moving to page 21, we can see here our capital expenditure. Again, we divide our CapEx into two blocks. The first is our recurring CapEx and the second is our special project CapEx. So looking at the recurring CapEx, we've invested R$64.6 million in the second quarter, which is 4.5% of net revenues and in line with our budget. And most of this investment was allocated to expansion projects into our facilities, maintenance, software developments et cetera. If you look at the year-to-date recurring CapEx, it was R$150.4 million or 5.5% of net revenue, which is a bit down from last year.

If you added our special projects, which are basically projects to expand or to build new units. We've invested in the quarter R$11.4 million. So when we look at the combined CapEx recurring with special projects in the quarter, a total of R$76 million or 5.3% of net revenues. And if you look at the semester, R$197.1 million or 7.2% of net revenue. This is in line, slightly better than our guidance and then our budgets, which was 7.5% of net revenues.

So we are in line and here I want to emphasize that this better performance in CapEx is basically the result of our policy, our restricted policy in terms of capital allocations and we are not impacting or we are not postponing any strategic projects such as new programs or new courses, the Greenfields or new Distance Learning centers. So these strategic projects are maintained and we are doing strict on capital allocation, but not putting at risk these special projects.

Moving to page 22, we can see debts and cash, our cash position which is one of the highlights on this quarter increased by 17.3%. So, we've ended the period with R$389 million in cash, which is a very healthy level for the Company. If we consider debt and looking only at the bank debt, our net debt is at R$560.6 million and if we add all short-term and long-term debt related with taxes and contributions and also installments and obligations related to M&A, our net debt is R$773.5 million, which is down from last quarter and that's about 0.4 times our EBITDA. It's a very healthy and conservative debt level and at these macroeconomic scenario cash is king and we consider these levels very adequate to the company.

Moving to page 24, we can look at cash generation. You can see a very positive cash generation despite the negative impacts of normative rule number 23 on FIES, despite that we have a very positive cash generation. Our operating cash flow before CapEx is R$268 million. After the total CapEx recurring in special projects, our free cash flow is about R$200 million, which compares to a negative cash flow last quarter of R$22 million. So a very positive highlight and this is basically the result of strict cost control. And here there are many things that we are doing.

Carlos and Rodrigo commented on the beginning, parts of these cost control and these cost benefit is related to the merger with Anhanguera, parts of it is related to our efficiency. You remember that we had an important layoff in the beginning of the year, almost 1,000 people. And therefore, the benefits of those efficiency and synergies is impacting positive to our cash flow. The second, we have a relatively stable level of accounts receivable and the third, which is important, our Distance Learning, which was not affected by the changes in FIES rules has also contributed very positive to our cash flow generation.

So now I'll pass the call over to Rodrigo for his closing remarks.

Rodrigo Galindo {BIO 17238232 <GO>}

Thank you, Fred. Let's go to the last part of today's presentation. (technical difficulty) we have made these corrections. It is important to say that we have (technical difficulty) the KLS 2.0 in August of this year for all first and second semester students at all institutions within all brands, including Anhanguera brand. During the development of KLS 2.0 we've met with 120 suppliers in 20 countries to incorporate various methodological and technological innovations such as competency-based development, flipped classroom and adaptive learning.

In terms of academics and educational quality, we are convinced that KLS 2.0 is a disruptive solution that represents an enormous improvement in quality. And in addition, its many academic benefit, KLS 2.0 will also produce an important gains and efficiency through the increased sharing of course and on the students in different semesters and programs, which generates important productivity gains in the process of forming classes.

Another important product is the Operational Survey. Nearly 1.5 year ago we began discussing the efficiency of our process for forming classes. We identified that part of this process was done manually by academic program coordinator, which represents an opportunity for improvement. Then we decided to apply the concepts of the Operational Survey to solve this issue. With other solution on the market both in Brazil and abroad and we failed to find tools that met our indeed. We did form a partnership with a multi-national company that helped us to develop a tool, 18 months of our work led to a proprietary Operational Survey system that radically changed how we form our classes.

In the second semester of 2015, the majority of our units successfully utilized this tool. The opportunities for efficiency gains over the coming years are endless. Firstly, the Operational Survey software will offer several functionalities that they are not yet available and will be released over the three semesters. And secondly, KLS 2.0 was only implemented for the first and second semesters, meaning that it will take three more years to encompass all the students, the more major KLS 2.0 and the greater opportunities for sharing between courses.

As such, we have two initiatives that we work together to increase efficiency over the coming years. The KLS 2.0, which allows the increased sharing of courses and the Operational Survey systems, which allows us to fully capitalize all these opportunities. There is a new path for value generation that we have blazed for the Company for the coming years and we are very optimistic with its outlook.

Another plan, we are accelerating in the Retention Program, which I stated at the beginning of this call. The Retention Program is a set of 20 projects for managing dropouts and the students retention with the aim of capturing important efficiency gains in the entire Postsecondary Education business over the coming semesters, and we are very optimistic with the opportunities that these products could bring for the company.

Moving on to slide 27, we emphasize that all the 380 projects are progressing, including those related to our organic growth, such as the opening of new campus and we maintained our outlook for opening 20 new campus per year.

Another highly relevant project is the rollout of the employability platform, the Concecta Channel. We have already implemented the Concecta Channel at 70 of our unit with almost 60.000 students registered. We have more than 931 partner-companies and more than 4,000 jobs announced in this platform. In the near future, with the roll out to other cities and maturity in the current cities Concecta Channel should become one of the country's primary employability platforms in Brazil, generating more employment opportunities for our students. This products serve to demonstrate that the Company's efforts to further increase its academical, operational and financial results.

I should also note that we have approved distribution of dividends of R$98.8 million to ensure a constant flow of distributions to our shareholders. And finally I also like to thank the market for its support and recognition which gave Kroton first place in six categories of the IR Magazine Awards including the Grand Prix for the best IR program among super large caps.

In closing, I would like to reaffirm a point that we highlighted last quarter, which is Kroton high capacity to adapt. We have shown that the Company is capable to generate value in the short and long-term by overcoming our diversities and delivering high quality education on a large schedule. Once again, thank you for participating in today's call and we will now begin the question-and-answer session. Thank you.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Ruben Couto of Itau BBA. Please go ahead.

Q - Ruben Couto {BIO 19172367 <GO>}

Good afternoon, everyone. Thank you for taking my question and it is related to FIES receivables. I think it was clear that the company received all that was due related to FIES receivables during the first half of this year and of course respecting the max new repurchase schedule. And Fred, I think he mentioned about this light uptick in FIES provisions due to the 6.4% price cap that happened this year and briefly on this subject, can you give us an update in the situation of students that were not able to renew their contracts due to this price cap and also to the block in the Internet system that students had to do to take part in?

We know there were some legal injunctions but yesterday we saw that institutions and MEC has seeming to have reached an agreement in increasing this cap to 8.5% and I just wanted to understand how does it affect your students -- students that R&D situations and what we should expect during the second half of this year in terms of revenue recognition, the FIES provisions based on the situation and also FIES receivables on the back of what MEC is going to do related to this issue? Thank you.

A - Rodrigo Galindo {BIO 17238232 <GO>}

Hi, Ruben. This is Rodrigo speaking. Thank you for the question. I will just start answering your question and then Fred will continue. About the Ministry of Education relationship and the possibility of agreement about the cap, just want to mention that, as we had meeting with Minister of Education one or two days ago and a proposal to solve the cap of 6.41% was present, but we discussed about the possibility to make a solutions of this case (technical difficulty) we don't have any formal decision from Ministry of Education, so it is very difficult to comment what should happen because we don't have any formal decision from Ministry of Education. So I'll hand over to Fred Abreu to answer the other part of the question.

A - Frederico Abreu {BIO 16674822 <GO>}

So let me explain what (technical difficulty) final results of either the injections or the negotiation with the Ministry of Education. So what we did on the first semester was to provision. We have basically two types of students starting from that. We have students that were able to renew their contracts without the cap because it was the time when the cap was removed. And we have students that were able to renew but with a cap, okay. Today, we do not have any pending students to renew. Some of them we were able to renew with a cap -- without the cap others we were not able to renew with a cap.

So all the students that we've renewed with a 6.41% cap what we did is we've constituted a provision, which is very conservative on the difference between our price adjustments and the 6.41% cap, okay. And this provision is basically constituted on two blocks, the first R$50 on the difference, we've provisioned 6.5% and the remaining on top of R$50 adjustment with provision 30%. So today we have a very conservative provision top of 6.41% on students that were able to renew, but with a cap.

For the future, what we may have is an upside because this 6.41% may increase to 8.5%, so this is positive. But what we do not know yet is what can we do with the difference on top on the 8.5%?So what we expect, trying to simplify, is we do not expect neither downside or an upside in terms of second semester because in ups and downs we think we'll be pretty much on the same level, if the 8.5% is the result of the negotiation since we already have a provision in ups and downs we should not have neither an upside nor a downside. But still, there is a lot of uncertainty on the final result of that negotiation.

Operator

(Operator Instructions) The next question comes from Rodrigo Gastim of BTG Pactual. Please go ahead.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

My question refers on the -- I was just wondering if you could provide us your view on how discretionary the Postsecondary Education in Brazil? I mean what are your qualitative opinion on how the overall market growth should behave in a scenario in which the disposable income going down, unemployment ratios are going up and how is the level of student's willingness to keep studying in this scenario? Do you already see any push backs from the students? Are you talking to them about it? So what are your views on this?

A - Rodrigo Galindo {BIO 17238232 <GO>}

Hi Rodrigo, it's Rodrigo speaking. Of course with the new scenario of low GDP growth activity and higher unemployment perspectives, we expect the reduction in the growth of the Postsecondary industry in Brazil. But we have a few signals yet about what should be this reduction of growth, but what we can provide is our qualitative perception about what will happen, we don't any science behind or supporting this perspectives, our perception about what will happen with the market. We believe that the market should to grow in a low portfolio [ph] for the following years and we believe Kroton could grow a little bit more than the market because we believe we'll have more efficiency than the average and we can capture and gain market share going forward.

So this is our perspective of all the market, low level of growth around the same level of the demographic growth between 2% and 3% is the best guess we have now and we can grow a little bit more than this. We are talking about base of students not about intakes.

The base of students overall -- in all will grow a little bit in the market and a little bit more in the Kroton. That's our best guess and Frederico will comment a little bit more about our perspectives.

A - Frederico Abreu {BIO 16674822 <GO>}

And to compliment, I think there will be some mitigates, let's call it this way, in terms of -- to mitigate this down scenario. The first is related with government funding and government financing over the last five years. The growth in the enrollments, the new enrollments was non-related with the economic growth because of FIES. So we have today FIES that is much smaller than FIES last year, but we do not think this will be sustained over the next five or 10 years.

There are discussions and we are initiating discussions with the government towards our associations to increase the size of FIES creating what we are calling FIES 2.0. We do not have yet any expectation on timing, but we are dedicated to help government expanding the size of government funding. The second, we probably see private financing initiating. We are working to implement our own solutions of private financing but we think this will be a trend in the industry, the development of private finance solutions.

And maybe the third, as Rodrigo mentioned in the Portuguese call, we will work for the new formats, which we already have, but we may roll it out to a larger number of schools -- students, which is the blend of learning. Today we have the two extremes of offering. We have the face to face and the distance learning, but there are -- there is a mid points in terms of face to face and distance learning which is blended, which is more than 20% of online, although I call -- it's less than 80% on-site and more than 20% remotely.

We already have this blended format in some of our courses such as a distance learning engineering and we think there may be an opportunity to introduce this type of blended learning, which is a product with a lower price and the same type of profitability for the Company.

Operator

(Operator Instructions) The next question comes from Ian Simmons of Charlemagne. Please go ahead.

Q - Ian Simmons {BIO 6360521 <GO>}

Can you just talk about your outlook for pricing over the next 12 months? Do you see a scenario with a smaller FIES that universities will compete on price for the remaining students who have to pay out of pocket?

A - Frederico Abreu {BIO 16674822 <GO>}

It's Frederico. Thanks for your question. So what are we seeing today in -- dividing face to face and distance learning. In face-to-face, we are not seeing today a price competition. In face to face, it's true that FIES was an important product that migrated some of our students to more expensive courses, but we are not seeing today a price war or a price competition in face-to-face. What we may see in face-to-face is -- maybe in the next 12 months or (technical difficulty) have and we do not know if this is going to happen is the migration towards lower ticket courses on onsite.

In Distance learning, we also expect to increase by inflation, but what we are seeing is in some series where we operate a higher level of competition. This is not generalized, but this is punctual and in this specific series where we have special campaigns, special promotions from our competitors, we respond and we respond punctually case-by-case, city-by-city where we'll see this is a need. But we are not generalizing these discounts or scholarships in all series in Distance Learning or in some cases in specific, okay?

Q - Ian Simmons {BIO 6360521 <GO>}

Okay, and if I can ask one more. I'm sure you maybe -- you addressed this on the earlier call, but can you just give us an update on the intakes for the second half?

A - Carlos Lazar {BIO 17238206 <GO>}

Hi Ian, this is Carlos speaking. Well, as we said, I mean the intake process this year is really not in the same line in terms of agenda. So it's rescheduled, it's not as a same as last year. So, we never gave guidance of intake process at this time of the year for the second half. So we'll wait some more time to review results and announce at the beginning of October.

Q - Ian Simmons {BIO 6360521 <GO>}

Okay, thanks.

A - Rodrigo Galindo {BIO 17238232 <GO>}

Yes, just to compliment and it's Rodrigo Galindo speaking, we have, maybe one information that gives a little bit more color about -- our perspective about base of students. We are not expecting, in any case, the reduction of base of students between the first -- the end of 2015 comparing with the end of 2014. So in the base of students we are really comparable, we will not have a reduction on this number.

So we still have one month on delay of this schedule. That's why we are not commenting yet. We are in the early stage in the process, even considering that we are in the end of August. For the intake process, we still have at least five or six weeks to continue making new enrollments so it's very early to provide any info, but we have another information and is very strong that is, we announced that guidance around R$1,930 million of EBITDA margin and even in the worst case scenario, we are really, really comfortable that we will deliver this guidance in 2015 and we know that with the results that we provide in the second semester and with the perspective for the second semester, we have space to delivering more than this.

So we have opportunities to deliver more than this, more than the guidance in EBITDA and more than the guidance in net profit. So we are comfortable with this numbers. We are very comfortable with the guidance that we already provided and we know that we have a lot of opportunities to surpass this guidance okay.

Operator

This concludes 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. Please go ahead.

A - Rodrigo Galindo {BIO 17238232 <GO>}

Okay. So thank you everybody to participate in this call and our IR area is available for more questions. Thank you very much.