Q2 2013 Earnings Call

Company Participants

- Carlos Alberto Lazar, Investor Relations Officer
- Frederico Brito e Abreu, Vice President of Finance, Chief Financial Officer
- Rodrigo Calvo Galindo, Chief Executive Officer

Other Participants

- Javier Martinez, Analyst
- Kartik Nehru, Analyst
- Kayo Mascardini, Analyst
- Rubin Quoto, Analyst
- Yag Patel, Analyst

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time, we would like to welcome everyone to Kroton Educacional's Second Quarter 2013 Earnings Conference Call. Today we have with us Mr. Rodrigo Galindo, Kroton's CEO. We would like to inform you that this event is being recorded and all participants will be in listen-only mode during the company's presentation. After the company's remarks are completed, there will be a question-and-answer session. At that time, further instructions will be given.

(Operator Instructions) Also, today's live webcast, both audio and slideshow, may be accessed through Kroton Educacional Investor Relations website at www.kroton.com.br/ir, by clicking on the banner 2Q '13 webcast. The following presentation is also available to download on the website's platform. The following information is available in Brazilian reais, in accordance with Brazilian Corporate Law and Generally Accepted Accounting Principles, BR GAAP, which now conforms with International Financial Reporting Standards IFRS, except where otherwise indicated.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Kroton's management and on information currently available to the company. They involve risks, uncertainties, and assumptions, because they relate to future events and therefore depend on circumstances that may or may not occur in the future. Investors should understand that general economic conditions, industry conditions and other operating factors could also affect the future results of the company and could cause results to differ materially from those expressed in such forward-looking statements.

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

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Good morning, everyone, and welcome to the quarterly earnings conference call of Kroton Educacional for the second quarter of 2013. With me today is our IRO, Carlos Lazar, and our CFO, Frederico Abreu. I would like to start today's presentation on slide three, with the highlights in the period.

The second quarter once again had an excellent results for Kroton, just like in the first quarter. The main reason for this performance is the success of our admissions and re-enrollment process for the first semester of 2013, which led us to reach almost 515,000 post-secondary students at --.

Another factor is the evolution in the FIES student base at the end of June; we had more than 79,000 FIES students which represented around 53% of our on-campus student's base. The growth in relation to the first quarter is explained by the high number of FIES students who had their contract normalized during the quarter.

This strong operating performance combined with the rigorous control of costs and expenses supported a very strong financial performance as well. EBITDA in the second quarter was 149 million reais almost double the amount in the same quarter of 2012.

And EBITDA margin 30.9%, the same behavior occured in the first half of the year when EBITDA grew by 84% to 384 million reais.

Net income growth was also strong reaching 113 million reais in the quarter and 299 million reais in the first half of 2013 or almost doubled the amount in the first half of last year. Cash flow also posted an excellent performance in the second quarter and in the first half. Considering the CapEx disbursements in the first half, cash generation was 336 million reais which represented an EBITDA to cash conversion ratio of 93%.

This indicator already give an idea of just how strong Kroton's performance was in the second quarter. During today's presentation, we will give you more details on these factors. I will now invite our IRO, Carlos Lazar to present our operating and financial performance.

Carlos Alberto Lazar {BIO 17238206 <GO>}

Thanks, Rodrigo. So let me start the operating presentation on slide five showing the growth in the number of students between the end of the first quarter and our situation in June 30. Well, the first quarter is almost is the most important period of the year in terms of new enrollments and dictated a large part in the (inaudible)

The second quarter on the other hand is historical market by an increase of the drop out rates resulting from the process of the start of the year, which this quarter was almost completely offset by the strong inflow of graduate students which grew 9.3% in the quarter. In the next two slides, in the next slide actually I will show some details over the student base.

On slide six. The table on the chart on the left side show the student growth in the on-campus, post-secondary business. As you can see the base remains stable due to inflow of FIES students whose situations were normalized during the quarter. On the right hand of the slide, you can see the student growth in the Kroton distance learning business between March and June.

The highlights was more than 5,000 students that entering the graduate base and offset a good percentage of the dropouts in this undergraduate business. However, between the end of the first and second quarters, the base of the whole -- as a whole remains practically stable, which is positive, since we also have the new enrollment process for the second semester, which should support even stronger growth in our base.

Well, on slide seven, we show more in details the FIES base. Here, we show the number of students that use FIES. And at the end of June, we had more than 39,000 students with FIES, using these loans, which represents around 53% of our income post-undergraduate base. This increase from the end of the first quarter reflects the normalization of the FIES student registration and contract attendance in the period.

In that matter, I would like to remark some aspects here. Our business cycle is it can be -- it's more appropriate to analyze our business cycle in a semester base, half-year base, not in a quarterly base. So -- and Kroton has been very conservative on the recognition of the revenues of our students. So we don't recognize revenue from the students that did not complete the whole process of higher of those contracts or the contracts of FIES.

In that matter, we had some around 5,000 students during the third -- during the second quarter that completed this process. So we have the recognition for six-months revenues from these students that impacted especially the second quarter.

However, this is -- I mean, this is very cyclical and it is part of our business. So for a better analysis in terms of revenues, we recommend that is -- that you take as a perception the semester revenues, not only the quarterly revenues to avoid any misleading in terms of our numbers.

Well going ahead we move on to slide number eight, and we present here how these steps are regarding the Anhanguera integration and how that's being structured. As announced in the association agreement, we have already begun the process of defining how the integration process will be carried out. Since the two companies are prohibited from exchanging strategic information during this period, because we have not got yet the approval from CADE, we are working as separate companies. However, we are close to define the very important consulting firm to organize and compare the information on both companies and leaves the best practice to be adopted in the future for the association approval. Note here that the conclusion of the association depends on the approval by CADE and also the shareholders from both companies.

Turning to the financial performance. We will begin the explanation here on slide 10, which highlights the company's net revenue breaking down by business segment. In the second quarter of 2013 net revenue in post-secondary business grew by 59% from the same quarter of last year. Analyzing strictly organic growth in other words in making the effects of (inaudible)

Net revenue grew almost 45% in the segments. In the first half of the year our performance was also very strong with Kroton's consolidated net revenue in the first six months growing by 50% for the same period of last year led by the growth of 57% in the post-secondary business. In terms of organic growth, the post-secondary business, which includes the on-campus and distance learning stood up 37% growth which validates the strength of our brands and is evidenced of our admissions and re-enrollment process.

Considering the on-campus business on slide 11, we showed a changes in net revenue growth income and operating results. While net revenue in this business grew 54% from the second quarter of last year driving here mainly for the growth of the student base and also the regularization of FIES students.

So like I said, it's also important to look in the semester base, the revenue growth which also grew a lot in this case 54% -- in the semester 44%. Well, here, meanwhile gross income almost doubled in the period with gross margin expanding 12.7 percentage points from the same part last year which is explained by the (inaudible) in our costs. Operating income grew almost two times in the second quarter with operating margin of 32% which also reflects the effective quanta of our operating expenses.

Moving on to slide 12. We showed the performance of the different learning segments, that includes six-year[ph] during the second quarter 2012 and 2013 completing the operation remembering back in 2012, we had only one off of this impact. As you can see the results in the different segments, business remains very consistent which highlights the importance of the business to the overall company especially in terms of the operating income which the business accounting already for 46% of the company's overall numbers. So and also reaching a margin -- operating margin of 58% during the second quarter of 2013.

Now on slide 13, represent the financial performance of the primary and secondary education business. As mentioned in the previous quarters, Kroton has adopted a strategic action to maximize the financial and operating performance of the business which includes for example significantly reducing our exposure to the sector.

Giving the very significant seasonal effects in this business, we believe that is more appropriate to analyze the performance also here in the first half of the year and the comparison of this half, this semester for which all indicators showed growth in both nominal and percentage terms.

In the first half of 2013, we posted a net revenue growth of 5% from the year before and this same can be seen in gross income and operating income accompanied by a margin expansion which reenforce the strong performance of the private sector which also have become the company's focus along the service provider school.

On slide 14, we present the evolution of the EBITDA and the net income, in the next slide, for both quarter and semester. Well, the EBITDA in the slide 14 was -- we reached 149 million reais with EBITDA margin expanding 7.6 percentage points from the year ago period and note here that the EBITDA was adjusted by non-recurring items totaling 3.6 million reais in the quarter which is basically related to M&A process and are already some factors regarding the Anhanguera merger.

This growth reflects the solid performance of our business and the continuos control and costs and expenses. And on top of that, we have also the excellent admission process at the start of the year. Well the first half results followed the similar path with EBITDA reaching 367 million reais and EBITDA margin of 6.9 percentage points from the same period of last year.

And next slide, the net income during the second quarter was 130 million reias, with net margin of 23.5%. Note here, also, that net income adjustment includes not only the non-recurring cost and expenses already mentioned, but also the amortization of intangible assets from the acquisitions. And finally in the first half of the year, net income was 299 million with net margin of 30.4%, which represents a strong improvement from the year ago period.

Well, thanks. I will now invite our CFO, Frederico Abreu, to continue the presentation.

Frederico Brito e Abreu {BIO 16674822 <GO>}

Thanks you, Carlos. Good morning, everyone. The next four slides, starting on page 17, analyze the evaluation of our working capital, accounts receivable and the provision for doubtful accounts. Moving to slide 17, we have the behavior and the performance of our working capital in the quarter, which is composed of the difference between current assets. Excluding cash effects and current liabilities excluding that effect.

Our working capital measured in days of net revenue had a significant reduction of 69% from 46 to 14 days compared to the same quarter last year and after excluding the effect from the FIES credits, which you're going to see in the next page has had a big evolution, registered also reduction of four days, from one day of net revenues to minus three days of net revenue.

So overall, an important improvement in the evolution of the working capital, which is explained and you're going to see in the next pages where the performance of our cash flow. So this improvement follows the trend observed in the prior quarter and reflects the intense efforts made in recent quarters on four fronts. The first, a reduction in the average FIES receivable term; the second, a reduction also on the average ex-FIES receivable term; the third, an increasing average payment term through some renegotiations with important suppliers and, finally, an optimization of our inventories mainly related to our K-12 segment.

So now on page 18. We can see the provision for doubtful accounts as a percentage of net revenue for each of our three businesses. Post-secondary on-campus, distance learning, and primary and secondary. Just a reminder, the PDA has been calculated using exactly the same methodology since 2010, which is basically provisioning based on statistical analysis of historical receivable. This is important to mention, because this PDA is comparable since 2012. So there is no difference in methodology, means that the periods are comparable to each other.

All receivables up to 365 days are provisions according to these methodologies, and the receivables above -- after 365 days, they're written off. So in short, we can observe a stability in our historic receivables curve in line with past quarters, which leaves us very comfortable about the level of PDA we adopted, once again, in this quarter.

So looking at the post-secondary, PDA stood at 4.2% of net revenues, which is down from 4.9% in the same quarter last year. So this is a positive evolution and this is mainly related with higher share of FIES students in our base and also a slight reduction in our PDA for ex-FIES students.

So looking at ex-FIES students, the green bars on the right, we can see the level of provisioning that evolved from 6.7% last year to 6.4% this year, a slight improvement vis-a-vis last year. And looking at ex-FIES students, we continue to provision 2.25% of all FIES revenues, despite being FIES students with guarantor or no guarantor.

So 6.4% for ex-FIES and 2.25 for FIES students leads to an average of 4.2% for the on-campus post-secondary. In distance learning, as mentioned before in previous quarters we expect the level of provisioning to converge to levels close to those of ex-FIES on-campus. And this was confirmed this quarter with a level of 6.5% PDA, which is slightly higher than last year, but exactly the same percentage that we reported on the first quarter which was also 6.5% this year converging to the levels of on-campus. And on the primary and secondary business, we have a stable PDA on the level of 1.5% compared to last year. So stability in PDA.

Moving to slide 19, we can see the accounts receivable, okay. So here we can see the evolution of accounts receivable net of provision of doubtful accounts, and we can see these broken down for each of the three businesses. So on the top at green; we have the post-secondary on-campus, in red, the distance learning, and in orange, the primary and secondary.

So overall, our accounts receivable totaled 287 million in the quarter which is 200 million in post-secondary business on-campus. So the vast majority of our accounts receivable on-campus, 61 million in distance learning and 26 million in primary and secondary. In post-secondary on-campus, the reduction from the first quarter is basically explained by the continued reduction in FIES accounts receivables and in the stability of ex-FIES accounts receivable of course also reflecting a seasonality if you compare from first to second quarter or third to fourth quarter there is also the seasonality between the quarters, but the reduction compared to the previous quarter mainly by the reduction in this FIES accounts receivable.

And here I'd like to make two comments. The first related to FIES credit. As mentioned in the previous quarter the FIES credits is seasonal and this is due to the contracting and contracted the process that we have today in place. So student's contracts is usually formalized in the FIES system in the first quarter or in the third quarter and the repurchases they happen on the quarter after.

So the student's contract has been in the first quarter and most of the repurchase is from the government occur in the second quarter. In the third quarter, it's going to happen the same. The students will contract and most part of the repurchase is from the government will happen on the first quarter.

So even if the students are spending in the classroom in the first quarter and the student do not contract formally or we did not receive any amounts from the government and we do not have accounts for the revenue of these students. Okay, so this is important to compare first to second quarter. In the second to emphasize what I'm saying, if you look at the average receivables, average corrections that we have from the government in the first quarter, we have an average of 38 million per month in FIES credits in the first quarter.

While in the second quarter, we have an average of 75. So part of what we received in the second quarter was a compensation of what we did not receive in the first quarter, which led us to an average of 57 million reais received from the government for month and seasonality should happen again in the third and the fourth quarter.

Moving to slide 20. We can see here the behavior of the average receivable term which is basically the division of net revenues to the accounts receivable multiplied by 360. If the accounts receivable term increases, means that it takes longer for us to receive from the students, if the accounts receivable reduced it means that we are recovering faster.

So in general, we are comfortable with the evolution that we show on this page. Through various analyzes, we've demonstrated our high cash flow generation capacity and part of it is explained by the more effective correction and recovery actions which are translated in the reduction of these accounts receivable term. So looking for the post-secondary business, we have four analyzes.

The first looks at the accounts receivable term from a consolidated point of view looking at FIES and ex-FIES students and here we had a reduction of 51 days compared to last year. So from 117 days on average last year to 66 days this year and a reduction of 13 days compared to the first quarter of 2013.

To understand better the evolution of ex-FIES, we have two analyzes there, criterion two and the criterion three. So looking at the analyzes number two, we can see a reduction of 9 dates compared to last year. And looking at the criteria number three on ex-FIES, we can see an increase of seven days.

Part of this is explained by the migration of what we have in long-term receivables to the short-term. So part of our accounts receivable is not do yet. Part of it in first quarter was long term, about 16 million reais. And in May, part of this receivables migrated to short term, about 8 million reais migrated to short term.

And therefore the average emerging factored by this is six days. So from the increase of seven days, six days alone are related to these migration of our loan terms to our short term accounts receivable. And therefore the better comparison would be excluding these effects which would mean that we would move from 70 days last year to 71 days in this quarter, one day increase which is marginal.

And then last in the fourth analyzes represent only the balance of FIES. Here we have a very important reduction of 55 days. Sorry, we have an average term of 55 days, which is an important reduction of 155 days from last year and 35 days from the first quarter this year.

This is below our initial expectation. One year ago, our initial expectations for these FIES term was about 80 days. We are today at 55 days. This is the result of the significant improvements in the operational processes of FNDE and we believe that 55 to 60 days is a reasonable target for this year.

And again, it's important to stress that this is seasonal. So we have 55 days as we expect and in third quarter, this 55 days because of the seasonality explained before is going to increase and is going to decrease again in fourth quarter and target a level of 50 to 60 days.

Now in distance learning, we have an average term of 41 days which is pretty stable related to last year and in primary and secondary, we have a reduction of 15 days, which reflects the restrictive practices and renegotiation that we've been describing over the last quarters.

Now moving to slide 22 represents the capital expenditure. In the quarter, we've invested 32.6 million in what we call recurring CapEx. This was allocated to laboratory, IT, library, and also expansion in improvement projects. This is recurring CapEx, which is basically the CapEx to compensate for the depreciation and also to guarantee short-term growth from a, let's say, an origin[ph] of one to two years.

So after recurring CapEx consumed approximately 6.8% of net revenues in the quarter and 6.4% of net revenues in the semester, reaching a total in the semester of 62.4. And in complementary to what we have as recurring CapEx, we have also special projects. In this project, they impact the more of mid-term and long-term. And this is a horizon of three to five years and these types of investments are relatively properties or buying properties, expanding existing properties or even building new properties and they support our long-term growth.

So we've invested in the quarter 4.7 million and we expect that the higher amounts of special projects to happen now in the second semester. So as a result, total investment in the quarter reached 37.3 which corresponds to 7.7% of net revenues and if you look at the semester, we have 74.6 or 7.6% of net revenues.

So now on slide 23, we can see the company's debt and the company's cash position at the end of the quarter. We've ended the quarter with 357 million reais in cash, which is an increase from the first quarter of the year and this is mainly due to a very strong operational cash flow in all businesses and also includes the payment of interest on debentures in June and the payment of dividends related to 2012 and the first quarter of 2013 which totaled about 100 million.

So a strong operational cash flow and the most important non-operational payments were the debenture interest and the dividend. So net debt, considering all the financial debts, was 194 million in the second quarter, which is about 0.3 times projected EBITDA for the year, and if includes also short and long-term liabilities related to M&A and taxes, we have a total net debt of 441 million or around 0.7 times projected EBITDA. So very comfortable financial structure and capital structure by the end of the quarter.

Now on page 25. And this is one of the most important and stronger messages of our results is that cash generation, the cash flow generation in the period. So here we look at three different optics. So we look at cash flow before CapEx, cash flow after CapEx, recurring CapEx and also cash flow after recurring and Special Projects CapEx.

So operating cash flow in the quarter before CapEx was 240 million which is 165% of EBITDA to cash. If we look after recurring CapEx, cash flow was 212 million or almost three times higher than the cash flow last year and EBITDA to conversion ratio of 146%. And if you look at free cash flow after recurring and Special Projects CapEx, we have a cash generation of 208 million or an EBITDA to cash of 143%.

Now looking at the right side of the page, we can see the same three analyzes but on the semester, and we believe it's a better, it's more let's say important to look on semester because of the seasonality, mostly because of the seasonality of the FIES repurchases.

In the first quarter, our cash flow generation was about 50%. Now we have about 150%. But if we look at the semester which makes more sense, our cash flow generation after CapEx, recurring CapEx and Special Projects was 325 million or 3.5 times more than in 2012 and an impressive 90% EBITDA to cash conversion ratio compared to 49% last year.

So we believe this performance is the result of a culture that is focused on cash generation and that culture starts in the corporate headquarters and work around to each units and that's also translates into variable compensations.

So we can see the results of these. And in summary, the main levers why we had such a good performance in cash flow are the higher EBITDA. So EBITDAs were strong and the higher profitability in all businesses, in all businesses. A continuous improvement in our working capital, this includes ex-FIES and FIES students, also in the gradual optimization of our tax, effective tax rate to the optimization of our goodwill amortizations. So now I will hand the presentation back to Rodrigo.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Thank you, Frederico. And in view of the excellent results achieved by Kroton in this first half of the year we are once again providing our total guidance. So in slide 27, we showed a new guidance, the new Kroton guidance for 2013. We had reviewed it towards the forecast for our three main lines.

The net revenue forecast was increased by 2% to 1.9 billion reais, our EBITDA forecast, which was 550 million reais, was increased by 50 million reais or a 9% to 600 million reais, with EBITDA margin of 31.6%.

And projected net income is now 460 million reais, or 11.4% higher than our previous guidance. For an investment we mentioned our previously announced guidance, in other words, 6% of net revenue for maintenance and organic growth and 4% of net revenue for Special Projects. Let's go now to the last slide of today's presentation for a closing remarks.

As you can see, Kroton delivered very positive quarter with growth in absolute and relative terms and a significant margin expansion. We also enjoyed a strong cash generation in the quarter and first half which gives us a substantial security to develop our long-term strategy which focuses on the essential issues involved in the quality of our educational services.

As for the process of merging Anhanguera, we are confident and already concluded important steps, such as the due diligence and the filing of documents at the antitrust authority CADE.

In the near future, we will start the deep planning work for the effective integration with the support of a leading consulting firm that will be announced in next week. Another point I should mention is our confidence in the current student admissions and retention process and our belief that we should continue to enjoy strong growth over the coming years.

Here I should mention the possibility created by Minister of Education, MEC in 2013 for post-secondary institutions participating in the national program for access to the technical educational and job called Pronatec. One of Pronatec's initiatives is to provide free access for the students with scholarship aid by government.

Pronatec is a very important program for the government and Kroton is one of the institutions authorized to offer it. We are very optimistic with the evolution over the coming years for the Pronatec program, but already in this semester we should have Pronatec student enrolled at many of our units.

In the next earning release, we will provide more details about Pronatec and the reuse for Kroton. Concerning the capital markets, we approved the distribution of dividends of 24 million reais which will be paid to our shareholders on August 30. And last, I'd like to thank those of you who participated in the recognition we received for the IR magazine Award in which Kroton received its four awards including best IR programs.

In view of the excellent performance achieved over the first half of the year, we remain very confident that 2013 will be a very positive year and that we are on the right track to continue growing over the long-term by offering high quality education to our students. Once again thank you for your participation in today's call and we will now begin the question-and-answer session. Thank you.

Questions And Answers

Operator

Thank you. Ladies and gentlemen we will now initiate the question-and-answer session. (Operator Instructions) Our first question is from Kayo Mascardini with HSBC. Go ahead please.

Q - Kayo Mascardini

Hi, everyone. I have a few questions here. How many of those 5,000 new undergraduate students at the campus are related to the regularization of FIES contracts? And on the guidance side, I would like to understand what the results of the first half of 2013 show that to end up reviewing our guidance again and EBITDA margin guidance in 2 percent points? And if you could tell us from where these two points of increase would come, I would appreciate it. Thank you.

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

Hello, Kayo. Thank you for the question. It's Rodrigo speaking. We are talking in the second quarter, we are talking about 5,000 students that make their regularization of their contracts after the first quarter. So we are talking about 5,000 students. For the other question, Frederico and Carlos Lazar will comment a little bit.

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

Hello, this is Frederico. On the new guidance, we are increasing 2 percentage points. So what modifies us to increase the guidance. The first we have a better than expected intake and enrollment in the first semester, that's the first thing.

The second, we are confident now that we would reach our targets in the second semester which we didn't know three months ago. So the combination of those two effects believe us that we are comfortable in reaching net revenues. Okay, most of our fixed expenses both G&A in our units and the corporate expenses will not change in the same proportion. Okay, of course they will increase marginally, but not in the same proportions. So parts -- the most part of the increase in percentage points comes from an improvement in G&A and corporate expenses. And also complementary to that you're going to see that, an increase in our gross profits.

As Rodrigo mentioned in the Portuguese Conference Call, our classrooms have more students, better intake, and a better and especially a better re-enrollment means a larger classrooms and those larger classrooms leads us to a better gross profit, means a lower cost per student.

So in summary, higher revenues, not translated in the same increase in fixed costs and also an improvement in our gross profit due to more students per each classroom. That's pretty much the summary of the guidance. Okay.

Q - Kayo Mascardini

Okay. Thank you guys.

Operator

(Operator Instructions) Our next question is from Rubin Quoto with Plural. Please go ahead.

Q - Rubin Quoto

Good afternoon. Thank you for taking my call. I have two questions. Actually, the first one is regarding the on-campus average ticket. Could you provide us what was the actual increase in the average ticket, excluding the extraordinary revenues that were recognized from the new FIES students?

And the second one would be regarding the Greenfield projects that you mentioned in the Portuguese Conference Call. If you could give us more color on where are you planning to expand from a regional perspective? Are you looking to reinforce a position in the market that -- already present or that leads to tap new markets? And which bank are you going to use in this new Greenfield project? That's basically it. Thank you.

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

Hello, Rubin. It's Rodrigo Galindo speaking. I will start answering the second question about Greenfield and then about Greenfield and then Carlos Alberto will answer the first one. About Greenfields, we are planning to implement to launch 20 new Greenfields in the next four years to implementation.

We are planning to issue this product from Ministry of Education apart and through the end of this year and apart until in the beginning of 2014. It takes more or less two years to this product be approved by Ministry of Education, so we are talking about launch the Greenfields in three or four years from now.

Our preference targets are in north, northeast, and central, and Midwest but we are looking all looking all Brazilian cities. We have a deep market analysis to indicate as which are the best cities. We are looking for new cities, cities that we don't have -- we don't have Krotons operating and Anhanguera operating. So we are looking forward to new cities and we are very confident that in two years, we will have the approval of this

Greenfield. These are long-term product, but we will be starting now, because we will spend the next two years a very -- with a strong focus in the integration of Kroton and Anhanguera. And then when we are more comfortable to other products, we already have the approval of the Greenfields products. So that's why we are asking this project now because it takes time to get the approval.

Next Carlos Alberto will answer or Frederico.

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

Well, Rubin, regarding the average ticket, we had an improvement -- an increase of 4.6% over the first quarter. But you're right. I mean the second quarter is impacted by the revenue from the six months revenue recognized in the second quarter of around 5,000 new students that was admitted in our base of students. So we had this impact --.

However, this impact should be a little bit -- probably the average ticket should go back to approximately a level between the first and second quarter, already in the third quarter because that we are going to be under normalization of this process. That's why we ask it to, it's a more appropriate analysis to have, let's say, on average ticket also for the semester here that you can do only by the average of the first and second quarter that we now send through the market. So going straight to the points here, in the third quarter what we expect is the average ticket should be something around 580 to 600 reais and approximately around that figure.

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

And let me just, hi it's Frederico. I'm going to just give some numbers on this. So if you look basically what we have, that the largest impact that is increasing tickets between the two quarters is the mix of FIES student. Okay. So, in the first quarter we have 66,000 FIES students, now we have 79,000 students of FIES.

So we move from 44% FIES over the base of on-campus to 53%, part of the increase of 66 to 79, so an increase of 13,000 students, part of it is related to 5,000 students that are new students. But 8,000 students is a migration from ex-FIES students to FIES students. So even if you isolate the 5,000 students that are new, the average ticker increase because the ticket of FIES students is higher than the tickets of ex-FIES students.

So even excluding that effect, we have an improvement, a slight improvement on average ticket mainly due to mix. And for the third quarter we should have slight improvement, not relatively new students, but relatively the better mix from the students that were ex-FIES that moved to FIES.

Q - Rubin Quoto

Yeah, that makes sense. Thank you for being more clear. And going back to the first question, I asked about which brands are you planning to use for these new expansions. Do you have any idea of how you're planning to work with your brand architecture going forward?

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

Yes, Rodrigo speaking. What -- the brand strategy that we have is to keep our -- what we call it iconic brands. We have some iconic brands, like Unic in Mato Grosso State. There is a very strong local regional brand. If we decided to launch Greenfield in the State of Mato Grosso. For example, Unic will be the brand. If you decided to launch the institutions in the State of Parana, Unopar, will be the brand. So it depends where we decided to launch the Greenfields. We are ready, we didn't decided yet the cities, but we will consider the strongest brand in this area.

In the areas that we have no iconic brands, we will launch the Pitagoras brand that is our national brand. It didn't mean that after the integration of Anhanguera we can't change the brand and start to use another brand, like Anhanguera for example. But this decision is -- we just can take after the integration process and we didn't start the integration process yet.

So we will launch with Pitagoras brand in the regions that we don't have iconic brands. So if we started in Greenfield in Mato Grosso, Unic. In Parana, with Unopar. In Santa Catarina, we'll be Uniaselvi. If it's in Rio de Janeiro, it is Pitagoras and in the cities that we don't iconic brands, we can after the integration change for Anhanguera. Okay.

Q - Rubin Quoto

Okay. That's great. Great. Thank you.

Operator

Our next question is from Yag Patel with HNC Capital. Go ahead please.

Q - Yag Patel {BIO 5993207 <GO>}

Hi, gentlemen. Just a very quick question. In your earnings release, you alluded to some changes in, I believe, Q1, structural changes in the graduate program in Q1. Can you remind me what those structural changes were which led to the growth in the graduate students and what we should expect going forward in this business?

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

Yeah. So when we consider the results of these restructuring the numbers of the first graduation in this quarter. We did a very strong restructuring. We give more power for the business unit of post graduation -- of graduate and we increase 9.3% of the student in this process. So we developed a sales team exclusive for graduate, so it with a lot of things that was implemented. And the most important was build a business unit, give more power for this business unit, give more autonomy for business unit and increase the number of the sales force that use it to have in graduate.

Besides this, we make improvements in the quality of the programs, apart of the programs were the content where reconstructed, redeveloped, and we are delivering a program that we believe to have more quality than before. Carlos, if you want to complement something?

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

I think it's pretty much like that. I think that the number showed the results shows that the restrictions working through well and are reinforce -- the company now has a strict focus sales teams only through thinking about the graduate studies and also the development of new programs and new courses in the regions that we operate.

Q - Yag Patel {BIO 5993207 <GO>}

Okay. That's helpful. And are there any other sort of initiatives like that that you're implementing currently that sort of are in the works that will hopefully bear fruit at a later point in other parts of your business?

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

Yeah. There is one initiative. It's a very, very, very important initiative that is about Pronatec, that is about technical courses in Brazil. However the Brazilian government is supporting and prioritizing the technical courses. And Pronatec is the tool, the program that the government developed to help the increase of number of students in technical courses.

Kroton will have the authorization to offer seats for Pronatec, for technical courses, and we start on September, we are launching the technical courses in lot of the units in Kroton, around 20 units in Brazil. It could be a very, very big program but we are just starting.

So this semester we will allow 20,000 seats, we are expecting around 5,000 students in the semester. So for this semester is not a transformational or a very big program but in the long-term we are very, very optimistic that it could be very big in the company.

Q - Yag Patel {BIO 5993207 <GO>}

Okay. And then I noticed that you started disclosing language students in your quarterly release. You've got about 7,000 language students. Just out of curiosity, why did you decide to break that out? I don't recall seeing that previously, but maybe I'm wrong?

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

Hi, yes, I mean we had disclosed that for a while already. I mean it's just a margin of one year that we had disclosed that information in the press releases. And so it's something that's quite stable, the number of students didn't change too much over the term. But we have disclosed that figure in the other releases.

Q - Yag Patel {BIO 5993207 <GO>}

Okay. Thank you very much.

Operator

(Operator Instructions) Our next question is from Javier Martinez with Morgan Stanley.

Q - Javier Martinez {BIO 15226046 <GO>}

Hi, regarding the share buyback program that you announced a few weeks ago. Can you please remind us what are the rules of the game in terms of the equation swap? So do you have any specific clause in the major contract that specify if you compare differential dividends versus or if you can do share buybacks? And what do you do with those shares in order not to impact the liquidation swap?

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

Well, I think Javier for the question it's Carlos speaking. Regarding the buyback program we announced that a couple of months ago. It's about 2.5% only, the limited buyback program. We cannot, according to the agreement that we signed in with Anhanguera, we cannot cancel the shares.

We can keep it in our treasurer. So the only thing that we cannot do is to cancel the shares but we can. Also back to the markets and give as our stock option to the stock option plan to obtain the stock option plan. So this is about the buyback programs that what I can say to you.

And regard the dividend, we have aligned with Anhanguera also, we can distribute up to 25% up, what our bylaw says, 25%, actually. It's the minimum distribution that our bylaw says. So we will continue probably distributing the same level of dividends depending of course on the plans -- on the long-term plans for the company.

Q - Javier Martinez {BIO 15226046 <GO>}

Brilliant. Thank you, Carlos.

Operator

(Operator Instructions) Our next question is from Kartik Nehru of Carlyle Group.

Q - Kartik Nehru {BIO 18007618 <GO>}

Hi, thanks for taking my question. I just had a quick question on free cash flow. So you're obviously generating a lot of cash and according to my calculations, so far through the first half of this year, the amount of cash you've generated is north of 300 million reais. And so if you look at on an annual basis, it's close to 600 million reais and you're growing, as well.

So I'm just curious. Once you pay down some more of your debt, what are your thoughts on, after the merger with Anhanguera, buying back more stock or I guess, what are the other uses of cash? How would you prioritize them in terms of acquisitions, organic growth and buying back stock? Thanks.

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

Hello, Kartik. Thank you for your question, Rodrigo speaking. We had a lot of opportunities to grow yet in the post-secondary environment in Brazil. Of course in the next one or two years, one-and-a-half year, we will be focused in the integration of Kroton and Anhanguera. There is a lot of value to create with this integration. But after this, we have a lot of opportunities to consolidate market, and you have a lot of opportunities to bring, to implement new products like Pronatec, for example, like increase the graduate programs. So there is an industry that has a lot of opportunities.

We don't know yet if the opportunity that we have will be -- will come from all the cash flow that we will generate.

So it is possible that in the long-term, we have more cash and we can increase the dividend level for the company. But it's soon what we announced the new level of this dividend that we can deliver in the mid or long-term. The message that I can give you is there are opportunities to continue growth. So we will need investments, we will need a part of the cash, this cash to or acquiring new institutions in cities that we are not yet even considering Kroton and Anhanguera or develop Greenfield projects or develop the graduate product or Pronatec product that even considering the investment is possible and it's probable that we can increase the level of dividends in the long term.

Q - Kartik Nehru {BIO 18007618 <GO>}

Great. Thanks.

Operator

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 comments.

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

I just want to thank you for participating in our conference today. And now that we are very confident for the 2013 results in the short-term and more than this we are very confident that we are generating value for a long-time in a sustainable platform, we're using a sustainable platform to continue creating value and generating value for the company in a long term. Thank you everybody.