

Q2 2019 Earnings Call

Company Participants

- Carlos Alberto B. Lazar, Investor Relations Officer
- Jamil Saud Marques, CFO & Member of Board of Executive Officers
- Roberto Valerio Neto, Undergrad DL & Centers Officer & Member of Board of Executive Officers
- Rodrigo Calvo Galindo, CEO & Member of Board of Executive Officers
- Unidentified Speaker

Other Participants

- Analyst
- Guilherme Palhares
- Marcelo Santos
- Maria Azevedo
- Susana Salaru
- Thiago Bortoluci

Presentation

Operator

Good morning, ladies and gentlemen, and thank you for waiting. At this time we would like to welcome everyone to Kroton Educational Second Quarter 2019 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 complete, there will be a Q&A 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, may be accessed through Kroton Educacional's Investor Relations website at www.kroton.com.br/ir by clicking on the banner 2Q '19 webcast. The following presentation is also available to download on the company's website. The following information is available in Brazilian real, in accordance with Brazilian corporate law and Generally Accepted Accounting Principles. BR GAAP, which now conform with International Financial Reporting Standards IFRS except, where otherwise indicated.

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

future. Investors should understand that the 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 Kroton's CEO, Mr. Rodrigo Galindo, who will begin the presentation. Mr. Galindo, you may begin your conference.

Rodrigo Calvo Galindo {BIO 17238232 <GO>}

Morning, everyone. Thank you for participating in our earnings conference call of Q2 '19. With us today Carlos Lazar, our Investor Relations Director; our Finance VP, Jamil Marques; and the Managing Director of our business unit, Roberto Valerio, Higher Education; and Mario Ghio Junior, K-12.

Again reinforcing the in our earnings release in the last 10 years, we made very relevant strategic decisions that changed the direction of the company. In 2011, the acquisition of Unopar, we made that decision because we believed education would go through a course of digitalization, which really happened, this way has allowed for us to generate a lot of value. Same thing in 2013 with the merger with Anhanguera. The merger decision was made because, we believed in the capacity to generate value with the integration of assets and increasing the efficiency of these assets.

Now late '17 early '18, we had another turning point. We made another relevant decision maybe the most important in our history, of all strategic decisions. And to see what came up from this discussion. First, increased our exposure to K-12 at Kroton and next engage in a deep journey of digital transformation after one year, how these two fundamental theses has contributed and will contribute to generate value in the company.

First K-12, the acquisition of Somos helped us increase our K-12 participation, Somos allowed for us to operate in two segments; B2C managing K-12 schools and also creating the largest service platform for K-12 schools in Brazil. We're very happy with the results so far both with the platform and the B2C operation. We'll tell you more about this during today's presentation and we'll tell you our plans and dates for the plans in the future.

We're going through the greatest digital transformation, we've experienced in the last 10 years of the company. It's a mindset change and the new digital mindset has allowed for us to improve current business through the transformation and at the same time, we've identified new business opportunities, services that were considered less relevant in the past. We now view them as opportunities to create new businesses.

Our business model based on subscription and B2B services supported by technology platforms, are examples of this digital mindset that is changing the way we do business at Kroton.

We have a lot to tell you and our Kroton Day this year will focus the opportunities in each line of business. It's going to be in October, you're all invited for Kroton Day and we'll give

you more information about the changes and opportunities we are currently developing. But we cannot deny our DNA, we cannot build the future if we do not deliver earnings in the present.

So the first relevant information about the results is that the numbers of the first half make us confident and comfortable that we will obtain the results announced in the guidance. Some revenue was displaced from the second Q to third Q, but the second Q was then a bit weaker, than historically we did not necessarily deliver 50% of the guidance in the first half, but all indicators tell us we'll have a strong second half and the guidance will be delivered.

Now, for better understanding of these messages. Let's go to slide four, where we have a comparison to the guidance. Traditionally, the first half has been stronger because of seasonal effects in higher education this year, we had the impact of K-12, which is different and the weight of K-12 will make the second half stronger.

Now net revenue we delivered to 49% of the BRL 7.4 billion projected for the year. In the second half we'll have a bigger contribution of K-12 as I mentioned. And we will have accounts receivable of the National Textbook Program and the Literary program, which was postponed for the second half of the year. Also results of the second student intake in higher education will be strong.

EBITDA we've retained more than 45% of the projected number for the first half of 2019 or 1.4 billion of the BRL 3 billion total. The second half we will see positive impact in net revenue and also solid margins in addition to more synergies being captured and more efficiency that we built in the first half. Additionally in K-12, we will have a reduction in marketing expenses because some of them were anticipated for the first half of the year.

Finally, also compared to the guidance, we generated BRL 141 million cash after CapEx in the second quarter which reduced our cash consumption. BRL 489 million, the guidance of cash generation of BRL 800 million is maintained.

Talking about government programs. They will be much more relevant in the second half of the year, which will concentrate 90% of the overall amount to be received by National Textbook Program and 60% of total FIES. We also expect a lower volume of CapEx and nonrecurring expenses in the second half which were already budgeted and an improvement in the average payment terms in 2018, which impacted the result in the first half.

So, we will see benefits in the second half of the year. As we know, it is important to deliver the annual earnings. Although, we see some variations between the different quarters, but we are very confident and we confirm our guidance.

Let me now invite our Investor Relations Director, Carlos Lazar to talk about financial results in the quarter.

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

Thank you, Rodrigo.

Let's turn now to slide seven, in which I will comment on the higher education performance. In terms of net revenue, we posted a decrease of 6.6% from BRL 1.5 billion to BRL 1.4 billion, owing to the decrease in the student base, which in turn reflects the number of graduations that occurred this year and also the fact at which we had a strong student recruitment in '13 and '14, and of course we see that in FIES students, we also have a challenging scenario.

Our seasonality have been a little different this year compared to 2018 with anticipation of some effects to 1Q '19 owing to some adjustments also in the student workflows. And also there was an impact in the average ticket as we had announced in last quarter's conference call. The numbers of the average ticket in the second quarter were quite positive in-line with what we had been talking about with the market, 6.7% in on-campus and 5% in distance learning.

Net income showed a decrease of 8.3% with a reduction of gross margin of 150 basis points. And we also see that was a pressure associated with the launch of our own units, but this is a one-off event. So finally, we had a decrease in our operating results of around 15.6% in the annual comparison, also because of the effect of net income and as we said in the last quarter's conference call, we saw a decrease in marketing and also in the PCLD line.

Slide nine, we can detail the K-12 performance and similarly to what we did in the first quarter to make for better comparison. We will comment variations pro forma considering some of the numbers in 2Q '18 after the convergence of the -- to the Kroton's accounting standard. We had BRL 363 million net revenue in the second quarter '19, 3.7% down in the annual comparison, and this is probably an effect of the seasonality in repurchases of the National Textbook Program.

There was also a high volume of acquisition that were concluded by some of them crossing in 2018. It's important to mention that in the third quarter '19 we expect there will be an increase in revenue. So in spite of the synergies we have captured we have made great progress not only in net income, but also in gross margin from 14.1% and 800 basis points respectively. And finally, the operating results post-marketing reached BRL 103 million representing a growth of 27.4% with an operating margin reaching 700 basis points in the annual comparison, following the trend we see in gross income.

Now in the consolidated results, we're off to see the same pro forma comparison including the sum of numbers in the second quarter '18 for better comparison. So, here we saw some negative event, extraordinary event, with an impact on the 2Q results. For example, we can mention K-12 event with the postponement of revenue coming from the National Textbook Program and the result of this BR L90 million of EBITDA were not posted in the second quarter and they are going to be moved to the third quarter.

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There were other events of -- there was negative impact on 2Q '19 results. That's why we maintain the conviction that the guidance numbers will be reached. Consolidated net revenue totaled BRL 1.7 million, down 7.6% vis-a-vis to 2Q '18. Also with an impact of higher education, regulations and the different schedule of the National Textbook Program. And also in terms of our EBITDA after nonrecurring expenses amounted to BRL 625 million, down 7.9% where we're reflecting the impact of some performance of the for the third quarter together with the launch of our own units.

The situation remains stable. And in terms of the EBITDA margin. We are capturing the synergy and efficiencies. And also we see a reduction in nonrecurring expenses line. In the first half of the year we reached 45% of the guidance from base line, which represents 21% annual growth even in the pro forma including the numbers of Somos.

Finally, adjusted net income and after considering intangibles, amortization reached BRL 267 million, down 14.3% reflecting our higher interest expenses and also an increase in indebtedness, because of the acquisition of Somos in the first half of the year. As a whole, we reached 43% of the BRL 1.3 billion expected for the year, representing an increase of 14% in relation to 2018, and the second of the year, will have the benefit of EBIDTA supporting the achievement of our goals.

With this, I close my presentation. And then, I hand it over to our CFO.

Jamil Saud Marques {BIO 21416820 <GO>}

Thank you, Carlos. Now in the next section we're going to look at our provisions for losses and evolution of our average term of receivables per segment and type of student.

Slide 13 on the left an annual comparison higher education. We have an increase of 70 basis points in the volume of total provisioning. These are increases of PDA and paying students that attained 9.1% this quarter. We had an increase in on-premise PDA and stability in distance learning. In both cases efficiency initiative has have mitigated part of this worsening macroeconomic scenario and the increase in the number of students facing a default situation.

But also on-premise we had some effects of the maturation of renewals from the first half of 2018. Also negative impact in the system migration that happened in June 2018. In the annual comparison, we see the incorporation of Somos, in the quarterly comparison we see an increase of 90 basis points reflecting the natural seasonality of operations after the integration of Somos and a PDA of 1.5% is comparable to 1.9% posted in the 4Q '18.

Now in slide 14, want to talk a bit more about the average term of receivables beginning in higher education an increase of 27 days, attaining 192 days. So, an increase of 27 days, compared to the second Q '18 reflecting the same trend as the last quarter, when we had an annual increase of 21 days.

In the case of paying students PMR attained 129 days in this quarter, 32 days above the annual comparison, basically because of the same factors that I mentioned before. So we

had to increase our provision for doubtful accounts and because of the impact in the migration of system of the student from the first half of 2018.

But in the second half, we will have a positive impact in cash. And let me highlight that well, Rodrigo also mentioned that but we are more strict in our policies to make agreements on payment with students. We also have a better strategy of communication and incentive for payment on time and improvements in our financial NPS. So this promotes more on time payment.

Now in the case of the average time of fee FIES, it was 91 days, 75 days below the second Q '18 because we now have more normal flow of receivables after all due payments in the context of PN23 were. Finally, the average term of PEP/PMT was 591 days, up 166 days compared to the same Q last year.

Now in Q -- K-12, the average receivables term was 51 days, an improvement of 34 days, showing that after the acquisition of Somos we were able to reduce the term of receivables. And also the incorporation to the business of new -- or new schools, our new owned schools. Now, finally the average receivables from the integrated platform was 63 days, 22 days below second Q '18, which is again an improvement.

Now, slide 16 we will talk about CapEx and cash generation. On slide 16 on the left our CapEx BRL 120 million in Q2 '19, 6.9% of the net revenue which is stable in the annual comparison. We want to remind you we eliminated the concept of special Project CapEx is already included in the total CapEx which attained BRL 277 million of which 88% were invested in the development of content, systems, extensions and improvements in our units and editorial CapEx.

Investments in the implementation of the new units amounted to BRL 53 million in this second quarter '19. So the total invested in the year- to-date was BRL 98 million.

On the right you see our cash generation post CapEx operating cash generation BRL 141 million in the second quarter '19. With an EBITDA to cash ratio of 23%, a reduction in the annual comparison is due to a higher consumption of working capital, change in the profile of our student, graduation of FIES students, and the increase in the number of students using our financing options. And also as Rodrigo mentioned receivables of the National Textbook Program that were postponed to the second-half of the year.

Now for the year, we expect a cash generation, the post CapEx generation positive is BRL 800 million at the second half will benefit -- will be benefited by a few factors. First, receivable from FIES and the national Textbook Program. Although the National Textbook Program, we will receive less than in 2018 most of these receivables will be in the second half. FIES because the government is cutting on the payments of November, already in December, then we will have a bigger concentration of receivables in the second half of the year. Approximately 60% of the overall amount received in the first half of 2019. Now also reduction in cost and expenses and less out-of-pocket expenses in marketing.

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Now slide 17, you can see the variations in cash balance. Beginning from operating cash consumption, that's the post CapEx BRL 141 million for each block of extension and M&A. We invested BRL 1.8 billion, of which BRL 53 million in extension projects, including three new units that will help students and pay for the first time in the second half and BRL 1.7 billion in acquisitions of controlled companies. The acquisition of participation of minority shareholders of Somos concluded May. In the second block, you see shareholder value generation we paid BRL 133.5 million dividends.

Next, you have funding and amortization in the quarter BRL 778 million positive for the issuance of debentures in April, to reinforce our working capital and elongate our financial liability. With that we had BRL 996 million cash flow.

Looking on to slide 19, we can see the evolution of net debt in the quarter. Our cash position and also cash availability reached BRL 1 billion at the end of the 2Q '19 down 50% in the quarterly comparison reflecting the effect I have mentioned in the previous slide. Also highlighting the disbursement for the offer at the Somos cash consumption and investment in expansion and dividend payout.

So considering our debt and other obligations in the short and long-term our net debt reached BRL 7.4 billion in 2Q '19. We also have to mention that we have receivables in the short and long-term comprehending the second part of payment for the sale of Uniasselvi. As such our net debt at the end of 2Q '19 was BRL 7.3 billion. 35% above the first quarter also as a result of the decrease in cash availabilities and also the first emission of debentures of Kroton in April totaling BRL 800 million. In spite of this we continue to be in our leverage level that's adequate consistent with the projects and opportunities. We are seizing.

On slide 20 an update on our prospects in the three main K-12 businesses. The public market sales in the National Textbook program PNLD we already know the results of the approvals for the 2020 program. We were very happy to report a record approval, about 90% of the books we submitted were approved by the committee. It reflects the assertiveness of our investment in content and the quality of our editorial team. Now after the approval, we will begin disseminating information, the materials are sent to the 48,000 public schools in Brazil in addition to the samples we have intense work of on-premise communication and digital communication.

So we expect to exceed our market share in the last few years. The private market, our number one business is school management. We've concluded our commercial strategy after the acquisition of Somos and the integration. Now, we have a new commercial structure, we call it the GTM 2020. All activities to prepare the process of student intake and renewal for 2020 beginning in August.

Now, amongst the main activity, we have a detailed analysis of competitors in each marketplace. We've added equation of strategy also pricing strategy using all of these information establishing different levels of authority to provide discounts on student payments, creation of digital marketing for schools, adaptation of digital channels, attraction of new readers and investment in online and off-line communication in all

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trends. With that, we are confident that we will be successful in 2020 in this segment of B2C K-12 and as this materializes and our service platform comes to the level we expect we can continue to consider in the second half of 2020 the process of consolidation in this market.

Let me now speak about our second business in the private market, which is the B2B service platform for K-12 schools were very optimistic. After the restructuring that was really relevant our business model is based on subscription with recurring revenue high retention, high predictability of revenues long-term contract, the lifetime value is very high. So this business is based on technology and all of that will potentialize our growth capacity or capacity to grow our revenue on this platform.

Now to ensure this growth, we have also prepared a go-to-market for 2020 for this platform. This was structured between October '18 and March '19, the commercial teams are already using the new go-to-market as of April '19. So the school is in the center of our strategy, we still have a long way ahead of us, but we see a very promising outlook with many more contracts of educational solutions than we had last year and we're very excited about the pipeline of opportunities for this year with the implementation of the service platform concept and all the changes implemented we expect to deliver high growth in the total number of contracts already in 2020. So high growth of revenues.

Finally, the capture of synergies which will total a BRL 115 million until year-end more than 30% of the BRL375 million announced. Now higher education Green Fields are also confirming, as of the business plan, both and also in student intake for 2019 second half which shows a great path to growth and generate value in this cities.

About student intake slide 21 for my final consideration an update on student intake for higher education 2Q '19 have more than a month to conclude to the process to close the student intake process. But it's very, very promising already. Although we know we still have some way ahead of us. Now the macro economic and competitive scenario is as challenging as earlier this year. We expected the economy to recover but so far it has not happened. But we have initial results that are very good and we have a few qualitative messages.

Not considering ProUni which does not bring revenue. We have in distance learning a sight volume growth with a ticket higher than that in 2018 the second half and on-premise, we expect stable volumes but the intake ticket will also be higher than in the second half of 2018. Considering the macroeconomic scenario, we believe this result is quite positive in terms of student intake for the second half of 2019. And that's yet another reason that makes us certain that we will deliver the guidance announced for the year.

Now in the second quarter 2019, we made two important moves in our journey of digital transformation, we trained more than a hundred collaborators in the safe methodology, so that we can implement the new agile development training for the K-12 systems as well. And the second important move is the conclusion of distance learning convergence project. In 2018, we migrated all on-premise graduation students that used original system to the new whole info system, our system.

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At that time, we had a few operating exceptions, which made it more difficult to collect payments for -- from students. So that's why a worse performance in receivables from on-premise students. And we had to carry that for 360 days, so the impact ended only in July 2019. Of course, we didn't want to have the same problem in distance learning. So -- but now months ago we were able to solve this issue all students from distance learning at Anhanguera are in the colaborar system which is Kroton's system.

We did not identify any operating system. So the migration was successful, no operating noise and we now have standardized administrative processes, operating efficiency gains. And what is really important an improvement in the experience of our students NPS is growing significantly and we did not want the system migration to worsen our NPS. Now the digital transformation that we are experiencing, especially the implementation of agile methodology for development have been key for this migration to be successful.

We learned a lot during the process and we concluded the migration quite successfully. We have lots of news in terms of products and digital solutions that will be made available soon for our students and they will be communicated to the market right about October, I believe we will have news to tell you.

Now finally, we have a career reading that we are now coming to a new phase in the company, when we will have new strategies providing more autonomy to business units with B2B and B2C operations very clearly segregated, operating in different segments and unlocking value depending with different approaches depending on the segments.

In 2018, we said our digital transformation view was broad, but not only technology, it was a cultural change. The big value was in the cultural change. Today we can tell you that we already see that in practice developing services and new businesses that will make our growth sustainable. Kroton Day in October we'll provide news on the opportunities that we have identified and how the company is organizing to capture these opportunities.

Now, thank you all very much for your participation. I'd like to invite you for the questions-and-answer session.

Questions And Answers

Operator

(Question And Answer)

Thank you. Mr.Galindo. (Operator Instructions) Our first question is from Guilherme Palhares, from Banco BTG Pactual. You may proceed.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Good morning, everyone. I have two questions. First of all about the some of the synergies. How much of the synergies have been captured? And I would like to

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understand a little bit about K-12 and the ACV bookings. What parts has been completed considering, the 2Q '19 results?

A - Unidentified Speaker

Good morning, Guilherme. Let me answer your question. For the end of 2019, we expect BRL 115 million. Part of this has been captured last year. And we'll complete those BRL 115 million of the previously announced amount. About your second question, the second quarter, that closes at June 30, it represents 20% to 35% of our commercial campaigns for the year. So as we said in the announcement, we are very satisfied with initial results, but they still represent only 20% to 25% of the year's target.

Q - Guilherme Palhares {BIO 20879946 <GO>}

Just to clarify the question I'm talking about ACV. So that is the previous campaign that you still -- you weren't captured yet. Do you have a little bit of this curve? And also, I'd like to understand more about the dropout rate. We saw an increase in that. So what are the strategies the company is adopting to manage dropout? And what we can expect in the client in the future.--

A - Unidentified Speaker

Guilherme, about between an '18 and '19, since we didn't have this integrated platform concept in place. I cannot answer your question. We only inaugurated the use of this concept, this year and we'll be announcing ACV for this campaign next year only.

A - Roberto Valerio Neto {BIO 3305285 <GO>}

This is Valerio, answering your questions about the dropout rate. The macroeconomic scenario in Brazil is still adverse. There are some there were expectations that the economy would be much better now. So, we have -- we could see in the last month, there has been an increase in default rates, both in terms of the students, individual students and also in the volume of default. We have been tracking this very closely.

In this program that you know very well for a correction for part of the dropout rate that are increasing, come from the fact that we are able to detect lesser engagement of students and act on it sooner. So, before we saw this only at the transition between one quarter and another but now we see it earlier. So, I think that's the challenges to work together with the financial team, Jamil and I have been doing a lot together, using different renegotiation policies to bring down dropout rates. We also tried to increase student engagement, both academically and in terms of timely payments. And what we'll see in the next semester is that there will still be pressure on dropouts on-campus, but stability in DL for sure.

Operator

Our next question is from Susana Salaru from Itau, you may continue.

Q - Susana Salaru {BIO 16170633 <GO>}

Thank you very much for this opportunity. We have two questions. First of all, could you tell us a little bit about the first and second tax receiving. We would like to know how this is being handled? In terms of receivables. And another question. You mentioned that you were that you have several digital products and services in the pipeline are those solutions geared to the integrated platforms and are they solutions that will drive margin expansion?

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

Good morning, Suzanne. This is Jamil. In relation to PEP, yes, we have around 1,000 students and what we see is that, if you compare this with out-of-pocket, we see based on our projection -- we see 80% of reversion in those contracts. So obviously, this is just a first thing. We have several other programs. We have been working very hard to try to understand the reason for the defaults, for there is an increase in the situation.

A - Unidentified Speaker

I'll answer your second question. Yes, we can assume that the digital solutions we're implementing, focus on the assumptions that we'll be able to plug into the K-12 platform, creating full service offering for schools, as we have said last year. Our idea is to become the one-stop shop for schools and many of our services are strictly digital. And as you've seen Kroton doing we will explain how digital transformation is helping us tackle problems with efficiency engagement and in other areas.

So that's why digital solutions for the company as they're seen as a lever for revenue. Of course, we want efficiency, but what we want is to invest in digital solutions that will create new sources of revenue for this company because, this is the driver that has been guiding all of our work in the area of digital solutions.

Q - Susana Salaru {BIO 16170633 <GO>}

Thank you very much.

Operator

Our next question is from Mariana -- from Credit Suisse. You may proceed.

Q - Analyst

Thank you very much for accepting my question. I have three questions, if I could. Firstly, about higher education margins. I think it's clear that we see a decrease that is clearly explained, but could you tell us a little bit more about the normalization of this drop. When we'll see the maturity affecting this impact? And the second point is in relation to cash generation.

You have really emphasized this in relation to the guidance, being met for the end of the year. But I would like to know in relation to the FIES and the national textbook program. What is that contribution? How relevant it is? And what are the other impacts? And about K-12, could you give us a little more flavor on it? Because I know that you gave us numbers

for cumulative cushion for 2020. But what are you really investing on systems? What's really making the difference in terms of the initial metrics? What do you expect for 2020?

A - Roberto Valerio Neto {BIO 3305285 <GO>}

Hello, Mariana this is Roberto Valerio. In relation to higher education, we I think that you're right, in relation to the pressure, we have been feeling in margins, we start to see benefits however, in the second half of 2020. With the maturity as it comes along and this will also help us even surpass the other champions, we'll see this.

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

Good morning, madam. This is Jamil. In relation to our cash, we used up BRL 90 million rent of our cash in the first half of the year. And we have generated BRL 900 million for the second half. So this increase, two-thirds come from governmental programs, just to give a more objective measure.

A - Unidentified Speaker

Mariana this is -- I would to answer your question on K 12. In fact, we don't even have commercial targets, in terms of textbooks. What we're doing right now on our got-to market, 2020, is to get agreements we usually use the schools. They are schools that we probably have a relationship in which we can easily market our services, either through textbooks or creating or a mix between digital and textbooks, depending on the segment.

So, your question was about a preview of our results. We signed more learning system agreement, than in relation to the financial bottom-off. And something that was very interesting was the penetration of or solutions, are complementary solutions among our existing clients base. According to commercial, we have the profound opportunity that grew out of proportion, considering the size of our client base.

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

Just to add -- this is Rodrigo. I think that the first message is the B2C platform doesn't sell books, it's just impossible. What we market is services. So all revenue is based on a subscription model with long-term agreements, including sale of books. So, we are a company that's on subscription on a subscription model. This is a key message especially when you consider that we have -- we.

Q - Analyst

Thank you very much.

Operator

Our next question is from Roberto --, Bradesco BBI.

Q - Analyst

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Good morning. Two questions. As mentioned the standard behavior of higher education revenue, was decline of 7% in higher education. Of course we know that the student base has decreased but considering that there has been a relevant increase in tickets as well. Could you please explain this scenario? Why do we see this decline of 7% in revenue considering

Considering you don't break down the account? We don't exactly how much is coming from on campus, but we believe that it will be important to understand what could offset this, if not the increase on tickets. Could you please explain this high single digit decrease? And also in terms of student recruitment, the cycle for 2019. Could you give us some light on the PEP 30, 50? We saw exposure to PEP30 in the last cycle and of course PEP50 is more relevant, and we would like to know if that situation will remain the same or if we'll see more significant volumes in the future.

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

This is Jamil. I will answer your two questions, the first question in relation to revenue. In fact of course, there has been a reduction of our student base, because of the maturing of FIES students in our base. And overall, this decrease comes mainly from own units and on-campus and in DL we see more stability. In relation to that we have an increase in PEP50. In the second half, we continue to see relevant penetration of PEP50. However, lower than in the first half. So this is excluding much growth into PEP50 than 20 to 50, as we saw in the past.

Q - Analyst

Thank you very much.

Operator

Our next question is from Marcelo Santos, JP Morgan. You may proceed.

Q - Marcelo Santos {BIO 20444938 <GO>}

Thank you very much. Good morning to everyone. I would like to talk about that national textbook program. What's the schedule for recognition of revenues in that area for the half of the year? Do you think that the receivables will come in this year or early next year? If you can give us some numbers. I know that you had some agreements in place, but it's also a line that's very hard to predict, in terms of forecast and also in relation to the same program.

Could you talk a little bit about discipline? Were you approved in all disciplines? How many were approved? What's the comparison in relation to the previous year? I think this will be interesting. And also a clarification in relation to the same textbook program. If I understood correctly in the presentation, the literary part of this would represent BRL 90 million in EBITDA, and this will be only coming in later.

A - Unidentified Speaker

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Yes, Marcelo. Three questions about the textbook program. I'll start with the second one. We can never make a comparison on an annual basis because in the PNLD, we have cycle one and two, and we can make a comparison with three years back in fact. So with 91% of our textbooks were approved, in comparison to 73% in the previous year. In terms of discipline. Yes, we're competing in all disciplines with the exception of one discipline. We have at least three books competing in all of the ones. So we have a very robust platform that's being advertised and we're still waiting for two books to be approved in a second hearing. At a course and this would take our books to over 91% in approval in relation to the textbook program revenues. It was initially in the first quarter that we posted the repurchases.

So we had to think the government, in truth the government buys new and then we obviously repurchase. Usually this was in the first quarter, now we've moved it to the third quarter. The purchase is all focused on the fourth quarter. The negotiations takes place in September. But only when the books are available for shipping, that we recorded in this half in October. In this year, the literature books that should have been invoiced at the end of 2019, were moved to 2020 in the first quarter. This would move to the second quarter.

So we have of course, invoiced part of the literature books, but we haven't recognized this revenue or just a little of this in the quarter. So this isn't a typical year. And for the second half, we'll have everything, the repurchase and the purchase and the literary books and in terms of cash generation between the program and FIES will have two-thirds of the cash generation needed to close our numbers for the -- in relation for the EBITDA traction, here we're talking about repurchases, not literature books. And this is a much smaller participation that cannot result in of a business.

Q - Marcelo Santos {BIO 20444938 <GO>}

Okay. Thank you.

Operator

(Operator Instructions) Our next question comes from Maria Tereza Azevedo from UBS Bank. You may be began.

Q - Maria Azevedo {BIO 16178885 <GO>}

Hello, good morning, everyone. Thank you for taking my question. I have two questions. The first, what is the priority in terms of capital allocation, organic expansion of higher education, M&A in K-12 or M&A in learning systems? And how can you generate more value to shareholders in K-12? And the second question about higher education.

If you could speak a bit more about Greenfield operations, when will they ramp up? If you have any projections on ticket and dropout. Is that going to be better than previous units and if you see any room to accelerate or speed up the strategy to open new units, looking at macroeconomics and this competitive scenario today.

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

FINAL

Thank you Maria Tereza. So this is Rodrigo. I'll begin the answer and if needed Ghio and Roberto will about CapEx, we will discuss about opportunities and priorities on Kroton Day in October. But I can give you some color. We have seen relevant opportunity in B2B products and services. In the K-12 platform, which is up and running generating value and growing. We still see opportunity to add more services to the K-12 platform.

So we become our one-stop provider for K-12 schools. So part of capital will be allocated there. New products, M&A of products on the K-12 platform, but we also see opportunity - I mean other business opportunity, all of them based on technology solutions, digital solutions and we will talk about that on Kroton Day. Still, about capital allocation by the midpoint of 2020, we may resume the process of K-12 school consolidation because they add value, it has an adequate ROIT, the market is not highly professional, so we can capture synergies and efficiencies and we believe they can add a lot of value in this process of K-12, schools consolidation.

It's similar to higher education a couple of decades ago. Of course, the integration is different, the consolidation is different. But at the end of the day, we have a lot of efficiencies needs to be captured. So in this game of consolidation and efficiency, we played in higher education in the past, we cannot play in K-12. However, we made a strategic decision to first optimize our K-12 platform with the schools in our base. And then, as we see or the time has come, we will resume the process of consolidation with a good student retention for 2020.

So, 2020 may be the right time to resume this process of K-12 schools consolidation, and then capital would be allocated. About your second question on Greenfields. In general, the some of our Greenfields. Here above the business plan in revenue, in volume and earnings. It doesn't mean that the project is already generating positive cash, but it's consuming less cash than expected in the business plan. Greenfield is long term. It adds a lot of value but, during the first four or five semesters, or two or three years, it consumes cash. So we already have Greenfields that finished their ramp up. There already providing cash.

But overall, Greenfields are still consuming cash. But Roberto said, we expect that in terms of margins, we will already have positive margins about the second-half of 2020. But, the overall message is that the project is doing really well. Thank you. As we add up all Greenfield projects, we are above the business plan. And we're very optimistic. Also in relation to turning-K in 2020. So, these indicators we have is, well the student intake for the second half of 2019 and we expect a very good results. That is we're certain we will overcome our target for Greenfield operations.

Q - Maria Azevedo {BIO 16178885 <GO>}

Okay. Thank you.

A - Unidentified Speaker

Yes.

Operator

Our next question comes from Thiago Bortoluci from Goldman Sachs. You can begin.

Q - Thiago Bortoluci {BIO 17950069 <GO>}

Hello, everyone. Good morning. Thank you for taking my questions. I have two. The first is about K-12. We believe this year is atypical. We still had the integration with Somos, but thinking about 2020 and the mid-term, what would be a top-line satisfactory growth rate for this business unit?

And what products would be the focus of this growth in run rate? And the second question about the guidance. You've delivered almost half of the guidance in revenues, but a bit less in EBITDA. In Terms of EBITDA what kind of acceleration do you expect in the second half, coming from K-12 on-campus or distance learning?

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

Hello Thiago. This is Rodrigo again I'll begin and Ghio will complement. First about K-12. We cannot give you the rates of growth, this is something we cannot inform now, but we can talk about that qualitatively, what we expect in terms of growth. We are optimistic about our growth, and one product is not any more relevant than any other.

What we want is to be an integrated platform that provide content services, technology services to support the content, we provide and pure digital service. So this is not a platform or a solution that provides only content. It's much more thorough because we deliver content, technology to support the content and also technology solutions, which we can provide and maybe needed by the school.

This is what is going to create growth in the future and it increases our addressable market. So, we expect huge growth in the platform. Penetration rate. That is now it's fairly small compared to their potential. And we still have a big penetration potential in our client base. The message is that in the current client base, we can grow our penetration. So we have a lot of room for upsell and cross-sell in the existing base. And in addition, we have some dozens of thousands of schools in the addressable market, so that we can capture part of their business. So I think this is the message our K-12 and growth.

A - Unidentified Speaker

Yes, well, I think Rodrigo has already spoken about most of the relevant factors. But if you think about only products and services for the core function of school, which is to teach. We have seen that our unique positioning has provided very good results, for this capacity of ours to provide good textbooks and learning systems at a reasonable pricing range, is a very powerful offering. So this year or next year, we expect a lot of revenue to come from these new products and services, which are the most common that schools buy.

About our growth as Rodrigo mentioned, we cannot give you precise numbers, but if we can -- I mean in the next few months of student intake, if we can keep the same growth we've seen in the first results, well, then we will grow much more than in previous years.

So most probably at the end of the third quarter, we will be able to talk about this, how this student campaign produce results for next year.

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

Now Thiago, this is Rodrigo again. About your second question. To make a long story short, we're confident we will deliver the guidance. And the numbers in the second quarter, have only confirmed this optimism, that we will be able to deliver the guidance. You said, that in revenue we're very close to 50% and EBITDA we're at 45%. So it is easily understandable. We had seasonal impacts and we understand these seasonal impacts, so we are concerned about, attaining the EBITDA, but very confident that we will, provided that we can generate cash.

We feel very comfortable that we will be able to deliver the guidance. Some elements that give this confidence to us, first, the quarterly deviations we mentioned during the presentation. The BRL 90 million EBITDA, that were moved the 2Q to the 3Q, related to the National Textbook Program. Also, synergies and efficiency. We implemented actions in the first half, but we will capture the results in the second half of the year. So that's also value to be captured in margin. And so therefore in EBITDA as well.

Now a reduction in marketing expenses in K-12, which were moved to the first half of the year. So these are some examples that give us this certainty that the second half will deliver more than 50%. So that we will be able to deliver the for guidance full 2019. This is the final message. And if you have any more questions do come and talk to us, we'll provide more color on this information, but we feel confident and we want the market to also feel confident about this.

Q - Analyst

Yes. If I can follow up. So on revenue from K-12 in B2C for K-12. When will we begin to see the first G&A results with partnered School?

A - Unidentified Speaker

Can you please repeat the question?

Q - Analyst

I'm sorry. In K-12, in B2B, when will we begin to see the first results from the management services and partner schools?

A - Unidentified Speaker

Okay. Let's talk about this. Our objective is to provide services to schools, no matter what services the school needs. So, now we are plugging services to the platform and we will be talking about this on Kroton day. There's not much I can tell you today, but we will attach priority to digital solution, which are more scalable to plug to the platform. We'll give you more color on what these services are and we'll give you more information about the platforms, the services we already offer. The services we are preparing and what we expect, in terms of results. We'll talk about this on Kroton day, in October.

Q - Analyst

Okay. Thank you.

Operator

Ladies and gentlemen (Operator Instructions) Let me now give the floor to Kroton for final consideration.

A - Unidentified Speaker

I would like to reinforce just one point. Value generation that's adequate and responsible is the one that thinks in the short-term and build of the long term. This is what we are looking for in Kroton. And this is the strongest message we have to give you. We will deliver the guidance for 2019 as I said, but we talked a lot about the value generation, the ramp of new opportunities and how digital transformation is creating an impact on the way we work with education. And you're all invited to participate in Kroton day. As soon as we get all the details, we'll communicate it to the market because, we'll gives a lot more color about the opportunities that we are seeing and implementing in the organization. And of course, our IR continues to be available for any other question.

Operator

Thank you very much. Kroton conference call is now complete and we thank you all for your participation.

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