Q1 2017 Earnings Call

Company Participants

- Daniel Sonder, Chief Financial, Corporate, and Investor Relations Officer
- Rogério de Araújo Santana, Managing Director-Investor Relations

Other Participants

- Alexandre Spada, Analyst
- Carlos Gomez-Lopez, Analyst
- Domingos Falavina, Analyst
- Eduardo Nishio, Analyst
- Frederic de Mariz, Analyst
- Marcelo Cintra, Analyst
- Mario Pierry, Analyst
- Thiago Kapulskis, Analyst
- Tito LaBarta, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call about the Earnings Results of the B3 for the First Quarter of 2017. At this time, all participants are in a listen-only mode. Later, we'll conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded and broadcasted live via webcast. The replay will be available after the event is concluded.

I would now like to turn the conference over to Mr. Daniel Sonder, Chief Financial Officer of B3.

Daniel Sonder {BIO 18250247 <GO>}

Good morning, everybody. Thank you so much for joining into our call. I'd like to welcome you to B3's First Quarter 2017 Results Conference Call. I am sitting with the Investor Relations team as well as the finance team with the colleagues from both the former BVMF as well as former Cetip. And before we start, just wanted to thank them for the excellent work that they've done, in particular, in this quarter when we had, as you have noted, all the impacts of the combination and the material that you see in front of you are obviously their work.

So this is our first earnings call after the approvals of the business combination between BM&FBOVESPA and Cetip and on behalf of the entire executive team, I would like to thank our shareholders and the analyst community for the confidence that you have put in us throughout this process. We are honored and humbled by the challenge of leading this outstanding organization and the team at B3 into an exciting future.

Going to the first quarter 2017 results. In order to help shareholders and analysts to better understand B3's performance in the quarter, we based our analysis on a combined non-audited income statement which includes BM&FBOVESPA and Cetip's figures for the entire quarter. It also eliminates revenues and expenses of transactions carried out between the two companies, although these are rather small.

So if you move now to slide 3, it shows first quarter 2017 highlights. We present our operating and financial highlights for the quarter. We will then go into more details in the following slides. As you can see on the top of the slide, B3 net revenues reached almost BRL 1 billion, growing 7.6% in comparison with first quarter 2016. This is a result of a solid performance in four of our five segments, especially in equities and liens and loans registration. The only exception was the BM&F segment derivatives that showed revenue reduction. We will go into more details in the operating highlights in the following slides.

Our adjusted expenses reached BRL 252 million for the quarter, an increase of 8.5%, mainly impacted by the annual salary adjustments. It's important to say that the company's net income was impacted by non-recurring items related to the business combination with Cetip, which we will explain in more details in a minute. Excluding those non-recurring items, net income would have grown 9.6%. We also announced the distribution of BRL 140 million in interest on capital, which represents 50% of the IFRS net income for the quarter. As we have said in previous earnings calls, we intend to pay out 50% of our accounting net income in the first three quarters of the year and then adjust and decide whether to increase this rate in the last quarter of the year. It's always important to mention that this is a discretionary decision of our board in each and every quarter as to the final earnings distribution.

Moving to the new budgets we just announced, we announced guidance for OpEx between BRL 1.05 billion and BRL 1.1 billion for 2017, which means a 4.9% growth considering the midpoint of this range. Starting from this year, we also included a depreciation and amortization budget to guide the market on this expense line. The guidance for this expense is between BRL 790 million and BRL 840 million and this includes the amortization of intangibles. Our budget for CapEx for 2017 will be between BRL 250 million and BRL 280 million.

As you know, we approved in the shareholders' meeting the new board of directors for the next two years. The number of directors increased from 11 to 14, with 3 members coming from the board of Cetip. Also, in the beginning of May, Gilson Finkelsztain became CEO of B3. We have already started the integration program, which has three main pillars: one company, pleased clients and motivated teams. We expect to conclude most of the integration projects within the next 18 months.

In the next slide, there are some more details about the non-recurring items before we go into the business itself in a minute. So we try to summarize in this table the non-recurring items that impacted our first quarter results. The expenses directly related to the business combination with Cetip reached BRL 341 million and they are made up of: first, the impairment of the iBalcão platform at a value of BRL 65.5 million; write-offs and provisions for fines related to contract consolation (06:37), reaching BRL 35.5 million; third-party services including banks, lawyers and advisory fees and accountants and others to close the transaction in the amount of BRL 100 million; and the payments related to the cancellation of long-term incentive plans to the tune of BRL 141 million. Additionally, we recognized BRL 134 million in non-recurring provisions related to some legal disputes which we updated and registered here.

And now, I will turn to Rogério, and he will give you more details about our operational performance.

Rogério de Araújo Santana

Thank you, Daniel. Good morning, everyone. I would like to ask you to move to slide number 5 where you'll see the revenue performance and breakdown for the first quarter of 2017. In the bar chart shown on your left side, we see that only the – the BM&F segment is the only segment where we saw revenue reduction in this quarter, while all the other four segments, I mean, Bovespa segment, the Cetip units, and the financing units, and also the other revenues of course (08:03) show revenue growth.

In the pie chart on the right side, we see the breakdown of total revenues for the quarter. By combining the BM&FBOVESPA and Cetip business, we have an even more diversified revenue base with equity-listed derivatives and securities and OTC derivatives registration represent roughly one-fourth of total revenues, each of that (08:25).

Moving to slide 6, we will find details on the performance of the financial and commodity derivatives market, where we have a 9.8% revenue reduction. As you can see, as you can track through the monthly operational data we released, we had an important reduction of 30% in the average RPC, that was partially offset by a 20% growth in the ADV in this segment.

Another important information related to this segment is that we adopted a cash flow hedge account for part of the U.S. dollar-denominated revenues in this segment, which comes from the fees collected in the trading/post-trading of FX rate, interest rate and in U.S. dollar, and some commodity contracts. This hedge were offset (09:18) by designating the one-year U.S. dollar loan we entered into December 2016 to cover part of the U.S. dollar-denominated revenues generated by this contract.

Moving to slide number 7, we have the performance of the equities markets where we saw 21.2% growth in revenues. This growth was mainly driven by the increase of ADTV from BRL 7 billion to BRL 8 billion, a 15.6% growth. We also saw 1.5% increase in the trading and post-trading margins for this segment. This performance reflects the recovery of the

Brazilian equities market, which we can see in the chart – in the market capitalization of Brazilian companies in the chart on the bottom right of the slide.

In the slide number 8, we have the performance of the Cetip UTVM segment where revenues grown, the registration of fixed income secured and OTC derivatives grew 4.6% over the first quarter of 2016. The main sources of revenues in this segment are the fees charges on the registration of secured, maintenance or custody fee on the open positions, monthly utilization fees and fees per transaction paid by our clients. In the first quarter 2017 particularly, the main driver for revenues growth was the increase in the number of transactions made by our clients in (10:51).

Moving to slide 9 in the Financing Unit segment, also called as Cetip UFIN, the revenues are generated by fees charges on the registration of liens and loans related to the vehicles private (11:13). Revenues in the segment grew 15.8% year-on-year. This growth was mainly driven by a 7.2% increase in the number of vehicles financed which reflects the combination of growth in the number of vehicles sold with higher penetration of credit in this market.

Now I'll pass the word back to Daniel, who will detail our expenses and other financial highlights.

Daniel Sonder {BIO 18250247 <GO>}

Thank you, Rogério. In the next slide, which is page number 10, we showed the adjusted expenses and how they performed for the combined company. Adjusted expenses reached BRL 252 million for the quarter, a 8.5% increase, mainly impacted by the adjustment personnel expenses which exclude long-term incentive plans. This increase in adjusted personnel was mainly explained by the annual salary adjustments applied in August 2016.

We'll move now to slide 11, where we have the cash position and other financial highlights. We show that the company has maintained its financial robustness with a solid cash position, which is an important part of the business of being a credible counterparty in the financial market. Total cash amounted to BRL 15.7 billion at the end of the quarter, composed by B3's own cash, as well as third-party cash. This third-party cash is mainly related to collateral pledged in cash by clients.

On the right side, you'll see that B3's own cash, made up of restricted and unrestricted cash amounted to BRL 13.4 billion in first quarter 2017. Our own cash includes the necessary cash to run the day-to-day activities of the company that totals between BRL 2.5 billion and BRL 3 billion. This amount includes approximately BRL 1 billion clearinghouses' required safeguards. The remaining adds to the liquidity that support our activity as a central counterparty and other general corporate needs.

Excluding this cash position that is necessary to run the business, we had almost BRL 10 billion in available cash that was retained as of the end of the first quarter to fund short term obligation including first of all BRL 8.5 billion regarding the payment of cash portion to Cetip shareholders that was made in April 28. BRL 511 million to settle the FX swap the company entered into, to hedge the principal of our 2020 notes. The swap was set out on April 3. It's important to mention that we entered into a new swap to hedge this FX exposure related to the bond and BRL 1.1 billion in debt obligations that are due throughout 2017 including principal and interest.

On the blue bars on the graph of the left, we see the third-party cash which amounted to BRL 2.3 billion and it's mainly made up of market participants, cash collateral of BRL 1.8 billion. It's important to highlight that the company does earn interest on most of this cash balance.

Moving now to slide 12. We see the first quarter of 2017 financial results which amounted to BRL 199 million flat compared to the same period of 2016. We show the financial income on the top part of the slide and these were impacted by a higher cash balance carried by the company for the payment of the cash portion of the combination with Cetip and which was paid out on April 28.

And on the bottom in lighter blue, we show the financial expenses. In this quarter, we had the full impact of the interest accrual on the debentures issued in December 2016, which amounted to BRL 96.2 million. We also had the impact of hedging cost for the 2020 notes, which amounted to BRL 79 million in the quarter and includes the hedge of the principal and certain coupons.

In slide 13, we call attention to some balance sheet highlights. We show the balance sheet for the combined company. We have already performed a preliminary purchase price allocation or PPA analysis for the Cetip combination transaction. This appraisal shows approximately BRL 5 billion in intangibles, mainly made up of softwares and technological platforms, which we expect to amortize in approximately seven years and this will impact our company's expense through the depreciation and amortization line.

The goodwill, which is another amount, adds to BRL 7.9 billion according to this recent evaluation, which we estimate will allow us to have roughly BRL 7 billion of goodwill for tax amortization. This is a preliminary evaluation which could be reviewed within a 12 months period for the company. Although we don't expect material changes to that.

We also had two other significant balance sheet impacts for the quarter. The impairment of the iBalcão platform amounting to BRL 65.5 million and BRL 134 million for the provision of some legal contingencies after we reviewed the criteria for probable losses in these contingent liability. And lastly, the payment of the cash portion of Cetip transaction of BRL 8.4 billion was done and completed on April 28 as mentioned before.

So, we now move to the new guidances. And as we announced last Friday, they are as follows: Adjusted expenses for 2017 will be from BRL 1.050 billion and BRL 1.100 billion. Considering the midpoint of the range, it means a 4.9% growth from last year. Depreciation and amortization should be between BRL 790 million and BRL 840 million and includes the amortization of intangible assets I mentioned in the previous slide. And

CapEx for 2017 will be between BRL 250 million and BRL 280 million which is lower than the combined numbers we saw in previous years for the separate companies.

Moving now to slide 15, we show the OpEx and CapEx budgets that relate to the combination with Cetip itself. It's divided into two main groups. In the first group, we show the expenses and other impacts in the accounts that arise from the completion of the business combination with Cetip. These were the expenses we incurred to conclude the transaction effectively. They are mainly made up of contractual commitments and other accounting impacts, expenses related to retention and severance programs approved in our last Annual General Meeting and three fees paid mainly to advisers and consultants.

These are estimated as a total for 2017 as BRL 420 million, of which BRL 304 million have already impacted our numbers in the first quarter of 2017. The other group in the bottom half of the page show the expenses and investments that we expect to incur to capture synergies. These include severance payments and also payments to service providers and they should range between BRL 175 and BRL 190 million, of which BRL 150 million in 2017.

In the case of CapEx, we expect to spend roughly BRL 50 million equally split between 2017 and 2018 to make the changes in our technological infrastructure as well as our physical infrastructure necessary to put the two companies together.

So, I would like to end now the formal presentation and open our Q&A session. Thank you very much.

Q&A

Operator

Ladies and gentlemen, we'll now begin the question-and-answer session from investors and analysis. Our first question comes from Mario Pierry, Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi. Good morning everybody. Congratulations on your results. Let me ask you two questions, please. The first one, if you could explain to us the impact of a lower interest rate environment on your five business units. So basically you're trying to get a feeling here how do you see your business unit performing as interest rates come down in Brazil.

And then the second question is I just wanted to understand a little better here these guidance that you're providing especially on the OpEx. Basically, trying to understand how much of the synergies are already reflected on your guidance? And also, it wasn't clear to me here on page 15, you're showing that you were going to incur expenses of BRL 175 million, but you're only going to keep BRL 100 million in synergies. So just trying to understand, it seems like you have much higher costs than benefits from capturing synergies. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay, Mario. Thank you very much for your questions. So let's start with the first one, with lower interest rates. And I think I'll just highlight a few points which I think are worthy of note. On the BMF segment, I think that the lowering of rate essentially means that the total, let's say, outstanding balance of transactions that could be hedged, especially interest rates, grow, right. If banks are lending more because of lower interest rates and the economy is moving faster, they will need to sort of increase their balance sheets on both sides. And hopefully that will combine with a movement of lengthening of maturities as well as changes in the profile of fixed to floating or floating to – sorry, less floating to more fixed or inflation-linked securities. And all these things, I think, help us in the traditional derivative business, particularly for rates.

In Bovespa, I think you know how to do this math better than anyone. So lower rates likely means higher market capitalization, growing businesses with higher earnings and particularly interesting, I think, will be to experience again what we may have seen in the last cycle of rates lowering, which is investors not being happy anymore with just sitting on government bonds and seeking other ways to increase their returns particularly looking for opportunities in equities. So you know how skewed the investment profile of most of Brazilian individuals, pension funds and asset managers is, towards public government debt. And I think we should benefit greatly in the equities business, should we see a prolonged and sustained period of lower rates with a consistent fiscal policy backing it up differently from what we saw last time.

In the securities units of Cetip UTVM, I think again you see two things there. One is the same thing that I mentioned earlier for listed derivatives you should see for OTC derivatives, but also, I think importantly, you have the whole corporate sector and the corporate bonds, the debentures, in Brazil. And the fact that you'll have lower rates again in a scenario of a growing economy as well as less access to public bank funds such as BNDES and others should lead to a more active capital markets activity in fixed income. So that's, I think, an exciting part of the securities business in Cetip which we look at run rates are lower.

And finally, in the auto loan and lien registration business and in the real estate further down the road, those two definitely benefit from lower rates as not only demand picks up, but also, let's say, the coupon payments or the monthly payments that are due on cars and on real estate become lower, I think the willingness to borrow should go up. So I think we are pretty well-positioned in all fronts and that's one of the tailwinds that's going to push us forward.

With respect to the guidances which you asked, we have released a guidance for synergies of BRL 100 million that we will seek to capture by the third year of the combination. That means that our expenses will be lower as a total company by BRL 100 million compared to what we had as separate companies. Some of that is already being captured in 2017. We are not, at this point, giving this breakdown by year, but yes some of it is already incorporated into 2017 as you look at the numbers that we have released. Some of that will be there and we will be sort of keeping everyone posted as we move forward, but we're keeping the combined goal of BRL 100 million as the number we are sharing with the market, although internally obviously we have more specific targets for how that should scale up or grow over the next three years cycle.

And then finally, regarding your observation on the cost of the integration, the BRL 100 million is an annual recurring number. So, the right way to think about it or the better way to think about it is to model it out for several years and then compare that number in present value terms with the costs that we are incurring with the integration, which is one-off. So it's not BRL 185 million versus BRL 100 million, but rather BRL 185 million versus BRL 100 million throughout many, many years.

Q - Mario Pierry {BIO 1505554 <GO>}

Got it. That's very clear. Just if you can provide just a little bit more color where these synergies are coming from in specific line items?

A - Daniel Sonder {BIO 18250247 <GO>}

Yes. So we have companies that are very similar in terms of the breakdown of their expenses, right. And in both cases, between 50% and 60% of expenses are related to personnel. So it's not surprising that we should see the majority of these savings coming from that but we also have savings in contract, in certain service provider, both things such as accounting fees and other sort of corporate overheads, but also IT contract maintenance or some of the systems which are overlapping, which we can simplify. So this is what we are focusing on.

As I have mentioned before, in the client-facing activities, if you will, the main business of operating the platforms of derivatives, equities, trading, post-trading, registration of securities, registration of derivatives, registration of auto liens and loans, these things don't change. These things don't overlap. So we don't expect to see much savings in dump – converting one platform to the other or something like that as you might expect in a merger that would be a more vertical merger. This is a horizontal merger. We don't do the things that – each company didn't do the things that the other company did. So we're basically parking the two companies side-by-side from an operating standpoint and most of the BRL 100 million will actually come from corporate functions and overhead.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Just related to this question of synergies, when I look at your CapEx guidance here, if I can properly read the line here, seems like your CapEx for BVMF alone would have been higher in 2017 than in 2016. So I was under the impression right at the end of your CapEx cycle the BM&F, so just wondering why would your CapEx still be going higher for BM&F in 2017.

A - Daniel Sonder {BIO 18250247 <GO>}

The guidance we had given earlier in the year for BM&FBOVESFA standalone was BRL 165 million to BRL 195 million compared to an actual of BRL 224 million for 2016. So we were already lowering our own CapEx standalone. And as we look at this, if you take the midpoint of BRL 180 million here and you add the number for Cetip from last year, that's essentially where we are for this year at the top of the range. So that's BRL 180 million for

BM&FBOVESPA, BRL 100 million for Cetip that takes us to BRL 280 million. That's the top of the guidance. So I think, we're not increasing our CapEx vis-à-vis what we had announced earlier in the year, neither is Cetip.

Q - Mario Pierry {BIO 1505554 <GO>}

Perfect. Thank you. Very clear. Thank you very much.

Operator

The next question comes from Thiago Kapulskis, BTG Pactual.

Q - Thiago Kapulskis {BIO 19187926 <GO>}

Good morning, everyone, and thanks for the opportunity to ask. I have a couple of questions. The first one is in terms of the integration of clearings, with the end of the process with Cetip, is there any update on that? Is the calendar already (32:05) of the final dates for that changing or if you guys could give me an update on this, it would be interesting. And my second question is in terms of the public hearing of pricing. How is it going? Is there any update on that? If you guys could provide, that would be interesting as well. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. Thank you, Thiago. So with respect to our clearing integration project, it's moving forward. We are doing a number of rounds of tests with the market as well as engaging with the regulator. This does not become affected by the merger, neither in terms of technology or requisites or requirements that we need to adjust in the system itself, nor with respect to any different regulatory approvals. And neither lastly, with respect to teams because we have made a very clean cut in the company in terms of who's dedicated to projects in the integration front versus who's dedicated to projects in the clearinghouse front.

So we are separating these out and again moving forward, it's, as you know, complex and very mission-critical project not only for us, but for close to 70 brokers in the market and financial institutions and custodians and so forth. So there's a big effort underway and expect that during the third quarter we should complete that. The public hearing for pricing, the period for comments ends at the end of May. We have not received any comments thus far. So when we have something that we receive, we will make that public.

Q - Thiago Kapulskis {BIO 19187926 <GO>}

Great, Sonder. Thank you very much.

Operator

The next question comes from Alex Spada, Itaú BBA.

Q - Alexandre Spada {BIO 16687974 <GO>}

Hi, gentlemen. Good morning. I have a few questions. First one is on your strategy to pay back the debt you have maturing in the following years. So what can we expect in terms of dividend payout ratio in this period and also would B3 be willing to distribute IOC to the point where it creates tax credits or would you rather distribute dividends, if that's the case? And then I'll come back with another question. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Spada, welcome back. Nice to have you.

Q - Alexandre Spada {BIO 16687974 <GO>}

Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

So first of all, with respect to debt and dividends, we have published the schedule for our debt amortization as it's hired (35:21) right now or as it's in the books as of now. We expect to amortize all of our debts on time and our target is to reach a level of a maximum of one-time gross debt to EBITDA by the end of 2019, okay.

So that's what we have in mind. And to do that, we will pay the maturities as they come due. And it's according to what we have planned and obviously with some degree of flexibility here, we find that over the next three years, we will basically pay between 70% and 80% of our accounting net income in terms of payout which, as you know, our accounting net income is smaller than our cash generation. It roughly means that 50% of the cash generated by the company will go to amortize debt and 50% will go to payout to shareholders.

That's roughly the calculation we work right now, but obviously that will depend on the performance of the business and on each decision that the board will make regarding that. We will mainly use interest on capital to do that. And we will evaluate when we reach that level whether we should pay more IOC and accumulate tax credits for the future, or whether we should change to dividends. There is no decision made on that point yet, but there will be a priority given to interest on capital for obvious reasons as the preferred instrument of paying out this portion during this period.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. That's very clear. Thank you. And a follow-up. You provided guidance for depreciation, amortization. I just wonder if that includes also the amortization of goodwill, which doesn't flow through the income statement, or if that range you gave refers only to what we're going to see in your income statement as an expense?

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. That does not include the goodwill portion, okay? It includes only the items that flow through the...

A - Rogério de Araújo Santana

P&L.

A - Daniel Sonder {BIO 18250247 <GO>}

... let's say, top part of the P&L. And for the goodwill, you should take the BRL 7 billion and we are planning to amortize it in five years. So you can run the tax book calculation on the side and then bring that back through the tax line as you well know.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. Very clear. And one quick follow-up. Do you have an estimate on when you will really start amortizing that, if I'm not wrong you depend on certain procedures to really be able to start amortizing that?

A - Daniel Sonder {BIO 18250247 <GO>}

Yes. It's going to be in the third quarter. So we're working hard now to get all those things done that are necessary for the, let's say, legal merger, you know, incorporación of Cetip into B3 and we should expect to start amortizing in the third quarter.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. And that applies to the goodwill and also intangibles created in the merger?

A - Rogério de Araújo Santana

Yes. In the case of the intangibles, you're going to see the amortization in the income statement, right? But the tax credit, we're going to benefit from that only in the third quarter after the legal merger, as Daniel mentioned, but you're going to see the amortization in the income statement and then in the third quarter it'll start to benefit.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. That's clear. Thank you all.

Operator

The next question comes from Tito LaBarta, Deutsche Bank.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning, Daniel and everyone. Thanks for the call. A couple of questions. One just a little bit technical in terms of the extraordinary expenses. Just trying to reconcile the difference between the managerial and the IFRS. You had expenses of around BRL 275 million in the managerial, but in IFRS it was BRL 45 million. And comparing that, you said I think roughly around BRL 400 million in extraordinary expenses for the year. Just wonder how is that going to be calculated. Just wanted to understand the difference between those two numbers there and how is this going to show up throughout the rest of the year?

And then my second question in terms of financial income, given the payment to Cetip, I mean it's fair to assume I guess the financial income should fall roughly in half – roughly BRL 200 million this quarter with that payment and I guess also interest rates coming down. I would expect the financial income is going to fall. Just want to confirm that. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

I'll start with the second one, Tito. You're absolutely right. So financial income will drop significantly. In fact, if you think about BM&FBOVESPA prior, we always had a very positive financial income with a lot of cash and old debt particularly over the last few months when we were carrying the cash for the transaction. This will now flip, right, because we now have a lower cash balance and we do have debt indeed. So financial income will change. Again, I think the general numbers are what I mentioned earlier in the discussion, carry cash for our own purposes of BRL 2.5 billion, BRL 3 billion and then whatever cash we carry from third-party which also generates financial income for us.

A - Rogério de Araújo Santana

Hi, Tito. It's Rogério. Regarding your first question. You are right. There is a difference between the numbers you see in the IFRS income statement and the numbers in the combined income statement we provide you. The difference is related to the fact that all the impacts that comes from Cetip's side is not in the IFRS income statement because it was included in the equity base used in the purchase price allocation. So what you see in the IFRS numbers is only the part that comes from Bovespa – BM&FBOVESPA. So you have the impairment of the iBalcão platform and the expenses related to the fees paid by BM&FBOVESPA to their advisers. This is the difference between these two lines in the IFRS versus the combined numbers.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Great. So we won't see any additional related to those Cetip expenses. What is left to see is roughly BRL 100 million for the rest of the year that you talked about earlier. Is that correct in extraordinary expenses?

A - Rogério de Araújo Santana

Yes. Now on everything that you're going to see will impact both IFRS and any other combined numbers because we are read as (42:48) a single company.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Great. That's very clear. And if I can, just one follow-up question, I guess on the tax rates. Excluding the goodwill amortization and with payments of interest on capital, what kind of tax rate are you expecting for the year because I guess this quarter was not impacted by interest on capital. Correct?

A - Rogério de Araújo Santana

Yes. You're correct. The first quarter was not impacted by interest on capital. We approved the IOC distribution that will impact the second quarter. So basically, you can deduct the amount we pay on interest on capital from your EBT (43:25) base that you have in your model, then you're going to find probably tax rate that will be around 20% in the accounting numbers.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Perfect. Thank you very much.

Operator

The next question comes from Frederic de Mariz, UBS.

Q - Frederic de Mariz {BIO 15383052 <GO>}

Thank you. Good morning, everyone. Thank you for the call. Congratulations for the consolidation. I have a few follow ups. The first one on the one-offs that we saw in the first quarter. Can you just repeat or confirm what kind of other one-offs you may expect for the second quarter and for the following quarters?

The second question has to do with the depreciation. We've got the guidance you gave for the full year. It looks like a large acceleration in the depreciation expense in the P&L. So should we expect something like BRL 200 million to BRL 250 million in depreciation in the P&L per quarter?

And then the final question on the integration on the clearings. We set the guidance for 2017 for CapEx. Should we expect the CapEx to come down meaningfully next year as you've already done with those one-off projects? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. Let me start with the CapEx. Frederic, thank you for the question. We find that we are finishing the clearinghouse integration at the BM&FBOVESPA. And this is already a year where we are seeing a reduction compared to the two previous years in our company. Cetip also finished some investments, in particular, the migration of their main platform to São Paulo from Rio, which was also weighing a little bit on their CapEx for the past two years.

Now having said that, the number – sort of long-term number that we are guiding for is around BRL 250 million for the companies. We think that technology is obviously a key asset and a key advantage and an attribute that we are recognized for, and we will make the necessary investments to keep our platforms very, very up-to-date.

So, if you look at the amounts that were invested in both companies to build the current systems and total, let's say, assets that we have in terms of computers as well as capitalized development of proprietary softwares that are key to do what we do, I think you will see that this number of BRL 250 million is not much higher than simply the replacement cost of things that amortized over a period of 5 to 10 years, which is the case for – of our technological assets. And then, you asked a question on depreciation, right?

Depreciation, we guided the number that we see for depreciation and amortization, which is around BRL 790 million to BRL 840 million per year. So, you're right. The number you mentioned, which is BRL 200 million per quarter, I think is right on, in terms of what we expect as well.

And finally, you asked on the one-offs, we tried to give as much (48:00) as we can on the combination/integration-related expenses. This is the numbers that we're working on internally, we don't expect any surprises there. I think, the way we tried to handle these budgets that we announced publicly, a very tight process internally, so we don't expect deviations from those numbers in terms of one-offs, but other one-offs are other one-offs. So, I don't know – I don't want to promise that we're not going to have any one-offs, ever.

Q - Frederic de Mariz {BIO 15383052 <GO>}

Sounds good. Thank you, Sonder, that's very clear.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you.

Operator

The next question comes from Domingos Falavina, JPMorgan.

Q - Domingos Falavina {BIO 16313407 <GO>}

Thank you, Sonder and Rogério. Congratulations on the quarter and the M&A fully concluded. My question is more, I guess, directionally on margins. How should we think about it? I have an understanding that you have a new pricing committee that will have also clients participating and I believe that there is a directional view of sharing some of the scalable gains with the clients. So my question is volumes – let's assume volumes do pick up and we start having a bit more activity in Brazil, can we assume like margins significantly increasing or is there more a scenario where we should think of margins more flat or most likely (49:43) up because the pricing would decrease in order to share some of the gains with clients? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you, Domingos. I think you've obviously touched on a very important point. We don't like to guide on margins. But I think as we think about this, we have to ponder exactly those elements that we mentioned, right, – that you mentioned, which is we have a highly scalable business which is very good and should be to the benefit of our shareholders. And yet, the fact that we now dominate most of the services here in our market, should give us pause and make us think about how the market and the regulators are also viewing our financial performance vis-à-vis the benefits that they're getting from a growing market. So, that means making the proper investments in technology, in systemic risk, in robustness of our platforms, which is something that obviously our regulators will look at as well as sharing the benefits of the gains of scale with market participants. So, we – I think both companies have had a successful track record in doing that and having a close enough relationship with the clients where they feel that if we are making an additional return, how are they participating in that. That doesn't mean giving away 100% of our operational leverage at all. But we will be conscientious of the fact that having a one-sided view of a growing market might be interesting in the short term, in the next quarter or the next two, but it's definitely not to the company's long-term benefit.

So, I think this new forum will bring a additional layer of governance perhaps and seniority to something that was already very much in the DNA of both BMFBOVESPA and Cetip. Cetip had an actual pricing committee as an advisor to the board. We had several chambers or forums in the market where we put together brokers and clients and investors of different products and users of different products and we shared with them what we were doing, both in terms of investments and the view of where we were headed, but also in terms of pricing. I think that will continue to be a very healthy exercise and that's most of what I know for now.

Q - Domingos Falavina {BIO 16313407 <GO>}

Perfect. It sounds as if something in between, some benefits and some (52:54). My second question is a simple one. It's actually – it seems to me – I noticed you've hedged some of your dollar contracts. And I had an understanding that some of this was interpreted by the company as a benefit to have some dollar revenues, as well as some hedge versus the CapEx which, according to the company, has dollar components in it. What's the strategy going forward? Should we expect that dollar derivatives contracts to be fully hedged or was something very unique of this quarter?

A - Daniel Sonder {BIO 18250247 <GO>}

Yeah. Thank you. It's not unique for the quarter, but it's the first time we do it and it will be there for the remainder of the year, okay? So, essentially, we had some financing needs and we chose to finance part of those needs that were related to the Cetip's funding with U.S. dollar-denominated debt. And as we looked into that and we looked to the fact that we had some dollar-denominated revenues, we said there's more than one way to structure this, but let's do the following for this year, which is we hedged, for accounting purposes, the debt with the revenues, so that we have this matched month-by-month.

And this is the impact that you see. The impact of a lower dollar is not reflected fully in lower revenues and it's also not reflected fully in lower cost of finance – financial expense. So this is something we'll have for the year. The board will review this and it was intended, again to, let's say, mitigate the impacts of these variations in these two lines during the year. We've also practiced for a number of years a hedge of our dollar expenses as well as the investments in dollars that we can foresee at the beginning of the year. That doesn't cover 100% of our dollar expenses nor does it cover 100% of our dollar investments. But for those things that we can see and have a clear contractual obligation that we can see at the beginning of the year, we do hedge and that's, I think, a way of, again, managing the company without being impacted by effects in our expenses. I think it gives management a better view of how the different areas are managing the money that was allocated to them under a certain FX scenario at the outset of the year.

Q - Domingos Falavina {BIO 16313407 <GO>}

Yeah. Super clear, as regard the dollar denomination there. Thank you.

Operator

The next question comes from Carlos Gomez, UBS (sic) [HSBC] (56:10).

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Hi. Carlos Gomez, HSBC. Two questions. The first one refers to your legal contingency expenses (56:23) for BRL 834 million in spite of your one-off expenses. If you could give a little bit more information about the nature of them and whether there are more to be done in the future.

Second and unrelated to the merger, could you give us an update about where you stand in terms of your dispute with the federal authorities regarding the past tax advantage from the merger of Bovespa and BM&F? We understand that you already had a resolution, not a positive one, from CARF. We wonder whether you have already appealed to the ordinary courts or you plan to do it in the future, what timing it is and there might be a cost associated with that? Thank you very much.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. Thank you. So, with respect to the provisions I think was your first question, Carlos, we basically put the legal teams to work together over the last one month to look through the whole inventory of contingencies that both companies had, and we found that for certain items, there was a slightly different treatment of cases of a similar nature.

And, in particular, these cases with Cetip, they have to do with something that we already face at BM&FBOVESPA which are litigation regarding the demutualization process, so former quota holders of the previous mutual identity suing for certain amounts that they find are due to them. So, we have a, let's say, a portfolio of these cases, if you will, and I'm not going to get into the minutia of how we treated them. But we found that some of the cases at Cetip should be treated as they were for analogous cases at BM&FBOVESPA. So that's why we treated them like that. And since I'm on that subject, most of the discussions relate to the fact that people who had these quotas understand that they should have had shares of the two companies. And therefore, these litigations, until they're completed, the value at risk is a function of the price of our share because should we be found to have to make any payments to these guys, it would probably be linked to what our stock is worth at the time of that final judgment. So that's just to give you some more detail that that could fluctuate in further, in other periods going forward.

With respect to the CARF, the dispute we're having with the government at the administrative level with our tax issues of the Bovespa merger, we have the first case which is the 2008-2009 period, we were unsuccessful in our appeal. We have not yet received the official notice from the court. This is now a sort of bureaucratic process. There's no discussion anymore of whether they could change their mind, regrettably, they can't, but we haven't received the formal documents from the end of those procedures. Once we receive, we will go to court. This will happen at some point during this year. I'm not able to give you a precise time right now, and then we'll start at the lower levels of the judiciary and it might take a few years for us to have a final resolution on that.

With respect to the second case, which covered the 2010-2011 period, we want to – we will, again, continue to appeal. We have a hearing scheduled for tomorrow. We have had a first hearing on this which was interrupted in the middle as one of the board members of this administrative court asked for some additional time to familiarize themselves with the documents. So it's coming back tomorrow for judgment. And again, it will follow the same steps that happened to us in the first case, which is lower court if we are – in either scenario, whether successful or not, there's a chance of the other party appealing. It depends a little bit on how the ruling comes out. But we would be, again, have an opportunity to evaluate whether we can appeal to the higher court of CARF. The government has the same rights to do that should we be successful at that first level. And then in any case, if we aren't successful, we can take this to the judiciary.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Thank you very much. And again, to clarify on the first case, you implied that depending on the evolution of your share price, we could see these provisions for contingencies go up and down in value over time?

A - Daniel Sonder {BIO 18250247 <GO>}

That's correct.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Okay. And then the second one, if you appeal to the ordinary court, again, it is customary that you might have to place a bond. Do you have an estimate or the possible cost of having to provision for that?

A - Daniel Sonder {BIO 18250247 <GO>}

Yes. So, yes, we'll likely have to post bond to the full amount of the discussion. So, the reported numbers that you see for case one and case two, we have already engaged with some counterparties to provide us insurance and/or letter of guarantee. This will have a cost. It's not a very significant cost. It's below 100 basis points per year for a company of our size and credit risk and this will mean no provisions from the principal amount standpoint, right? We will have this, now, expense for carrying this bond and this insurance, but there will be no provisions made because our legal opinions continued to be very firm that we will win the case.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Okay. That's very clear. Thank you so much.

Operator

The next question comes from Marcelo Cintra, Goldman Sachs.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Hi, Sonder and team, thank you for taking the question. Actually I just have two quick follow-ups on your non-recurring expenses. Here, when we look at the slide 4, you show that you had expense related to long-term incentive plans of roughly BRL 140 million. And when I look at the presentation that you guys provided in April, you mentioned that there could be non-recurring expenses also regarding incentive plans of BRL 81.3 million. So, I just would like to hear from you, if this BRL 81.3 million, they were considered on the first quarter or not and if this is something that it's going to impact the second quarter results.

And then my second question is regarding the impairments. You mentioned that you don't expect any other impairments, so just a quick follow-up on the CCP that a TP (01:04:34) was developing. Is there any chance that we could have an impairment regarding these assets, maybe in the midterm or not, this is something that it's already decided by the company that there won't be an impairment on this asset specifically? Thank you very much.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. Cintra, I don't have in front of me the number you referred to from the previous quarter. And we're going to look it up and then reach out to you offline if you're okay with that. But the number of the impact from the long-term incentive plan that you see of BRL 140.6 million is essentially the payroll effects, payroll tax effects of buying out or cancelling the stock option programs of former Cetip employees as well as their matching programs.

So, we had these (01:05:41) hours which obviously had the proper long-term incentives that are linked to the share price of Cetip. And we, as the transaction was triggered, and it's not uncommon that this happens, these programs all called for the, let's say, the early vesting of these options. So, we did a program with them of cancelling and paying the proper compensation for the cancellation, of early cancellation of all these options and it was presented as these numbers now. So, the other thing that you mentioned was the CCP, right?

Q - Marcelo Cintra {BIO 16463628 <GO>}

Yes.

A - Daniel Sonder {BIO 18250247 <GO>}

And the CCP was, in fact – the CCP project at Cetip was, in fact, written off in this quarter and I know there's a lot of numbers going around regarding these one-offs. But this is described in page 4. It's asset write-off and fines related to the cancellation of contracts in the second line in page 4, that's BRL 35 million. That's the writing off of the CCP project. And on the BM&FBOVESPA side, there was a provision made for impairments which is the BRL 65.5 million. It's – effectively it's the same thing, but with two slightly different accounting treatments. Don't let the accountant hear me saying it's the same thing.

A - Rogério de Araújo Santana

Cintra, it's Rogério, let me ask one thing. You mentioned that in the documents we released on April, we mentioned BRL 81 million expenses related to stock option. Are you referring to the general meeting documents when we approved its extraordinary stock grant programs for our – to access retention and severance of the management?

Q - Marcelo Cintra {BIO 16463628 <GO>}

Yeah. Exactly. It's the material that you guys provided for the shareholders' meeting where you mentioned that there would be BRL 166.8 million of the overall (01:08:22) compensation for board meeting, of which BRL 81.3 million would be non-recurring.

A - Rogério de Araújo Santana

Yes. In the page number 15 of the earnings presentation, in the table on the top, you can see that there's a line called retention or severance programs approved in the Annual General Meeting of April 28, right? So, all of the programs that were approved in the meeting, only BRL 4.1 million impacted in the first quarter 2017. So, the remaining should impact the second quarter. The part related to the severance should be entirely recognized in the second quarter. And the BRL 44 million related to the retention program should be accrued over a four-year period. It's important to mention that the BRL 81 million that was approved in the general meeting is related only to the principal of the shares that we are granting. So, on top of that, we need to calculate payroll tax.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay...

A - Rogério de Araújo Santana

That's why you find a higher number here.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. That's clear. So, just to clarify, the BRL 81 million difference will be impacting the second quarter results, right?

A - Rogério de Araújo Santana

Part of it.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Part of it. Okay. No, that's perfect. Thank you very much.

Operator

The next question comes from Eduardo Nishio, Brasil Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Hi. Good morning. Thank you for the opportunity. Just a question on your reporting. I noticed you had a change the way you report this quarter, no adjustments on deferred tax liabilities. So, it does affect your cash earnings. Of course, adjustments are quite subjective, but I just want to know your thoughts about the way we should look at that, especially to the goodwill tax benefit and the intangibles. How are you going to provide us with those numbers going forward? If there is any charge, any write-off amortization from Cetip acquisition this quarter, the seven-year amortizable impairment, if there is any this quarter. This is the second question, but just related to the first one. And again, how should we think about those adjustments going forward? If you're going to provide us with some kind of cash earnings calculations, so we can make adjustments in our numbers. Thank you.

A - Rogério de Araújo Santana

Hi, Nishio. Thanks for your question. In the first quarter, we had the impact of the deferred tax created by the goodwill amortization of Bovespa that was created 2008. So, the number is BRL 133 million and we should see that impact in the coming quarters in 2017. Regarding the new intangibles and the new goodwill that were created by the combination with Cetip, it will start to impact our numbers in the second quarter in the case of intangibles.

And in the case of goodwill amortization, the deferred tax should impact our numbers in the third quarter. So we are working on that. We should give you visibility on the amounts related to each of these items. And by doing that, give you some tools to help you to calculate what would be our cash earnings.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay. But this quarter, you haven't adjusted the cash earnings for the goodwill amortization of Bovespa, right? Next quarter, are you going to adjust that or is it going to be only the Cetip acquisition tax benefit?

A - Rogério de Araújo Santana

What we showed here in our documents was the non-recurring items. But of course, there are other non-cash items, as is the case of the goodwill deferred liabilities that's impacting our earnings. So, this quarter, we prefer to highlight what was the recurring and what was non-recurring numbers and the next quarter, when we'll start to have the impact of intangibles and goodwill from Cetip, then we will revisit and see how would be the best way to show what is the cash earnings of the company and what is the recurring earnings of the company and what is the accounting earnings of the company.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you. Thank you so much.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Daniel Sonder to proceed with his closing statement.

A - Daniel Sonder {BIO 18250247 <GO>}

Well, thank you very much for taking the time. Thanks for keeping up with the coverage and with all the extraordinary items and movements that you've seen in our books over the last several quarters. I think we have tried to give as much visibility as possible, but please feel free to give a call to our team, and finally, thanks for the team for putting all this together. We are available and have a good day.

Operator

That does conclude the B3 Audio Conference for today. Thank you very much for your participation. Have a good afternoon and thank you for using Chorus Call Brazil.