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Q2 2020 Earnings Call

Company Participants

- Bruno Giardino, Investor Relations Officer
- Jamil Saud Marques, Chief Financial Officer
- Roberto Valerio Neto, Executive Officer, Kroton
- Rodrigo Calvo Galindo, Chief Executive Officer

Other Participants

- Felipe Pascowitch, Analyst
- Marcelo Santos, Analyst
- Mauricio Cepeda, Analyst
- Samuel Alves, Analyst
- Susana Salaru, Analyst
- Thiago Bortoluci, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. Welcome to Cogna Educacao's Second Quarter 2020 Earnings Conference call. We would like to inform you that this event is being recorded and that all participants will be in a listen-only mode during the Company's presentation. After the Company's remarks are complete, there will be a question-and-answer session for analysts and investors. At that time, further instructions will be given. (Operator Instructions)

Also, today's live webcast, both audio and slide show, maybe accessed through Cogna Educacao Investor Relations website at ir.cogna.com.br, by clicking on the banner 2Q webcast. The following presentation is also available to download on the Company's website. The following information is available in Brazilian reais in accordance with Brazilian Corporate Law and Generally Accepted Accounting Principles, BR GAAP, which now conform with International Financial Reporting Standards, IFRS, except when otherwise indicated.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Cogna management, and on information currently available to the Company. They involve risks, uncertainties and assumptions because they relate to future events and therefore, depend on circumstances that may or may not occur in the future. Investors should understand 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 Cogna's CEO, Mr. Rodrigo Galindo, who will begin the presentation. You may proceed, Mr. Galindo.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Good morning, everyone. Thank you for participating in today's call to discuss the second quarter 2020. With me, Bruno Giardino, our IR Director; Jamil Marques, our Finance VP; and the Managing Directors of each unit, Roberto Valerio, Kroton; Paulo de Tarso, Platos; Paulo Serino, Saber; and Mario Ghio, Vasta.

I'd like to begin today's presentation from Slide 4, with an overview about the first half of 2020. Where we see a neutralization of quarterly seasonal effects. Recurring EBITDA growing except for graduation Kroton, so Vasta, Saber and Platos had a good performance, even with the impact of COVID, but Kroton was pressured by COVID and the graduation of FIES. Now here, we see a positive post CapEx revenue in the second quarter 2020, so relevant positive performance considering all the pressure on operating results, solid cash position, adding BRL3.7 billion in the second quarter 2020, with a long-term debt profile. We will provide further details during the presentation. These BRL3.7 billion, do not yet include the IPO proceeds concluded early this month.

In the central portion of Slide 4, we have a table with net revenue evolution and recurring EBITDA in each unit, plus the behavior of the recurrent EBITDA margin, considering the pro forma view on Kroton and Vasta. In Kroton, we had a relevant volume impact with the graduation of FIES students. We also had new enrollments and renewals strongly impacted by COVID, and we had to reinforce our provisioning also because of COVID-19. So we had a 25% reduction in net revenue and 43% in recurring EBITDA, with a drop in EBITDA margin for Kroton. The negative impact of Kroton was concentrated in in-person education, and during the presentation, we will talk about the future and how to improve this performance in in-person programs.

All the units had a good performance. We had 23% -- Saber going up 12% in net revenue and 23% in recurring EBITDA. Cogna had a drop of 19% because of the impact of Kroton, and a drop in margins, because Kroton has a great weight -- has a lot of weight. So this is the analysis of the first half of 2020, three units did very well, but Kroton had a negative performance, concentrated in in-person programs.

In Slide 5, I'd like to show you perhaps the most important moment in the digital transformation of the Company. So let's focus on this slide, showing the Company's strategy for the next quarters. For a few years, we have been very clear and transparent in our perception that we are going through a strong digital transformation since 2017. We needed a cultural change, first of all, so that we would have a deeper change in business. And 2017 and 2018 were important years for us to build this no frame of mind.

We implemented a cultural change, including technology and business. We provided more agility to operations, and this was essential for us to enter new segments. So we were able to acquire Somos, working on K-12 and B2C and B2B. So between 2019 and 2020, we came to a second phase of the digital transformation, which was on K-12 digitalization, creating the platform concept and working on B2B and K-12. What was the result, we were able to build a Platform-as-a-Service, with a strong demand and we will talk about this demand.

But regardless of the result, we had from the IPO or the proceeds of the IPO, the fact is that we now have a platform, which helps us provide services to third-party units, help them in their digital transformation, and we have a huge growth potential in K-12. This year, we have a new phase, which is the digitalization of post-secondary. We see a migration of demand towards digital and this was accelerated by the pandemic. We believe that the changes brought about by the quarantine will not be only circumstantial, but structural. We have overcome the cultural barrier of digital post-secondary studies, students now see the value, the quality and the benefits of lower cost and flexibility in digital programs. So that will help us to start a new journey of transformation in the Company, which would happen naturally, slowly, however, it's been accelerated because of the pandemic.

We now view post-secondary in two clear segments that have very different opportunities for us. The digital platform of post-secondary education, and let me talk about that first. So it includes all offers of distance learning for end consumers, so B2C with or without in-person activities using third-party centers or our own units. In addition to solutions that provide content and technology to other institutions of higher education, we have high operating margins in this operation, low use of fixed assets, low use of working capital, so a strong cash generation and high growth prospects. Because of the moment we live in digital programs in the country, our focus here is growth.

On the other hand, we have the second segment which is Kroton in-person programs, including all in-person graduation programs, which will require restructuring. This restructuring has started to adapt to the new market reality. The number of students already show a migration from in-person to digital, and this will be accelerated by the pandemic. The change will be quicker, so we will be even more agile to restructure our operations for this new reality, that will include a reduction in the size of operations, renegotiation of contracts, reduction of units, repositioning our portfolio, focusing on premium programs, focusing on these premium product -- programs. So in-person programs will be these premium courses so that we will have more cash generation and stronger margins. This is a very relevant moment of reorganization in the Company, and we will provide more information in the future.

Now moving on to Slide 6, we provide some additional details. On the left side of the slide, you can see the digital platform for undergraduate and graduate programs, including B2C distance learning degrees that is the offer to our students directly to end consumers in third-party centers and also in Kroton's in-person centers. And this platform also provides B2B and B2B2C distance learning degrees and digital services in B2B and B2C models. That is in addition to digital B2C digital programs, this is a complete service platform for B2B and B2B2C.

Now, these services have a growing participation in our net revenue, last year 26%, and now this year, 32%. And we believe this growth trend will continue, we'll see more digital in our net revenue. The tickets are smaller, but the share is growing because this platform is growing much faster than in-person activities, and we believe the pandemic will only accelerate this process.

Now, we see two great opportunities. So the first one is, distance learning degrees B2C, that is our direct offer to end consumers. But we will also accelerate our growth on two fronts, first, the organic growth of our current centers. Since we are migrating students to digital, we will no longer provide all programs in in-person education because students are choosing to migrate to digital, so this is an opportunity for organic growth. The second growth front is the maturation of centers that were implemented a few years ago. So this has already contracted growth, its natural maturity. And the third lever or front of growth will be new distance learning centers. We now have seven work fronts open to ensure that we will grow in the number of centers.

But we also have a second opportunity of growth, which is to strengthen the concept of Platform-as-a-Service, which was successfully implemented. How do we do that, offering complete -- offering the complete end-to-end solution, distance learning undergraduate and graduate programs to support smaller institutions and also K-12 schools in their digital transformation.

Now on the right side, we talk about in-presence activities at Kroton. So -- but Kroton will also become a distance learning center and what are the services provided. Kroton has a smaller share of the net revenue because the digital platform is growing, so it was 74% in 2019, and it came down to 68% in the first half of 2020, and the trend is that this share will be further reduced because digital is growing faster.

Now here we have some important opportunities. We will restructure our in-person campuses, [ph] renegotiating contracts, restructuring and unifying units, and also provide more distance learning -- a broader distance learning offer because the digital platform is growing and its revenue share is also growing. The other relevant movement we see is repositioning our in-person portfolio focusing on premium programs. So in-person activities will be the place for premium programs, more basic programs where we have a reduced demand, we will see this migration towards the digital platform, keeping at Kroton, they more premium programs. So it makes sense for the Company to study potential acquisitions of in-person educational institutions, providing they have premium programs such as medicine. Our goal is to have a premium portfolio for in-person education that is profitable and can generate cash.

Today we see hybrid programs, but the pandemic has actually changed this scenario. We had a positive growth and going from cash consumption to neutrality and with the prospect to have positive cash generation in 2021. Smaller units also suffered because of the reduction of FIES students, but the trend was positive for 2021. However, the pandemic changed the scenario. So students who used to resist digital programs, they now prefer distance learning. That is the barriers that students had are no longer there. So today, it makes more sense to take these students to help them migrate to digital.

So at higher education, we have the digital platform plus in-person premium programs, and these will be working together with a different focus on the digital platform, growth is the name of the game, and in-person Kroton we will need to refocus on premium programs. But some of the assumptions will be protected, we shall not lose synergies in the process. Secondly, we will keep the operating capacity using the omni-channel concept that is for customers, it will be transparent, no matter what channels they use. All in-person Kroton can be will start working as distance learning centers. We are taking advantage of this change to make the most impactful change in higher education, preparing our higher education for this new phase.

Slide 7. Now, we have some news about our operation. Let's go back to the concept of PEP. It was the partial -- Private Special Installment program we set up in 2015 to provide credit -- student credit because FIES had a smaller offer. So that was a transition product. From FIES, public financing program of high volume and FIES had that drop, so we needed PEP for this transition because there was a demand for those in-person programs. However, the market has evolved and commercial processes have also evolved, and PEP became less relevant. As you can see on the chart, it came down from 29% of new renewables to estimated 6% in the second half of 2020. So at the moment, when PEP was created, it was the only way to provide credit to in-person programs.

Today, our portfolio or practically all of the portfolio is also provided as distance learning, so it makes more sense to provide lower tuition that students can pay for and for the Company it's also better because although the average ticket is smaller, we have higher margins and we have a reduction in accounts receivable. So facing this scenario, we decided to close down PEP in new enrollments as of 2021. But students who are currently using PEP will continue to have the product until they graduate. So these two factors have led to discontinue PEP as of 2021. We have an equivalent portfolio in distance learning that we can offer to students, so we will not lose these students. And also today, there is a clear acceptance of digital programs by students. And so PEP lost relevance. For this reason, we decided to discontinue PEP as of 2021.

Now Slide 8. Let us talk about the IPO -- Vasta IPO, which was successfully concluded after one year of intense dedication, we listed 24.9% of the Company at NASDAQ for $405 million, the largest IPO of an education -- of a Brazilian education company. The price was $19 above the indicated range between $15.5 and $17.5, and we've had 15 times higher volume than what was offered with 280 orders, generating cash and working as a complete platform of products and services, positioned to support the digital transformation of Brazilian schools.

With that, I'll close the first part and give the floor to Bruno Giardino, our IR Director to talk about finance in the second quarter of 2020.

Bruno Giardino {BIO 21658408 <GO>}

Thank you, Rodrigo. I would like to turn now to Slide 10, where I will present the results of verticals, Kroton and Platos. Starting with Kroton, in line with what we did in the previous quarter and also for comparison purposes, we excluded from 2Q 2020 results, the deferred revenue of BRL75 million from the late enrollment curves, besides the complementation for out of pocket PDA and PEP/PMT of the pandemic, BRL93 million and BRL229 million, respectively.

In this context, net revenue saw a reduction of 27%, owing to decrease in the student base and lower on-campus ticket, reflecting FIES students' graduations and the impact of the pandemic in new enrollments. These effects were partially offset by the increase in the digital students base, following the reacceleration of the new enrollments. Recurring EBITDA for Kroton dropped 36% as a result of the reduction in revenue and dilution of fixed costs and expenses, resulting from the substantial reduction in operating and corporate expenses, resulting from the Company's pandemic emergency plan and sales and marketing expenses. It's important to note that no judgment sort of faculty costs were made in the first half of 2020 in view of -- the loss of revenue caused by the pandemic.

Moving onto Platos, net revenue followed the positive trends shown in 1Q 2020 growing 8.5%, reflecting the increase in the average ticket and new enrollments whereas recurring EBITDA dropped 3%, impacted by the seasonality of expenses, especially marketing as we had anticipated last quarter. However, we saw an increase of 23% in recurring EBITDA in the semester with a gain of 4 percentage points.

Moving onto Slide 11, let's look at the numbers related to our K-12 operations. Starting with Vasta on top side of the slide, there was a reduction of 24% in net revenue because the billing cycle was moved forward to initial months after the commercial cycle. Additionally, there was a reduction in orders placed by partner schools that had higher dropout rates, mostly in early childhood programs because of the temporary lockdown of schools and also because of the sales slowdown in (inaudible) physical stores.

In the semester, Vasta posted growth of 9%, in line with what was indicated in Vasta's IPO prospectus. As for subscription revenue, it increased 16%, in line with ACV growth for 2020, discounting the BRL40 million that was announced as a material fact. Similarly, as in the last call, we showed the numbers of 2019 considering editorial expenses in COGS, and we also excluded the provisions for variable compensation. In relation to the levels of 2020, we excluded some extraordinary impacts such as the investments to face the current moment, the INSS expenses and the adjustment relating to our e-commerce. So in the pro forma basis, there was an increase of 10% in recurring EBITDA.

And moving to Page 38, we see a comparison of the numbers shown with the Vasta numbers. And in the second quarter 2020, Saber posted a decrease of 12% in its net revenue, coming from the impact of the pandemic, especially in freshmen yields in the counter shift. And also, there was the renewal or non-renewal of two contracts besides the revenue reversal. So there was an increase in -- of 34% in recurring EBITDA and the reduction of costs and the emergency measures taken during the quarter.

Finally, moving to Slide 12, let's analyze the results of other businesses and consolidated Cogna results. In the segment of others, we classify editorial expenses as cost of goods sold. The absence of revenue is coming from the National Textbook Program, also, was detrimental to the comparison. Considering all the effects for Cogna consolidated results, we see a decline of net revenue and EBITDA in this quarter. This was the impact of the Kroton vertical and also the seasonality that's different in Vasta. Year-to-date, we saw a reduction of 19% in net revenue and 33% in recurring EBITDA.

With this, I close this session. I invite our CFO, Jamil Marques to continue.

Jamil Saud Marques {BIO 21416820 <GO>}

Thank you. Moving on to Slide 14, I would like to give you some details on accounts receivable, coverage ratio and the average term of receivables of our companies, together with Cogna consolidated results. As we can see, we have adequate coverage ratios and average term of receivables under control for each operation. The increase of eight days as we see in Cogna, consolidated comes from Kroton, and this is something, I would like to detail on Slide 15.

Moving on to Slide 15, to the left side of this slide, we've broken down the numbers between payment plans out-of-pocket and FIES students, making it clear that all products had an increase in coverage ratio in the annual comparison. During this quarter, we observed a slight improvement in timely payments, which generated cash in the quarter. However, late payments deteriorated significantly, leading to a need to make and disproportionate increase of out-of-pocket PDA also to face the aging of the receivables portfolio because the older the debt, the higher need for coverage for losses.

So if we make a comparison, the PDA for out-of-pocket jumped from 16.1% in the first quarter '20 to 24.4% in 2Q '20, and in the annual comparison, the increase was also significant. However, it's important to note that the reduction was above 20% in net revenue, and this, of course, impacts this indicator. If we look at the coverage ratio in accounts receivables for out-of-pocket, this indicator reached 32.2% in 2Q '20, a slight increase in comparison to 31.6% in the first quarter '20, and more relevant increase in relation to 2Q '19 with 17.1%.

Considering the payment plans students, the worsening of the payment in delay and also the increase in dropout rates, consider also in the framework of long recovery period after the pandemic, led us to revise the premises for the coverage for PEP and PMT, anticipating a higher participation of dropouts and also deterioration in the recovery of those dropouts students. As a result, we increased PDA for those products to 58% over the receivables balance, or over the total revenue adjusted to net present value. And this created an impact accounting of around BRL229 million.

And finally, to the right of the slide, we see that the payment plans average time of receivables follows the expected maturity with a reduction of 6% in the annual comparison, reflecting the increase in provisioning.

Now turning to Slide 16. We take a look at the evolution of CapEx, investments and cash generation. Starting with the left side of the slide, CapEx and investments and expansion, totaled BRL89 million in the quarter, representing 6.5% of net revenue, with a reduction of 3.4 percentage points in the annual comparison since the Company closed the project for opening new units and now all this needed is to expand new units. It's important to remember that these results also had the impact of the action plan because of the pandemic that led us to revise some of the investments that were not considered sustainable for the business.

Now, going to the analysis of cash generation and not considering the receivables of the amounts from the escrow account related to the National Textbook Program of 2Q '20, we had cash generation after CapEx and investments of BRL57 million in 2Q '20. This is a very relevant and positive result, considering the drop in EBITDA that reflects a lower consumption of working capital.

Finally, let's turn to indebtedness in the quarter, moving to Slide 17. On the left side of the slide, we show our solid cash position and leverage in the quarter with BRL3.7 billion in cash as a benefit of the closing of the three-fourth [ph] of the escrow account of Somos in June. But still, we are not considering the remainder of this escrow account. To the right side of the slide, we see the amortization schedule. And our next disbursement will be due only in 2021 August.

With this, I close this part of the presentation. I invite Rodrigo for his final considerations.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Jamil. I have some final considerations in each business unit on Slide 19. Beginning from Kroton, new enrollments for 2020 second half is 100% digital. We see the same trends we saw in the first half of 2020, the first half of this year more pressure on in-person programs and growth on digital programs. Renewals, we may have an impact because of more restrictive negotiation policies to be able to protect our PDA and average days of accounts receivable. We had this policy of clusters established in 2018, and we see a clear trend towards more flexibility for students that have capacity to pay and less flexible with students that have less capacity to pay because they generate less cash. So we prefer to be less flexible with these students they will not be able to afford to continuing with those -- with their studies. And so it helps us to be more flexible with other students that have this capacity to pay.

In terms of Kroton, I think we spoke about our digital transformation already, I mean today. But we will provide more details about this because I believe this may be the most important initiative we have in the Company and we'll talk about that in the next Cogna Day, which will be announced soon. We saw a relevant migration of students to digital also, in Platos, not only in graduation -- in undergraduate, but also in graduate programs. We had a growth of 23% in new enrollments in the second half of 2020, and we believe this trend will continue.

Now, Platos ex Kroton clients base expansion, [ph] we already have contracts with third parties in advance to negotiations plan to start in 2021. Now, Saber, despite the isolated dropout we saw in freshmen years and in-person activities out of school hours, the digital school has ensured the continuity of our operations in our own schools. And the process of synergy and efficiencies capturing is evolving as expected, even considering the effects of the pandemic.

At Vasta, we believe the dropout in the first year is also an isolated effect, and students will be coming back to school as their parents go back to work in-person. So that is included in the 2021 ACV. Also about the 2021 ACV, we have exceeded our target in the first half of 2020, and our digital platform that has today more than 50% of the web traffic of K-12 education in Brazil and it has become an essential competitive advantage for us. Now, considering the IPO proceeds, we will be able to accelerate organic and inorganic growth, contributing for this positive moment we expect for Vasta in the next few years.

Finally, other business. Our processes for the National Textbook Program 2021 are evolving as expected. My final message, I believe it's important that three units are performing very well, three units of the group out of four. We do have a performance problem with Kroton, especially with in-person programs, and this is because of the combination of a reduction in FIES students, plus the impact of COVID. We will accelerate the digitalization of post-secondary and higher education, and we will have an offer of premium programs for in-person programs and also the digital complete offer. We're going through a turnaround resizing initiative, which will result in more growth on the digital platform. This is a very important moment that will take the Company to a higher level. We will talk about there is some Cogna Day. We are prepared for all the change that is necessary to resume growth in graduate programs.

With that, I'll close, and thank you for participating. We now invite you for a Q&A session. Thank you very much.

Questions And Answers

Operator

Thank you, Mr. Galindo. Ladies and gentlemen, we will now initiate the question-and-answer session. (Operator Instructions) Our first question is from Susana Salaru, Itau. You may proceed.

Q - Susana Salaru {BIO 16170633 <GO>}

Good morning. Thank you for taking our question. First of all, I would like to ask about the end of PEP and also distance learning and digital. Are you feeling confident about the enrollments of 2021? What was going -- what is going to happen, for example, if the student cannot afford the on-campus program, they will go to distance learning (Technical Difficulty) and many times the programs are not as premium, so what is the tool for traction that you're going to use for distance learning? This is the first question.

And the second question -- well, it's about the shift in portfolio to something more premium, and what verticals could be approached as premium? Are you focusing on what programs exactly?

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

Hello, Susana. Here is Rodrigo. I will start answering and then -- well, in relation to PEP, this is something that's a natural movement. In some cases, it's far more encompassing than just taking the salespeople to sell. We will discontinue some programs, the more basic programs in on-campus, and with this, there is a natural migration to DL. And we believe that there is of course. a small loss of demand in this process because there are some students who prefer on-campus. But we believe that with the pandemic, the number of students refusing DL is declining. And since, of course, there is less working capital and the margins are higher in DL, even if the ticket is lower, it's something that's really worthwhile for the Company. So naturally, our sales force was not driven to drop, and this is already at 6% of the enrollment. So it's a natural process that is in place and there is a smaller portfolio of on-campus programs where PEP can be offered as well by our sales representatives. There are very few courses that we don't have available in DL.

When students realize that we have the two options both on-campus and DL, if they cannot afford a program that's over BRL700 on-campus instead of offering BRL350 in tuition with BRL350 in the payment plan, they will start to sell DL premium program with tuition fee of BRL350, which is something that they can afford fully. So this is part of our strategy and we believe that will be losing minimum demand because of this, because it's a different era now. And what has changed when we considered, for example, that we had 30% of PEP before today, we have an equivalent DL portfolio to offer to our students and students are showing less resistance. So all of this justifies the end of PEP without any risks.

And I'll turn it over to Roberto to answer the second part of your question.

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

Thank you, Susana, for your question. In relation to PEP, in fact, for almost three cycles, we have been working with our sales representatives, so that this enrollment to becomes less relevant, and we see this being shown in the numbers. Secondly, our sales representatives use a model that is more proactive rather than passive. So in the example, you gave us, we had this idea of student that comes to us because they want to take a program in odontology, but it's too expensive and they can't afford it. But this is an unlikely scenario because we use several actions and clusters and companies and in schools who have a profile of students that can afford an odontology program like that, we are acting more proactively. Also, our marketing team has been leading several initiatives digitally, including to focus on students who have the payment means available for our programs. And we have used dropout information to identify any regions and hotspots with credit-worthy conditions to afford for these programs. And I think it's important to say that we are acting less reactively and more actively with a focus on actions.

And going back to your second question, in relation to premium programs, of course, medicine -- medical programs are extremely premium, but we have around 15 programs that we consider premium and on campus. Here we're talking about the medical school, odontology, veterinarian science. It's a roaster of programs that are, you know, mostly on-campus with higher tickets, higher margins. And with the percentage of students both in our base that is still very relevant on on-campus.

Q - Susana Salaru {BIO 16170633 <GO>}

Thank you for the answers.

Operator

Next question from Samuel Alves, BTG Pactual.

Q - Samuel Alves {BIO 18720076 <GO>}

Good Morning, everyone. Good morning, Galindo, Jamil, Bruno, all directors. I have two questions. First, about your restructuring process, about which you will provide more details on Cogna Day. But now for new enrollments in the second half of 2020 and the first half of 2021, is this ready? I mean for the new enrollments, is the Company already working with this new operational model, which will probably make changes to the campy, [ph] reposition some units? This is my first question.

And my second question is about the cognize, I believe that you have -- sometimes in EBITDA, you have a clause of debentures. But I mean when I look at this, you have a difference exceeded by three times. So can you explain that to us, I mean what kind of adjustments will I have to make here?

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

Hello, Samuel. This is Galindo. Thank you for the question. I will answer the first question then Jamil will answer the second. But no, there was no such break, and Jamil will explain to you about the numbers we delivered.

The first question about the restructuring, yes, we are already working to make the portfolio leaner and working on this migration towards digital. So we have been studying this restructuring. For the first half of 2020, one, a good portion will be implemented, so for the first half of 2021, the restructuring will be partially implemented and the implementation will continue in the first half of 2021. I mean the pandemic caused a quick and big change and we have to react as quickly.

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

Thank you, Samuel for the question. This is Jamil. We closed net debt in 2.96 times, [ph] and basically adjusted EBITDA by sub-effects in the net debt including financial debt and M&A debt. Let me highlight, I think, it's important, our cash position is sound. We have a long-term profile of the debt. We are generating cash, the operation is healthy. And we continue with a view that we will not exceed the covenants, we will not break any covenants in the next few months. We closed the first quarter above 3 times, but we would need two quarters in a row so as to break the covenant. So we do see a challenge in the debt because we had a reduction in EBITDA because of temporary seasonal effects basically, but because of the expansion we will see in Vasta, we do not expect to exceed this limit of 3 times in the next quarter.

Q - Samuel Alves {BIO 18720076 <GO>}

Perfect. Thank you.

Operator

Our next question is from Mauricio Cepeda, Credit Suisse. You may proceed.

Q - Mauricio Cepeda {BIO 21783651 <GO>}

Galindo, Jamil, Bruno, thank you for taking our questions. I would like to speak about the turnaround. I know that you don't have the details now because we still have the Cogna Day coming. But in the last slide, you talked about digital transformation. But what are the other building blocks that you were going to attack in this turnaround than there are more traditional in a process like this? And also you -- do you envisage any other changes, anything else you have been changing besides digital?

And two questions, I'll try to be quick. Speaking about the medical programs, the market is starting to look a little busy. What do you see the -- how do you view the activities of other players? And what about your capital increase, why did you go in that direction?

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

Hi. I'm Galindo. I'll start and then my colleagues will complete. Well, basically, I think that the turnaround plan, there are two major things in it. First of all, let's talk about digital transformation, what does it mean for us. It's much more than just working with distance learning or accelerating our activities in this area. It's a new way of thinking about the Company and working on other segments, integrating technology to our business. It's a change in mindset that's started in 2017, and that enabled us to build Vasta.

To give an example, in Vasta, we acquired a company or part of a company became Vasta. And it was the best-in-class producer of K-12 materials in Brazil. So it was a company that produced excellent learning materials. And based on this company, we developed the Platform-as-a-Service, providing services and products related to content and digital solutions. With this, we intend to work on the K-12 distribution channel in Brazil, creating such a complete offering that whatever company that wants to distribute products or services to K-12 schools in Brazil, can use this platform because it's easier than trying to reach 6,000 to 7,000 schools. This is digital transformation for us. It's a new way of doing business and what do we intend to do now in post-secondary.

Today, we know that we have B2C in undergraduate and we are building the platform to deliver the other services, B2B and B2B2C. Platos began this process and they are growing B2B2C in undergraduate programs, and starting to sign the first contracts in B2B2C with smaller institutions that don't have a scale to go through the digital transformation, providing to them everything they need to become digital. And this is a process that doesn't impact Kroton alone.It impacts the entire industry. But Kroton has the scale to promote digital transformation and the necessary investments. And we want to become the provider of choice for the smaller educational institutions that cannot fund their own digital transformation systems.

And of course, this is a huge change in perspective and it could really overhaul the face of education in coming years. The support that Vasta gives to digital transformation of private schools in Brazil and the post-secondary platform wants to give to private post-secondary institutions in Brazil. And this is of course our B2B platform.

So let's understand the digital platform as two deliverables. First of all, grow B2C undergraduate programs that are currently being offered and that will grow because there is this migration going on. And the second block is a platform of digital services that will support schools and post-secondary schools of small and medium-sized to complete their digital transformation just like Vasta does with K-12 in Brazil. And of course, here we're speaking about the digital world. And on-campus, it's a totally different story. We have turnaround repositioning. It's a game that we have played before in capturing synergies from acquisitions, renegotiating agreements, condensing campy, and as I said, with the pandemic, this need has become more pressing and we'll try to obtain the results as quickly as possible.

In relation to medical programs, yes, we are considering going into this market. In fact, we are currently evaluating potential assets. We have four schools of medicine, there are excellence [ph] in their regions with a few hundred openings in programs. And so for us, it's not only medical, but it's a group of 15 programs and all, but certainly, medicine is one of them. So we will be analyzing potential acquisitions in this area.

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

Thank you. Going back to your last question, Mauricio, about the authorized increase of capital after the follow-on. What we want is to give more flexibility to some of our strategic products.

Q - Mauricio Cepeda {BIO 21783651 <GO>}

Okay, very well. And what about the turnaround considering your experience, what do you think is a viable horizon for any change of direction in the earnings results?

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

Well, we started planning the turnaround three months ago. We have been dedicated to this. But we believe that the execution will start in the fourth quarter 2020 and first quarter 2021. So there are some activities that will take longer to be implemented, but most of the actions may be implemented in one single shot. And whatever we can do with one stroke to accelerate, the capture of benefits us, what we'll do. And this is something that we have been doing in the different integration processes, and we'll be using the resizing and turnaround competencies. We have to turn around our own operations from on-campus that has been impacted by something that is external to our will, the pandemic.

Q - Mauricio Cepeda {BIO 21783651 <GO>}

Thank you very much, Jamil and Galindo.

Operator

Our next question comes from Marcelo Santos with J.P. Morgan.

Q - Marcelo Santos {BIO 17186991 <GO>}

Good morning, everyone. Thank you for taking my questions. I have two questions. First, I'd like to speak about M&A and your strategy. Given your change, especially the change towards more premium programs on-campus, what has changed compared to the strategy you announced early this year when you said that to better the assets and you had that focus on growing margins, and trying to focus more on premium program, so what has changed in that strategy?

And my second question, I'd like you to speak a bit more about Kroton, what happens to the image outlook? I mean not only guidance but what happens to margins, thinking about -- perhaps a more complicated situation on new enrollments and renewals. But you already know the results from the first half, where you had a stronger performance on digital programs. So, I'd like you to give us some more color on Kroton.

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

Hello, Marcelo. How are you? I'll begin and then Jamil and Roberto will also add. First about M&A. Look, the Company was set up and generated a lot of value through M&A, so we are always looking at M&A. However, today, we have a clear movement of having more premium programs provided on-campus. So this is our focus. Of course, we do not ignore other possibilities, but everything that is more premium will deserve more attention right now.

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

Okay, Marcelo. I'll begin talking about expenses and then Roberto will talk about revenue. But we will have our margins pressured because of PDA, but we still have an important offer of programs in the second that is we had a temporary impact because of infrastructure cost. Part of that was captured in the second and third quarters, also workload. Now for the second half of the year, and because of the pandemic, we were able to optimize workload, and then corporate expenses. We are already preparing to have lower expenses. We will see that already in the third quarter.

Now for next year, we will have the reorganization of Kroton, which will certainly bring a positive impact. And then, will -- PDA will continue to exercise pressure. Although we have a good portion of payments on due date, we have some default backlog, which will still have an impact. And Rodrigo mentioned that, especially for students have a lower cash generation and a high debt. So that will continue to exercise pressure on our margin.

Now, Roberto will speak about dropout and a few other issues.

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

Hello, Marcelo. Now let me add talking. About revenue, we have those effects that we mentioned. We have more enrollments for distance learning programs. All the enrollments are now 100% online, but premium programs are also growing. In distance learning, we continue to work very strongly. We are no longer providing discount. We are not engaging in the price war. We know some competitors are, but there will be an impact on volume in -- especially, in on-campus programs for the second half of the year.

Now renewals, as I told you, out-of-pocket students have a high rate of renewals actually, above-expectation. But those that had problems of payment or default, the performance is not so good. So although we have pressure on the revenue, the cash generation in the mid-term will be benefited, as Jamil mentioned.

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

Now, Marcelo, this is Rodrigo again. Let me add that we must keep in mind, you know, about the second half of this year at Kroton, the turnaround movement will generate impact, and that will be seen in the numbers. So if we change the address of a campus, you have acceleration of that real estate depreciation. So the restructuring will certainly create impact, and it will certainly not add value. But we will have to conduct these initiatives that will generate cash in the mid-term and in the long-term, even though we may have a negative impact in the short-term.

My message to you is that we're doing things we are certain are the right things for the Company at this time. We are less flexible with students that generate less cash. And we take on the risk of perhaps having more provisions and having perhaps a higher dropout rate. We are taking on this responsibility of reducing on-campus programs because the pandemic will do that anyway, and we want to anticipate this movement so that we will conduct this restructuring in the swiftest possible way. And we will focus on digital platform and distance learning because we believe at the end of the day, these initiatives will help us generate more cash. So this is our strategy. This is what we believe will generate cash in the mid and long-term for the Company.

Q - Marcelo Santos {BIO 17186991 <GO>}

Thank you very much.

Operator

We continue with Thiago Bortoluci, Goldman Sachs.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Hello. Good morning. Thank you for answering my questions. I have three of them. In relation to PDA, our understanding is that in comparison to PMT/PEP [ph] should have a higher limit because of the fact that it's a long-term loan, but the ratio of PMT increase much more than PEP. So if my understanding is correct, we need to understand if this PMT disproportional increase could represent also an increase in PEP along the second half?

And the second question is in relation to distance learning. With the establishment of the legal framework, we have seen an increase of hubs, especially in your direct competitors' companies that are well structured to compete in this segment. And considering the leadership, you have in distance learning, what is the management strategy to hold on to its market share and what could be the impact of this on return ticket? And now we have a technical point related to Vasta, we would like to ask whether there would be a discount of recognition of revenue between Vasta and Cogna?

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

Well, thank you, Thiago. Jamil, Roberto and Bruno will be answering your question.

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

Good morning, Thiago. I am Jamil. To speak about PCLD, the answer is no. Basically, what we do with the PMT that we have, we use the best estimates we have available about PEP 58% for both sides. You probably have seen that a long time, the coverage of PEP/PMT showed a different perspective. And now we are putting both of them at 58%, but this is not in any indication that we'll be changing the PEP ratio. What we saw is a deterioration of dropout, and since we have some delayed payments, there was a significant increase in the PDA for drop out students. This is what led us to put those at the 58% ratio.

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

Thank you, Thiago for the question. In relation to DL and our competitors and our strategy to increase market share, I have a few relevant points to share with you. First of all, in relation to the increase of hubs with the new regulation, the competitors' ability to grow was natural because it's several players against one. So we will continue to grow our points of sales, and as such, we'll be able to capture more market share in locations where we don't operate yet. And secondly, with the volume strategy for 100% online programs, as we saw in the enrollment cycle of the beginning of the year with an increase of 25% in distance learning, this creates, of course, an important weight for 100% online. There was also an increase in the online premium programs, engineering, medical, in the hubs, we know that there is a limitation, because of the number of labs. And we're working very hard to be sure that the centers can have more laboratories and we want to create also some virtual labs so that we can increase the offering available.

Secondly, we give unconditional support to our network of centers. I think that they went through the worst of the crisis, and they had to face many simultaneous competitors all at once, starting in 2017. And our network of hubs is feeling very excited now that they've left the market. And this is the basis of our growth to grow through this network that's strong now.

A - Bruno Giardino {BIO 21658408 <GO>}

Hello, Thiago. Here is Bruno. Good morning. Thank you for your question. It's important to remember that the financial statements of Cogna and Vasta are done by different reviewers and they were done in different times as well. This creates some changes in terms of the timing for recognition of revenues considering quarters and sometimes even semesters. But if you observe the Cogna release, Page 37 and Page 38, there is a conciliation there explaining the differences. And when you look to the first half of the year, you see that there are no longer differences in the consolidated results between Cogna and Vasta. And this is how it should continue in the future because now the audits will be taking place on the same date. There will be a residual difference which is the surplus of stocks that still seen as a cost in Vasta, but this will no longer exist in 2021, so we will see a convergence in the numbers from now on.

Q - Thiago Bortoluci {BIO 20909105 <GO>}

Thank you very much.

Operator

Okay. And now Felipe Pascowitch from Mirae.

Q - Felipe Pascowitch {BIO 21468688 <GO>}

Good morning, gentlemen, and thank you for this opportunity. Two questions, first about Kroton. So this strategy for Kroton, this restructuring, so migrating from on-campus to digital and keeping premium programs on-campus, I'd like to understand, I mean, I can imagine there must be a breakeven, I mean reducing the size of your on-campus portfolio and increasing your digital portfolio. Can you give us an idea in terms of numbers of students, so we can understand this movement because I believe you will be losing top line, but you will gain margin, so there must be a breakeven point to reach a balance there.

About Vasta, I'd like to understand, I mean, looking at Bloomberg's numbers, we can see that the holders of Vasta, we have two big holders of Vasta. Apparently the stock, I mean since it was listed, it has never had a very good performance. Now do you think -- do you know why? I mean, I know that's something recent, but I mean to look at your [ph] Vasta today is quite low, so I'd like to hear your views about this. Thank you.

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

Hello, Felipe. This is Galindo. I will answer your first question then Bruno will make comments about the second. Yes, you're right, I think -- you know, there are some very detailed analysis to try and understand when it would be worse for each portfolio. So to have only distance learning and then close our on-campus portfolio. But this analysis cannot be done looking at each program. You have to look at the overall geographic offers. So that's why we've been planning on this for three months. We have to prepare 176 strategic plans for each location, and in each location, the premium portfolio may differ from that of another city like for instance, in Cuiaba, overhead or the business program may have a high demand. So in that marketplace, this program has a high demand, so it has a premium price. However, let's look at another marketplace, Vitoria de Santo. [ph] Well, there may be the business program has a lower demand, and so in that location, we may shut down the on-campus program although, we may lose a bit of demand and then migrate to digital because that's where we will have high margins and high cash generation to offset the loss we might have in on-campus programs.

So it's quite complex. That's why we've been dedicating to that for the last three months. It's 176 different business plans. But the assumption is one of the same that is, we will keep on campus those that add value and we will migrate to distance learning those programs that can add more value as a distance learning programs. So this is the assumption for all the 176 strategic business plans.

And now Bruno will make comments about your second question.

A - Bruno Giardino {BIO 21658408 <GO>}

Hello, good morning. Now about Vasta, our base is highly concentrated in long-term programs, so maybe this brings an impact on the stock. But as time goes by the market will become more familiar with the case -- with this case, and so I believe that will improve, especially with hidden debentures.

Q - Felipe Pascowitch {BIO 21468688 <GO>}

Right. This is what I wanted to hear. Thank you very much for the answers.

Operator

(Operator Instructions) If there are no more questions, we'll hand it over to Cogna's final considerations.

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

Ladies and gentlemen, I would like to finish the call saying that the Company is being very transparent in this time, in our strategic positioning, and I think that we can ensure that you put -- we put all of our energy in being agile, efficient. And like all companies in Brazil and the world, we were caught by surprise by the new behavior in students in this accelerated several of our decisions. And what we hope to do is to respond very quickly to this new behavior, to this brand new world that's being born after the pandemic. And very soon, we'll be announcing the day for Cogna Day in which we'll give you many more details about the restructuring of post-secondary, we believe that this is the right move for us right now. Thank you very much, and have a great day.

Operator

The earnings conference call for Cogna Educacao is now closed. We thank you all for participating and wish you a very good day.