

## Q3 2013 Earnings Call

### Company Participants

- Clovis Poggetti Junior, CFO and IR Officer
- Roberta Noronha, IR Director
- Romulo de Mello Dias, CEO

### Other Participants

- Eduardo Nishio, Analyst
- Gerardus Vos, Analyst
- Jorge Chirino, Analyst

### Presentation

#### Operator

Good morning, everyone, and thank you for waiting. Welcome to Cielo's Third Quarter 2013 results conference call. This event is being recorded and all participants will be in a listen-only mode during the Company's presentation. After Cielo's remarks there will be a question-and-answer session. At that time further instructions will be given. (Operator Instructions)

This event is also being broadcast live via webcast and may be accessed through Cielo's website at [www.cielo.com.br/ir](http://www.cielo.com.br/ir) where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via the webcast may pose their questions on our website.

Before proceeding, let me mention that forward statements are based on the beliefs and assumptions of Cielo's management and on information currently available to the Company.

They involve risks and uncertainties because they relate to future events and therefore depend on circumstances that may or may not occur. Investors and analysts should understand that conditions related to macroeconomic conditions, industry, and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I will turn the conference over to Ms. Roberta Noronha. Ms. Roberta, you may begin your presentation.

## **Roberta Noronha** {BIO 20488075 <GO>}

Good morning. I would like to thank you all for joining us as I present our results for the Third Quarter of 2013. With me today are Romulo de Mello Dias, our CEO; Clovis Poggetti Junior, our CFO and IR Officer; other members of the management team, finance and IR teams of Cielo.

Now I'd like to hand you over to Romulo.

## **Romulo de Mello Dias** {BIO 2054119 <GO>}

Good morning. Thank you for joining us for another earnings conference call. On page three we can see the highlights of the quarter compared to the same period last year. Net income reached BRL689 million, up 17%, with a margin of almost 40%. EBITDA reached BRL930 million, up 19%, with 53% margin.

The transaction financial volume, according to the market criterion reached BRL113 billion, 17.6% growth. Net operating revenue reached BRL1.7 billion, up by 31.6%. Please note that since the Fourth Quarter of 2012 we are consolidating Merchant-e Solution figures.

The following are the awards received by Cielo in the quarter. We are very proud of these awards and motivated to maintain our quest for improvement. Cielo has been elected for the second consecutive time the best company in the financial service in the Epoca Negocios. It was also the winner for the third time in a row in financial services ranking As Melhores da Dinheiro 2013. For the 13th consecutive time, Cielo is among the 150 Best Companies to Work according to ranking with Voce S/A Magazine.

In 2013 Latin America Executive Team ranking of Institutional Investor magazine, Cielo ranked first amongst financial institutions except banks with the best Investor Relations team, Best CEO and Best CFO, appointed by sell; and buy-side analysts. And first and third position as the best IR for customers according to the buy-side analysts. Cielo ranked second in the best in people management ranking of Valor Economico and Aon Hewitt. And ranked third among Best Companies for Shareholders in 2013 in the category that (inaudible) company with net revenue between BRL5 billion and BRL15 billion of Capital Alberto magazine.

On the next slide number 4 we have the evolution of our transaction financial volume with credit and debit cards. Year on year our financial volume rose 17.8% according to the accounting criteria. In the same period, credit volume was up 15% and debit volume almost 23%. Quarter-on-quarter, financial volumes grew 7.7% according to the accounting criterion as can be seen in the graph. In the same period credit volume was up 7.1% to BRL70 billion, while debit was up 8.7% to BRL42 billion.

On page five we present the number of transactions captured in Q3. Year over year we see a 14.9% increase in the number of transactions captured, representing 1.5 billion transactions in the quarter. Q-on-Q we saw an increase of 8.2%.

Speaking of operating indicators on page 6, we present the number of active points of sales, that is those that record one transaction in the last 60 days and the number of installed POS. Year over year the base of installed POS grew 5.5%, wireless device reached 54% of the base. In the same period, the number of active points of sales rose 9.8%. Q-on-Q the base of installed POS grew 0.5%, while the number of active points of sales rose 3.4%. It's important to say that the optimization of our logistics chain by speeding up the disconnections process and device recycling last quarter still had an impact in this quarter, make the installed POS base remain practically unchanged.

Now I would like to hand the call to Clovis Poggetti.

## Clovis Poggetti Junior

Thank you, Romulo. Good morning, everyone. On page seven we present our net operating revenues, which total BRL1.7 billion in this Third Quarter 2013. Year over year net operating revenues rose 31.6%. It is important to highlight the impact of Merchant-e Solutions consolidation into our figures starting in the Fourth Quarter last year.

The growth in financial volume does not include Merchant-e transactions, which means it represents the financial volume in the domestic market only. Quarter over quarter net revenues rose 8.4%.

On the next page, page 8, we have our expenses. Our expenses total BRL907 million in the Third Quarter 2013, up 47.8% quarter over quarter and 7.3% year over year. The cost of service provided was BRL657 million for the quarter, growing 55.7% year on year and 7.7% quarter on quarter. It is important to mention that the consolidation of Merchant-e Solutions was the most significant impact on the line year on year.

Our operating expenses represented BRL250 million in the quarter, up 30.6% compared to Third Quarter last year, and up 6.2% compared to the Second Quarter this year. This increase refers mainly to other operating expenses which in turn were impacted by the revision of the criteria for recoverability of outstanding balances of merchants blocked for fraud and also for the variation, year on year, the increase in the amount of uncollectible credits.

On the same slide we can see total expenses per transaction, which increased 28.7% compared to the Third Quarter last year, again, due to the consolidation of Merchant-e Solutions figures. During the quarter total expense per transaction was BRL0.59. This was already expected since the subsidiary only impacts the expense line and not the number of transactions.

Quarter over quarter we see a decrease of 1% compared to the total unit cost due to the larger number of transactions. And as a result, which we can see on page 9, are mainly revenue from prepayment of receivable operations. In the Third Quarter this year, gross revenue was BRL312.7 million, an increase of 50.4% compared to the Third Quarter last year, and 16.6% in relation to the Second Quarter this year.

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We have also started disclosing the managerial analysis of net cost of funding. In this analysis every resource used to prepay receivables is applied same cost of funding we had when we prepay our receivables flow with the issuer banks. According to the managerial analysis, net revenue was BRL147 million for the quarter, an increase of 9.5% and 8.9% compared to the Third Quarter last year and Second Quarter this year respectively. The difference in the growth rates of gross and net revenues is chiefly explained by the customer mix of the prepayment products in the quarter. This year the volume of transactions with large retailers has been significantly higher than in the past.

In the dynamics of the prepayment of receivables operations shown on slide 10 we can assert that prepaid volumes show an increase of 82.3% year on year and 10.5% quarter on quarter. The amount in the quarter total BRL11.7 billion, or 16.6% of total credit volume.

On slide 11 we have our financial performance with EBITDA in both absolute amounts and margin. EBITDA total BRL929.7 million in this Third Quarter. Year on year EBITDA increased 19% and EBITDA margin was 53.5%, down by 5.6percentage points. The year-on-year reduction in EBITDA margin is due to the consolidation of Merchant-e Solutions.

Please remember that acquirers in the United States record gross MDR or gross discount rate as gross revenue while the interchange fees are recorded as cost. So although the contribution of Merchant-e to the result is small, when numbers are consolidated, the contribution given as revenues ends up being the main reason for the size of the impact.

Compared to the Second Quarter this year, the EBITDA margin remained unchanged while its absolute margin rose 8.2%.

On page 12 you can see our net income total BRL689 million. Compared to the Third Quarter last year, net income rose 17% and net margin decreased 4.9percentage points to 39.6% impacted again by the consolidation of Merchant-e Solutions as explained earlier. Quarter over quarter net income rose 10.6% with an increase of 0.8 of percentage points in the margin. Now I will go back to Romulo.

### **Romulo de Mello Dias** {BIO 2054119 <GO>}

On slide 13 we show you information on dividends payment. On September 30 we paid BRL840 million in dividends and interest on equity to shareholders referring to the result of the first half of 2013. Debt amount was equivalent to a 70% payout. Since Cielo's IPO we have paid BRL7.68 per share considering the interest on average net of tax which provides a nominal number of more than BRL6 billion in the period.

On page 14, the last one, I like to show you the development of our mobile product. As you remember, we launched the first mobile solution of the Brazilian market in 2010. To use that tool all merchants had to do was download the Cielo mobile smartphone app and start accepting credit card payments through their phones. Since then the app has been downloaded over 200,000 times and we currently have 25 active merchants using this platform.

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The evolution of Cielo Mobile allows the merchants to download a new app and register and then receive a chip-and-card reader to be used by cardholders to type in their password. (inaudible) through new product merchants can not only receive credit and credit installment payments as used to be until then but also debit, (vouchers) and (cruzeiro).

The evolution of Cielo Mobile uses the strictest security standards established in the global electronic payment industry. All information transferred through this solution is encrypted, protected and no data, card number or password is stored in the smartphone, tablet or the card reader itself. The platform also counts on (Cielo Links) an exquisite anti-fraud network system that monitors on 100% of the transactions. This new mobile payment solution has ensured a greater conversion of sales.

Cielo is recognized for having the safest mobile payment solution with the highest level of sales approval in the market. The Company continues to seek innovation to offer more and more cutting-edge relevant service to its merchants for different options to meet their different needs. The Brazilian market still has a lot of room for growth in the payment industry. We believe we are well-positioned to keep leading the industry by offering merchants, banks and consumers a highly reliable service of -- in a safe environment.

So that is what I want to share with you today, and thank you for your attention. Now we are ready to take your questions. Operator, please

## Questions And Answers

### Operator

(Operator Instructions) Jorge Chirino, Morgan Stanley.

#### **Q - Jorge Chirino** {BIO 17127041 <GO>}

Congratulations on the strong results. I have a question about regulation. Yesterday the Central Bank published the frame book for the industry and I want to know if it's in line with your expectations. And in terms of the specific measures what are you expecting in the coming months? Thank you.

#### **A - Romulo de Mello Dias** {BIO 2054119 <GO>}

Yes, I think the two resolutions and the four (catha circulares) that they published provide the legal framework for Central Bank to act as a regulator of the industry. They are talking about inclusion, they are talking about competition, innovation, reliability of the system and other things. So at the -- and interoperability of networks. So at the end of the day I think the Central Bank wants to promote more all these things together (inaudible) is what we were expecting.

#### **Q - Jorge Chirino** {BIO 17127041 <GO>}

Okay. And in terms of the specific measures going forward, what are you expecting, any change to the current, to some exclusivities in the industry, et cetera?

**A - Romulo de Mello Dias** {BIO 2054119 <GO>}

Yes. Interoperability of payment schemes probably is something that will happen in the short term.

**Q - Jorge Chirino** {BIO 17127041 <GO>}

Okay. Thank you.

**Operator**

Eduardo Nishio, Banco Plural.

**Q - Eduardo Nishio** {BIO 15333200 <GO>}

I have two questions. First is on your mobile payments initiative. Can you give us a little bit more color of your targets and how much you expect to come from this initiative, the new mobile device you have just launched? And second in terms of the one-offs you had and other operation expenses, can you open up, give more color on the frauds increase you had in the sales channel? Is it something that we can -- we need to worry about or monitor, yes, carefully? Thank you.

**A - Romulo de Mello Dias** {BIO 2054119 <GO>}

Thank you, Eduardo. Regarding mobile payments we already have more than 25,000 clients, active merchants, and we have more than 200,000 downloads. With this new application we expect at least to have, let's say, three times more customers by the end of next year.

Regarding the first question -- the second question about frauds, first of all it's important to emphasize that this has nothing to do with our network but to the undue canceling of sales. I will ask Clovis to provide further details.

**A - Clovis Poggetti Junior**

Okay, Romulo. Hi, Nishio. Well as Romulo already mentioned it has to do with the undue canceling of sales. It's important here to mention that canceling of sales is a common procedure in the industry, okay, and that the fraud canceling always happen but in a known representative way, let's say this way. What happened is that more recently a breach in one of our channels was found, okay, in --

**A - Romulo de Mello Dias** {BIO 2054119 <GO>}

Customer service channel.

**A - Clovis Poggetti Junior**

-- customer service channel. And it's important to mention that these have already been solved, okay. And such effect resulted in a fraud peak, and unfortunately we should consider the amounts as of low probability of recovery. And given that we decided to treat it from now on, meaning that we are recognizing 100% of the loss at the moment we identify the fraud.

In order to help you modeling please consider BRL35 million to BRL40 million the recurring amount for this other operating revenues expenses line, okay?

## Operator

Gerardus Vos, Barclays.

### Q - Gerardus Vos {BIO 3301062 <GO>}

A few, if I may, just first of all from a competitive point of view, Redecard seems to be -- been very benign during the quarter but towards the end of the quarter it looked at -- we've seen some more discounting again in the market. Would you be able to provide some color on that?

Then secondly on the (mPayment) what kind of revenue model do you have on this, is it similar to the likes of (inaudible) you noted 275 of transaction, or do you have a different model? Then also on the mPayment, what market are you targeting, is this the small mom-and-pop shop or is this also the larger merchants you're targeting with this? Thank you.

### A - Romulo de Mello Dias {BIO 2054119 <GO>}

Regarding the competitive scenario, we see, let's say, our main competitors trying to regain some share and to gain more share. So in terms of how this approach has changed since the last quarter, what you can see is that our main competitor decided to hire more people in the sales team to more to work with the mom-and-pop, as you said, and even though that some of this is more merchants, they have up to BRL7.5 million, BRL8 million total revenues according to our classification and is what we can see right now in terms of competition. Competition in our opinion is going to be a little bit tougher when compared to this year.

Regarding the mPayments, you are correct, this new products is, we are targeting the small merchants, the mom-and-pop shop, and also we have the idea even though that we don't have -- we have a history in terms of the Cielo Mobile that today there are 25,000 merchants, active merchants, that will do transactions on a monthly basis. Having said that, when I say that we have the expectation that we could have three times more is because we do think with the new environment trying to have the small merchants in our base, as in our client bases, we do think that this new capture solution is going to be (inaudible) than it.

### Q - Gerardus Vos {BIO 3301062 <GO>}

Okay. Thank you. And from a business model are you -- well, what percentage are you charging to the merchant for your merchant service charge? Thanks.

**A - Romulo de Mello Dias** {BIO 2054119 <GO>}

It depends on the MCC, it depends also in the sector that you are. And we are charging a monthly fee, interconnection fee of 11.9% -- BRL11.09.

**Operator**

(Operator Instructions) Gerardus Vos, Barclays.

**Q - Gerardus Vos** {BIO 3301062 <GO>}

Sorry, just one follow up for me. Just on the guidance you provided at the beginning of the year, the EPS growth from 7 (inaudible) to 10%, clearly the run rate has been well ahead of that. And how should we think about it for the full year, do you feel comfortable with the current consensus numbers out there? Thank you.

**A - Romulo de Mello Dias** {BIO 2054119 <GO>}

Gerard, it's a good question because in the Second Quarter we had said that this informal guidance that you provide at the beginning of the year was not, say, was too conservative. We said that.

And just to give you an idea, when we were in December last year, our total sales volume was growing 9%. It's the reason why when at the beginning of the year we said that we would expect something between 7% and 10% in terms of net earnings. What happened, First Quarter came and we reached 13% and people asked us are you comfortable to keep or to provide another number, and we said it's too early to say; First Quarter. In the Second Quarter during the conference call we said after discussions, how do you think about between 7% and 10%, it's conservative. And what's new informal guidance, and we said we are not going to provide additional information about net earnings is what we said, but your are right.

**Q - Gerardus Vos** {BIO 3301062 <GO>}

Okay, negative.

**Operator**

Eduardo Nishio, Banco Plural.

**Q - Eduardo Nishio** {BIO 15333200 <GO>}

Thank you, again for taking my question. As you said, you think that (inaudible) you will be - will happen soon. In terms of your peers, what do think they will do to the market share over Cielo? I know that those brands, the remaining brands have very little contribution to your revenues but even so it offers you, for instance, in some sectors a good penetration



price in the restaurants, right? So I want to know if you can give us a little bit more color what you expect from competition and what perhaps you can do to avoid that? Thank you.

**A - Romulo de Mello Dias {BIO 2054119 <GO>}**

(inaudible) of \$1 billion if I had access to the (inaudible) it would be, lets say, very good. But sorry for the joke, but what we know that they are hiring people, as I said, trying to have more people in sales team. They changed some people as well. They now have a new name with other things. In the case of Santander, Santander is being more aggressive and they are with the big accounts. But remember that until one year ago they were not ready. There is also (Vealecom) but they're too small in Brazil today. And as well Global Payments in Brazil just began the operations.

**Operator**

(Operator Instructions) This concludes today's question-and-answer session. I would like to invite Mr. Romulo de Mello Dias to proceed with his closing statements. Please go ahead, sir.

**A - Romulo de Mello Dias {BIO 2054119 <GO>}**

I would like to thank you all for your participation and we look forward to seeing you again in our Q4 conference call. Thank you. And have a nice day.

**Operator**

That does conclude the Cielo's audio conference for today. Thank you very much for your participation. Have a good day. And thank you for using Chorus Call.

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