Q1 2017 Earnings Call

Company Participants

- Carlos Alberto B. Lazar, Investor Relations Officer
- Frederico Brito e Abreu, Chief Financial Officer
- Rodrigo Calvo Galindo, Chief Executive Officer

Other Participants

- Bruno Giardino, Analyst
- Rodrigo Gastim, Analyst

Presentation

Operator

Good afternoon, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Kroton Educacional's First Quarter 2017 Earnings Conference Call. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After the company's remarks are completed, there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions)

Also, today's live webcast, both audio and slide show, maybe accessed through Kroton Educacional's Investor Relations website, www.kroton.com.br/ir by clicking on the banner First Quarter '17 Webcast. The following presentation is also available to download on the webcast platform.

The following information is available in Brazilian real, in accordance with Brazilian Corporate Law and Generally Accepted Accounting Principles, BRGAAP, which now conforms with International Financial Reporting Standards, IFRS, except where otherwise indicated.

Before proceeding, let me mention that forward-looking statement are based on the beliefs and assumptions of Kroton management, and on information currently available to the company. They involve risks, uncertainties and assumptions because they relate to future events, and therefore depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of company, and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Kroton's CEO, Mr. Rodrigo Galindo, who will begin the presentation. Mr. Galindo, you may begin your conference.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Good morning everyone and welcome to the earnings conference call of Kroton Educacional for the first quarter of 2017. With me today are our IRO, Carlos Lazar and our CFO, Frederico Abreu.

In today's presentation we will cover in detail our strategies and operational efforts that allows us to once again start the year by delivering solid results in a challenging scenario. Let's start in slide four by going over our more important operational filers: Student Base, Dropout Rate and Delinquency. In terms of our Student Base, we're very pleased to report the results achieved by our team and the effectiveness of our sales strategies, highlighting the strong growth and students paying their tuitions 100% out of pocket, as well the excellent acceptance of our installment payment products, specifically (inaudible). We enrolled over 112,000 new students in the On-Campus segment, which represents a strong growth of 10.4% and was achieved through our continual efforts to improve the quality and the educational we really offer. We know that education is a long-term cycle and all the seats that we implemented in the company three, four years ago we are getting the benefits now. The quality is starting to be pursuant for the students and it's been easier to capture new students.

New enrollments were supported by the Private Special Installment Plan or PEP, which was used by 31% of new students, a level little bit below the next -- the last semester, sorry. So despite the highly challenging macroeconomic environment marked by recession and raising unemployment, we were able to deliver a very solid result ending the first quarter with an On-Campus Undergraduate Student base of 434,000 students who are only 0.7% fewer than a year earlier.

In the Distance Learning Undergraduate segment, we posted a strong growth in new students in the quarter of 11.4% in large part supported by the launch of new academic programs which included our Premium Distance Learning Programs which accounted for 80% of new enrollment in the quarter. Meanwhile, our 100% online students accounted 20% of the new enrollment in 2000 -- in the first quarter of 2017 compared to 18% and 25% in first quarter of '16 and third quarter of '16, respectively.

We ended the quarter with 546,000 Distance Learning Undergraduate Students, up 3% from the end of the first quarter last year. So considering the two business segments, On-Campus and Distance Learning, the total new enrollments grew by 11%, a very strong growth. While our total student base grew 1.3% to 979,000 Undergraduate students. So a very good performance of our base of students growing 1.3%.

On the chart in the middle of the slide, you can see our Dropout Rate in the Undergraduate On-campus and Distance Learning segments. In the On-Campus segment, the Dropout Rate improved by 20 basis points mainly due to our Retention Program which we've already mentioned before in another earlier releases -- conference calls focus on identifying and treating the root causes of dropout even before they occur. The success of this initiative is even more significant if we consider that we reduced (inaudible) the reduction despite also adopting more rigorous collection and renegotiation practices than in previous -- than in prior semesters. So, even implementing more rigorous collections and renegotiation practices in the prior semesters, we were able to reduce a little bit the Dropout Rate in the On-Campus business, so it's a very good method for the dropout in the On-Campus business. However, these more rigorous renegotiation policies did have an effect in the dropout rate in the Distance Learning segment, which rose by 324 basis point, also adversely affected by the higher number of 100% of online students, which naturally have a higher dropout rate compared to other Distant Learning teaching formats.

So we have two main impacts in the dropout, actually three more important impacting the dropout for the Distance Learning students. First, we have more students in the 100% online students that have structurally more dropouts; second, more rigorous renegotiation policies; and third, we have more students in the first and second semester, and we know that the first and second semester are the semesters where we have high dropout rate. So it is normal that we have more dropouts in the Distance Learning because of the students have our intakes -- intakes processing this semester and last semester.

And last on the -- on this slide, in the right side, is our Provision for Doubtful Accounts or PDA, I want to emphasize that we continue to adopt conservative revenue recognition and provisioning practices. In the On-Campus segment, PDA for the out-of-pocket remain practically stable in relation to the previous quarter going from 7.4% in the fourth quarter to 7.5% in this quarter, so mainly stable. Despite a slight increase, we are seeing signs of improvement in the delinquency curve, which leads us to believe that our provisioning levels may be stabilizing soon.

In the Distance Learning segment, PDA for out-of-pocket portion increased from 7.5 to 8.3 compared to the fourth quarter and the increase is slightly from 8.1 to 8.3 this quarter. Note that this grade will increase already where it is expected and is a (inaudible) the trends in the On-Campus segment as well as the deterioration in the macroeconomic scenario. Later on we will go into more details on our average receivable terms and delinquency rate in this presentation.

Moving to slide five, we had (inaudible) variation with the net average ticket in the quarter. Starting with the On-Campus segment, the average ticket increased by 17.9% between the first quarter of last year and this quarter, going from BRL744 to BRL878. The increase was reported by the annual tuition increase and the more premium product mix which are higher share of programs including medicine and engineering as well, the higher share of our private installment payment projects that don't have any kind of distance.

In the Distance Learning segment, the average ticket grew by 13.1% growing for BRL233 in the first quarter of last year to BRL263 in this first quarter supported by the annual tuition increase and the growing importance of our Distance Learning premiums which have higher average ticket than our other Distance Learning ticket teaching firms.

If we excluded the impact from Uniasselvi that was sold in the past, in the first quarter of last year the average ticket increased by 11.3% from BRL236 to BRL263. Our main operating indicators mainly new enrollment to student base and dropouts and provisioning, I will suggest these first quarter results are solid and sustainable.

Let's go now to the analysis of our financial performance by segment and on a consolidated basis for which I invite our IRO, Carlos Lazar to continue the presentation.

Carlos Alberto B. Lazar {BIO 17238206 <GO>}

Well, thank you Rodrigo. Hi everyone. Let's go now to the overview of our results starting on slide seven. You know that we have changed the layout of our presentation to make it more dynamic. On this slide you can see the variations in the main result lines for each segment in the quarter compared to the same quarter of 2016. Remember that due to the comparison with first quarter of last year, excludes the results of Uniasselvi.

Looking first On-Campus segments, in the left side of the slide, which includes the On-Campus Undergraduate operations besides the language courses and Pronatec, you can see that net revenue growth of 16% which is due to the robust results of our student admissions in the enrollment process due to higher average ticket that has already been mentioned.

Gross income grew 24% with gross margin expanding 480 basis points reflecting once again the efficiency initiatives implemented in this segment, especially the rollout of the operational research software, which remain the key driver of gross margin expansion in this segment by significantly improving the cost of admission to office.

Other drivers including restructuring of units, significant cost reduction from the strategic sourcing, project and lower costs with rent. Due to (inaudible) led our operating income before market expenses to grow by about 13% and the operating margin fell 155 basis points year-over-year, basically here due to the higher PDA during the opening of the PMT and PEP plans, which are new developments in our student base. But it's always good to remember that given the lack of historically representative base, we adopted to remain extremely cautious in our provisioning from this product for this projects by adopting PDA rate of 50%. All these effects were partially offset by the efficiency initiatives as quoted earlier and the efforts made to control the operating expenses.

Moving to the performance of the Distance Learning segment in the middle, which includes (inaudible) students and also the unregulated programs and the preparatory courses from LFG. You can see that the net revenue grew 2% in the quarter, which was driven mainly by the expansion in the student base and the higher average ticket, which all -- benefiting from the premium also Distance Learning program that was launched with annual tuition increase and the launch of the PMT plan for this segment also.

The gross income in the DL grew by 5% with gross margin expanding to 215 basis point reflecting the capture of synergies in the efficiency gains, including those resulting from sourcing of tutoring theme, which before was outsourced. This change aims to improve the quality of the services offered to the student and offer more agility to the sponsors and also to boost the operations for productivity. The operating result of the DL before market expanses grew 0.1%, while the margin fell about 50 basis points, also affected by the provisioning for the out-of-pocket for the summer part as all -- that's in to the (inaudible).

And also, these effects were partially mitigated by the efficiency initiatives and from the quarter perspective in DL, as presented in our earnings release, which includes Uniasselvi in the first quarter last year, we recorded a margin expansion of 100 basis points year-over-year. So it have a different approach when we analyze the full data.

Moving on to the primary and secondary education segment, the last one in this chart, well we -- as we mentioned in our last conference call, in the fourth quarter, the anticipation of the textbook collections business that already had been made in the fourth quarter 2015 became even more relevant now in the fourth quarter of last year, which impacted the result in the first quarter of this year. We wanted to reaffirm here our belief that these dynamical will recur between the fourth quarter this year and the first of next year leading to additional revenue for this year which will neutralize the lower revenue of the first quarter of 2017, exactly the same that happened between '16 and '15. This effect also so impacted all P&L lines, leading the declines of 32% in the net revenue, 38% in the gross income, and 565 basis points in the gross margin. The operating results also fell 42% with operating margin about 880 basis point down.

Moving to slide eight, we show our consolidated results which really reflects the highlights. The net revenue grew by 11% year-over-year or to about BRL1.4 billion, reflecting robust results in both On-Campus and Distance Learning segments. Adjusted EBITDA grew 9% to BRL639 million, reflecting top-line growth in the capital efficiency and synergy gains in the period with margin compression of 115 [ph] basis points to 46.8%.

On the next slide I will go into more details on the evolution in the adjusted EBITDA margin between the first quarter of last year and the first period of this year. Last, the net income, which are the most important highlights here, came to BRL577 million for strong growth of 18% reaching a net margin of 42.2%, up 230 basis points.

So a look at the slide nine, we show the main factors affecting the EBITDA margin compared with two first quarters between this and last year. Starting, so we started from the 48% margin in the year ago period and we had an impact of 20 basis points due to the anticipation of the book collections in the first semester, as I mentioned in the slide before.

The next bar, we had a very important impact also, which is regarding the FIES administrative fee that began to be charted last year, which reduced our D margin by 50 basis points year-over-year, but the more important by far was the higher provisioning due to the smaller student -- FIES student base, depended [ph] also to the expansion of the PEP and the PMT student base. So that generated a total negative impact of 650 basis points.

That means, I mean, considering all that, that we didn't have -- we haven't implement, if we didn't have implement all the initiatives to capital efficiency gain there in the synergies there in P&L, the EBITDA margin would have ended the quarter, the first quarter 2017, in about 40.7%. However, the actions that we continue to implement this year which include the optimization of the performance of the Distance Learning segment, the reduce -- the reduction of cost through the strategic sourcing projects and the rollout of the operational research among some other initiatives that we are carrying generated a forcing impact of 610 basis points which led our EBITDA margin during the first quarter of 2007 [ph] mitigating most of the impact reaching 46.8%, so demonstrating the resilience of our operation and our capacity to create value, even in an adverse scenario.

And so most important in these also the initiatives have not been exhausted, so we still have a lot of things to capture, which means that we will continue to pursue for more efficient gains and doing that by a lot of work and responsibility.

Well thank you, I'll now invite our CFO, Frederico Abreu to continue the presentation.

Frederico Brito e Abreu {BIO 16674822 <GO>}

Thank you, Carlos. Good morning, everyone. So on the next two pages, saw [ph] our Provision for Doubtful Accounts, our accounts receivable and our average receivable term. Just before getting into the numbers, I want to comment briefly on our (inaudible), on our three main indicators that we usually analyze for PDA.

The first is the delinquency provisioning and the three indicators that we look for delinquency provisioning, the first indicator is the coverage rate for accounts receivable, and I want to comment here that our coverage ratio will boost and remains the backward, we had a slight increase compared to last year, and this is an important indicator on the sustainability of our accounts receivable.

The second indicator is our provisioning rate which increased slightly for out-of-pocket students, both in On-Campus and Distance Learning segment, but here you'll see on the next page is that the increase this quarter was lower than the increases that we had in prior quarters, and this reflects basically a more restrictive policy in our renegotiation, but also because of the already higher than what we saw in recent quarters, and also we are maintaining our provisioning for PEP and PMT at 50%. So this on provisioning.

And the third indicator is the average receivable term. We had an improvement in overall accounts receivable, mainly due to the normalization of the FIES, and on out-of-pocket students, we already start seeing some signs of stabilization of the average receivable term, which is also consistent with what we've been selling through the market.

Now moving to page 11, we can see here the PDA as the ratio of net revenues starting with On-Campus in green, we can see that PDA stood at 12.4%, this is an increase of 790 basis points year-over-year, and this is mainly the reflection of higher share of PEP students and the launch of PMT. So those two parts of products have a higher PDA and they represent more of our base of out-of-pocket students, and therefore, a good part of the increase is related to that.

If we exclude those PEP and PMT and looking on the out-of-pocket portfolio, PDA stood at 7.5%, which is 80 basis points higher than last year, but just 10 basis points above last quarter, and this reflects again a marginally lower increase over the course of 2016. So we increased -- we have been increasing our PDA quarter-over-quarter, but marginally lower in each quarter and the increase from last quarter was 10 basis points, which was lower than the increase that we had from third quarter to fourth quarter of 2016.

Our delinquency rates is already showing some signs of improvement, and this is the result of our new recognition -- renegotiation policy which is based on student risk and also our collection actions, I'd say, are bringing some interesting results. It is still early to say that our PDA will stabilize on this level or (inaudible), but the recent sign in this quarter are positive.

For PEP and PMT, we have maintained our provisioning at 50% and here all the indicators that we also have provide us comfortable that this level of PDA of 50% is still robust and comfortable and therefore there is no indication of any potential change that we foresee in the short term in this PDA level.

Moving to PDA in the Distance Learning, there is an increase of 270 basis points from 7.5% in the first quarter to 10.2% this quarter, this is mainly reflecting the launch of PMT in this segment. If we exclude the PMT, the out-of-pocket balance -- the PDA for out-of-pocket was 8.3%, which is pretty much in line with what we saw in out-of-pocket in face-to-face, an increase of 80 basis points year-over-year and 20 basis points compared to last quarter. So the same trends that we are looking in the out-of-pocket in face-to-face, we are seeing exactly here in Distance Learning. So marginally lower increase quarter-over-quarter as a result of positive sign in terms of recoverability of our students -- of our balance of our students in this quarter. And finally the PDA in primary and secondary remains stable at 0.8%.

So moving to page 12, we can see here the average receivable term by segments. So starting on the top with the On-Campus segment, the average term as a whole decreased 13 days. Starting with the average receivable term only looking at the out-of-pocket students excluding Pronatec, we've ended the quarter with 88 days which is up nine days from last year, but is a considerably lower increase than the one we've observed between the fourth quarter of 2015 and the fourth quarter of 2016. This reflects the fact that we have been gradually reducing our flexibility in renegotiations as well as the high recoveries achieved through our collection action.

If we are looking on the FIES, the average receivable term was 150 days, which is down 36 days from last year, and this reflects the normalization of the FIES payment flow, and there we see in audit last year of 25% of the amount outstanding from PN 23 compared to the previous quarter, increase was 33 days, and this is mainly due to the receipt of one more FIES installment in the fourth quarter of last year, that's usually paid in the beginning of this year, that amounted for BRL192 million.

And here I want to emphasize that except for the outstanding balance related to normative number 23 everything else is related to the FIES repurchases is completely normalized. And finally looking at PEP and PMT average receivable term, it was 281 days, this is an increase of 40 days from last year, and this is due to the maturation and increase in the number of students with the types of installment payment plan, which is again completely in line with our expectations. This is for the On-Campus.

Now moving to Distance Learning, the average term was 78 days, this is five days up year-over-year, and it is also significantly lower. The increase was lower than the variation between the fourth quarter of 2016 and 2015. And this is due exactly to the same reasons that I have stated on the On-Campus segment. If you take -- if you look only at the PMT receivable term, it was 190 days.

Finally, looking at primary and secondary segments, we have an average receivables term of 108 days, and this is six days up from last year, but down 15 days when we compare to the previous quarter. So, here again, I want to mention that our strategy of balancing the volume of our negotiations, so more flexibility or more rigidity vis-a-vis the dropout rate in the average term, so the combination of these three variables, we usually look for long time value and we look at the lifetime value of the students. So we understand that we are managing these three variables in a good way and at a comfortable level, always to try to maximize the lifetime value of the students.

This means that if we are too strict in the renegotiation, we lose the student, if lose the student it's difficult to recover. If you are too flexible, we increase too much our average receivable term, so there is a trade-off here, there is a good combination, and I think we are managing in a very comfortable level of risk for the company.

Moving to page 14, looking at CapEx. We've invested BRL81 million, this is 5.9% of our net revenues. This is mainly investments in line with other quarters in content development, software systems and some expansion and improvement projects in some of our units. If we combine this with our special projects, which involve facilities expansions that are more structural and also Greenfield, our investment in a quarter was 95 million, which is 6.9% of our net revenues.

On page 15, we can see cash generation, this is one of the main highlights of the quarter. We had a significant improvement in our operational cash flow from last year. To make sure that the comparisons are fair, we've added up the repurchases of FIES that we've received in December but we're expected to receive in January. So this is more comparable to what happened in the first quarter last year.

And doing that adjustment, if you look at operating cash flow before CapEx, we have 325 million, which compares to 9 million last year, and this gives us an EBITDA to cash conversion ratio of almost 55%. If we discount the CapEx, our cash flow -- operating cash flow was 243 million, which compares to minus 39.5 million last year, and a conversion ratio of 40.8%. And if we also add up the CapEx for special projects and greenfields, our operating cash flow was 230 million, which compares to a negative almost 61 million last year. And finally, if you look at our free cash flow, already discussed in depth, both installments and interest and also dividend, our free cash flow was 191 -- sorry BRL198 million, which compares to BRL171 million. Just bear in mind that last quarter -- last year the first quarter of 2016 we had part of the payment of Uniasselvi, so this creates a bit of a distortion when we compare to the free cash flow in 2017. So very positive numbers in all lines of free cash flow.

Moving to page 16, we look here at net debt. I think the main message here is compared to last year, last year we had a net debt, so our debt was higher than our cash. This quarter is the first quarter where we have our cash higher than our debt, so we have a positive cash position, as all the numbers that we have here reported. So starting with our cash, we've ended up the quarter with BRL1,350 million, this is almost 136% higher than last year.

If we consider all financial debt and short-term obligation, we have a net cash position of BRL658 million, which compares to a net debt position of BRL390 million last year. And also remember that we have some accounts receivable in the short and in the interim term, there are liquids, the first one is related to normative rule number 23. So the balance of the year that was not paid in 2015, we still have 75% of those credits to be received in 2017 and 2018. This represents about what you see on our now page 16, which is the 359 million, which is the long-term, and the 196 million, which is the short-term, so it is the combination of these two amounts.

And we also have the second part of Uniasselvi payment adjusted for present value, which should be made in five annual installments between 2018 and 2022, which represents about BRL507 million, which only includes what is certain. Please remember that the part of payment of Uniasselvi have some contingent conditions that we've disclosed as earn outs. What we have here is only the amount that is already certain and achieved from these earn outs. So everything else from that earn out that is still not materialized is upside and is not consider here on these amounts. So if we had followed these receivables, we've ended up the year with a net cash position of BRL1.7 billion, which shows a tremendous strength of our balance sheet.

So now I will invite back to Rodrigo to continue with his closing remarks.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Fred. During 2016, we found [ph] that we still have lot of opportunities to get through efficiency gains in the company, and these efficiencies would be sufficient to neutralize the downward pressure on margins, potentially accounted by the reduction in FIES, the increases impacting our installment program and the increase of provision that these installment programs will bring for our P&L. Now we are presenting our guidance for 2017 annual year, reinforcing these provisions that we did in the beginning of -- in the last year. So the message is, we will not have pressure, we will not have reduction in margins in 2017. And the opposite, we will see 0.2 percentage points or 20 basis point in increase of margins from 43.9 EBITDA margin in 2016 to 44.1 in 2017.

So let's see the guidance column in the slide 18. For 2017, we are projecting new net revenue of BRL5.5 billion, which would represent growth of 5.4% on 2016. For adjusted EBITDA our guidance is BRL2.4 billion, plus 6% year-over-year. For -- these amounts represented adjusted EBITDA margin of 44.1, 20 basis points above last year. And adjusted net income should reach BRL2.1 billion, up 5.6% of 2016 with net margins of 38.4% practically stable compared to 2016. Projected CapEx is slightly higher than 2017 at 8.9% of net revenue, which included CapEx for M&A and special projects and greenfield projects, and to close any sales or acquisitions of properties.

In addition to the guidance given, we reinforce that we expect a strong cash generation in the year, which would leave our balance sheet even stronger. Given the very solid results achieved in our student admission and re-enrollment process for the first semester, that is the most important one, we are very confident that we will meet this guidance. In addition to our official guidance for 2017, we want to reinforce the same thing that we said last year. We still see a Kroton efficient level to be captured in 2018 that leaves us comfortable with regard to the sustainability of our results and value creation in long-term.

On slide 19, I want to give you an updates of our greenfield projects. Along with some images of the new units we opened in the first semester of this year, which are Bacabal on the left side in the state of Maranhao and Luis Eduardo Magalhaes is in the right side in the state of Bahia.

In the reserve of our 100 units planned, we have four units already implemented, two units to be implemented soon, probably in the second semester in 2017 and the maximum in the first semester of 2018, and 64 in process to be approved by with the Ministry of Education. So overall, having the total 60 units that we already have to get approval by Ministry of Education and we will ask more, 15 this year and 25 in 2018, getting the total of 100 units like our original plan. So the greenfield project is going very well.

Let's go to the last part of today's presentation, for my closing remarks, please let's go to slide 20. On the Estacio transaction we look into too much information, too much detail, but we are meeting regularly with anti-trust agency, CADE, which has until July 27 to issue a final ruling on the case. We remain confident that we have remedies to the due to deal with the all the competition concerns that CADE could bring to us. We continue to make progress on the planning of integration and to identify important potential synergies and benefits in the transaction.

I should also mention that as of this quarter, we are expanding our disclosure of information by including more details on the average ticket from the students' perspective, provisioning, accounts receivable and average receivable terms from the various payments options available to our undergraduate students, including PEP and PMT. These disclosure of information reinforce our commitment to transparent and to the quality of the information that we'd report.

I should also mention that the Board of Directors decided to increase the dividend payout rate from 35% last quarter to 40% this quarter of the attributable reported net income. As a result of this decision, we have BRL187.6 million will be distributed in dividends based on the adjusted net income in the first quarter of 2017, which corresponds to approximately BRL0.12 per share.

Another important development there is the -- is that the student admission process for the second semester of 2017 has already begun. The sales team have been well prepared, the administrative team and the On-Campus units are highly focused and being (inaudible) and the network of Distance Learning center is highly motivated, so we have all the elements in place to once again deliver an excellent result, and there is intake process for 2007 [ph] and as well as of 2017.

And the last thing I want to mention is that the Conecta - Employability Channel is being rolled all out national wide to serve our more than 1 million students, undergraduate students at our On-Campus units across Brazil, and Distance Learning across Brazil. The project has been very well received by both the students and companies. The platform had already advertised over 50,000 jobs offered by more than 5,000 partner companies; it is huge, 50,000 jobs offered by more than 5,000 partner companies, and the service is offered free to students and companies that has come to represent a huge competitive advantage for Kroton. We believe that Conecta has the potential to become one of the country's largest job platforms helping students to develop their life style.

Thank you for participating in today's call and now we will begin the question-and-answer session.

Questions And Answers

Operator

Ladies and gentlemen we will now initiate the question-and-answer session. (Operator Instructions) Our first question comes from Rodrigo Gastim from BTG. You may proceed.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Yeah good afternoon everyone. First I'd just like to bring back a topic discussed during the Portuguese conference call. I mean, cash flow generation remains one of the main concerns for most investors in general. So it will be extremely helpful to hear your thoughts about it going forward. I mean there is no official guidance related to cash flow but it would be very nice to hear how you do expect to do that EBITDA to cash conversion rates behaving going forward with this new product mix offered by the company. That's the first point.

And the second point is related to receivables. I mean you've come up with some good insights already during the presentation, but just to make sure, is it possible to break down this year-on-year deterioration into what changed from a preferred [ph] collection policy from new guys, so 100% bottom up and what came from an organic deterioration in the macro outlook? In other words, is the macro environment already bringing some relief here. That's our -- these are my two questions. Thank you very much.

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

Okay, Rodrigo, thank you for the question. Rodrigo speaking. I will answer the first question and then the second question Frederico will answer. About the cash flow, how is that, we didn't provide an official guidance for operational cash flow for 2017. But we have no reason to believe that we will see reduction on the conversion of EBITDA to cash from 2016 to 2017. Of course, we are talking -- we are considering the adjustment of the installment on FIES that was paid in November and normally it's -- it should be paid in January.

So bringing back these installments of BRL192 million from '16 to '17 and comparing the operation -- the conversion of EBITDA to cash from '16 to '17, there is no reason to believe that we will see a reduction in this conversion rate. So this is the conceptual and qualitatively our best guess about cash conversion for 2017.

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

Rodrigo, how are you doing? It's Frederico. Talking about receivables, so what I can tell you is this, and it's in line with what we said on the Portuguese call and what we said on the previous quarter. So next quarters, on the second quarter, we should still observe a deterioration in our accounts receivable. But starting on the second semester, we should start seeing a stabilization or even a reduction in the accounts receivable term. So this is one thing.

Why this is happening? So, I will divide it into two things. The first thing, we are increasing slightly our payment on time, so we have a worst rate of payment on time in 2016, first quarter of 2017 our payment on time is better. The second, we were a bit more rigid in terms of agreements, we've -- our student, in a renegotiation of delinquency students, they were trying to renew their semester, we were more rigid.

We saw that there was an increase in the attrition in the Distance Learning, this is a direct consequence of that and being more rigid we should also have payment conditions and the entrance, the proportion that the student has to pay upfront when they renegotiate with us at the higher, and therefore, which will also contribute to a deceleration of our average receivables terms.

And finally our recoverability, so when we measure the amount that we have outstanding compared to the amount that we are recovering the indicators that we have in this quarter are also better than the indicators that we had last year. And therefore, this means that our collection practices and the types of students that we decide to (inaudible) are showing better results. So the combination of these three things should lead to two things. The first, the stop of the acceleration -- a stop in the increase in the average receivable term, and in the second semester, maybe a decrease in the average receivable term, and also not increased in the PDA in the second semester, independent also decreased in the PDA.

The macro situation is probably helping and the only factor that I would attribute to macro situation would be the payment on time. The payment on time typically is a situation that we have not lot of influence, the student may pay or may not pay, usually when he pays more on time is that we have more available money and this is probably what we can attribute to the macro scenario. So in summary, we are showing some signs of improvement both in PDA and in the average receivable term and those signs should be more visible starting on the second semester of 2017.

Q - Rodrigo Gastim {BIO 19694950 <GO>}

Yeah. That's perfect. Thank you, Fred. Thank you, Rodrigo.

Operator

(Operator Instructions) Our next question comes from Bruno Giardino from Santander. You may proceed.

Q - Bruno Giardino {BIO 15974970 <GO>}

Hello, good afternoon everyone. Two questions on the cost side. The first one on slide operation, about the significant reduction in payments and other cost adjustments, I just wanted to understand the variation. And second, in the Distance Learning segment, you said that the cost of professors fall helped on a year-over-year basis due to the introduction of first internship, a new internship program, so just would like you to comment a little bit more on this process. Thank you.

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

Bruno, it's Frederico. So, on your first question, the reduction in maintenance and other costs in On-Campus students. The maintenance basically this reduction is a reduction that is seasonal. If you look at our maintenance cost in the fourth quarter of 2016 they were a bit higher. So what happened this year, we've anticipated at least the maintenance to our -- in our units to the last quarter of the year in the period of holidays [ph], which was pretty much on the last months of the year in December. So we've anticipated some of the maintenance cost and this means that in this first quarter we have a dip of maintenance costs compared to last year.

Year-over-year, we should not have a big difference between this cost line when we compare to 2017 to 2016. The other costs, the most important factor is a reversion of the provision for INSS, so the social practice on our employees -- we were provisioning provision when we basically when we fire a professor we were provisioning INSS over the period of time before the professor would officially leave the company and a part of that is not actually due. We are gaining some cost, we are gradually reversing the provision that we've accumulated until 2016, and this created a positive effect on the line of cost.

In terms of Distance Learning, it was explained on the speech, it's a change in the tutorship model, I don't know if Carlos wanted to provide more comment, but it's basically a change in the -- we are internalizing the tutor and this means that we are paying a lower amounts of cost -- of salaries to these tutors and we are complementing these with online support that complement this internalization of tutors. I don't know if Carlos want to complement or Rodrigo.

A - Carlos Alberto B. Lazar {BIO 17238206 <GO>}

Okay, I think complement, what we are doing is we needed to have much more tutors working with low number of hours. So low dedication of the -- for this activity and we are hiring tutoring full time not more on home, they are working in hours structures, so they are much more efficient than the other ones. So the name of the game in the change of the tutoring is more efficient, because we have tutors in full time and working in hours time.

The best thing is we are reducing cost, is increasing a lot of the quality providing for our students, all the survey that we did before and after the implementation of this measure are showing that our students are much more comfortable and much more happy now with the new structure of tutor than before.

Q - Bruno Giardino {BIO 15974970 <GO>}

That's very clear. Thank you, Fred and Rodrigo.

Operator

(Operator Instructions) This concludes the question-and-answer session. At this time, I would like to turn the call back to Mr. Rodrigo Galindo for any closing remarks.

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

I'd like to thank you all for participating in this conference call and leave our IR area available for further information. Thank you.

Operator

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