

Q2 2014 Earnings Call

Company Participants

- Clovis Poggetti, CFO & Director-Investor Relations
- Rômulo de Mello Dias, Chief Executive Officer

Other Participants

- Carlos Macedo, Analyst
- Tito LaBarta, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and thank you for waiting. Welcome to Cielo's Second Quarter 2014 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.

This event is also being broadcast live via webcast and may be accessed through Cielo's website at 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 webcast may post their question 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'll turn the conference over to Mr. Rômulo de Mello Dias. Mr. Rômulo, you may begin your presentation.

Rômulo de Mello Dias

Good morning. I'd like to thank you all for joining us as we present our results from the second quarter 2014. With me today are Clovis Poggetti, CFO; and other members of the management team, finance, and IR team.

On page 3, we can see the highlights of the quarter compared to the same period last year. In Q2, Cielo's net income totaled BRL 797 million, up almost 26% year-on-year. EBITDA reached BRL 956 million, up 9.3%. Transaction financial volume totaled BRL 125.3 billion, up almost 18%. Net operating revenue reached BRL 1.8 billion, up 13.6% year-on-year.

Also, another quarter highlight was that Cielo signs a memorandum of understanding with Linx, aiming at setting up a joint venture for the development of an integrated and unique solution, iPOS, which includes commercial automation, management software and electronic payments platform for the Brazilian small retail markets.

Another highlight was the partnership with Smiles, expanding the loyalty program in retail, signed on July 2. Cielo's further strength is positioned as a service provider with this commercial agreement by boosting its retailer solutions portfolio with a miles earning and redemption service, another effective loyalty program to its clients. This translates into more revenues to Cielo's merchants and more convenience to Smiles clients.

Now, let's present the awards received during the quarter. By the eighth consecutive time, Cielo reached first place in the service category, the ranking from Maiores e Melhores da Revista Exame. The company also placed second place among the Most Innovative Companies in Brazil in the ranking from INFO Exame magazine. Cielo stood among the 10 brands that have value the most in 2013. 16th place in the ranking of the most valuable brands in Brazil prepared by Istoé Dinheiro magazine in a partnership with BrandAnalytics/Milward Brown.

Cielo is considered one of the 100 most prestigious brands in Brazil according to the Época Negócios magazine. Additionally, Cielo was chosen by the fourth consecutive time among the best companies to start a career in the Você S/A magazine guide. Cielo also accomplished second place in the ranking of The 100 Best in Brazil according to IGC, a Corporate Governance Index published by the America Economy magazine.

On the next slide, number 4, we have the evolution of our transaction financial volume with credit and debit cards. Looking at the breakdown by products, we can see that the credit volume was up 13% and the debit volume, 26.4% over Q2. The total debit amount, excluding the Agro product, a product that has specific characteristics with a variable price due to extremely high tickets, debit volumes would have increased 23.5%. Regarding the immediately previous quarter, credit volume increased 3.9% to BRL 76 billion, while debit was up 6.3% to BRL 49 billion. Again, excluding the Agro product, debit volume would have decreased 0.5% over Q1.

On page 5, we present graphs with the financial volume annual growth, great evolution per quarter, for the years 2012, 2013 and 2014. As already mentioned in the previous conference call, we have a statistical challenge ahead of us. As a matter of fact, we expect that this year's growth should follow the same inclination as present in 2012. However, the rates themselves will remain below the ones we've seen in 2012.

FINAL

On page 6, we present a number of transactions capturing Q2. There is a growth of 17.3% in Q2 compared to the same period of 2013, representing an amount of BRL 1.4 billion transactions. Compared with Q1, the number of transactions increased by 3.1%.

On page 7, we have our operating indicators. We present the number of active points of sales which have recorded one transaction in the last 30 days and the number of installed POS. We can see in the graph that all indicators show growth in the period.

In comparison with the second quarter of 2014, the base of installed POS grew 9%, and in comparison to the previous quarter increased by 1.7%. Wireless terminals reached 58.8%. The increase of the active points of sales reached 11.3% compared to the (7:55) figure. In comparison with Q1, here, we had a growth of 2.6%.

Now I like you to hand the call to Clovis Poggetti who will continue our presentation.

Clovis Poggetti {BIO 16529642 <GO>}

Thank you, Rômulo, and good morning, everyone. On page 8, we have our net operating revenue which total BRL 1.8 billion, growing 13.6% over the second quarter last year. The increase in the net revenue is chiefly related to the ongoing business expansion and an increase in revenue generated by the subsidiary Merchant e-Solutions, this one was impact by the dollar appreciation. Compared with the first quarter of 2014, net operating revenue presented a growth of 1.3%.

On the next page, page 9, we have our expenses. Total expenses reached BRL 989 million in the second quarter of this year, up 16.9% over the same quarter of 2013 and up 7.6% over the first quarter 2014. The cost of services provided was BRL 703.8 million in the quarter, growing 15.3% and 6.7% year-over-year and quarter-on-quarter, respectively.

Detailing the items that most impacted cost in the period, we have mainly the increased cost related to subsidiary, Merchant e-Solutions, due to the appreciation of the average dollar rate and M4U; and also, the increase in rent fees from the increased number of transactions. Quarter-on-quarter, the rise in cost is related to increase in equipment maintenance and activation costs due to the replacement of discontinued equipment for new ones and the increase in wireless terminals, mainly due to the higher demands on the Mother's Day holiday, and to the increase in rent fees from the increased number of transactions among others.

Our operating expenses represented BRL 285.2 million in the second quarter, up 21.1% compared to second quarter last year, and up 10% compared to the first quarter this year. The increase in expenses over the same period last year is mainly related to the personnel lag (10:42), impacted by the increase in head count of the team of strategic projects and relationship with banks, and the increase in salaries agreed with the union, and also, to the general and administrative expenses line, which variation is mainly due to higher expenses with professional services related to corporate projects and the appreciation of the average dollar rate for the period.

Bloomberg Transcript

FINAL

In the quarter-on-quarter comparison, the increase was chiefly the result of the increase on general and administrative expenses mainly due to expenses with professional services related to projects and consultant services, and higher net operating expenses due to labor and legal contingencies, partially offset by the restriction in sales and marketing expense. On the same slide, we can see total expense per transaction at BRL 0.73, in line with the second quarter of 2013 and 4.4% higher than the first quarter this year.

Financial results, which we can see on page 10, are mainly revenue from prepayment of receivables operation. In second quarter of the year, gross revenue was BRL 439 million, an increase of 63.8% compared to the same period of last year and 7% in relation to the first quarter this year (12:23).

As usual, let's also present the result of the managerial analysis, net of cost of funding. In this analysis, every resource used to prepay receivables is applied to the same cost of funding we have when we prepaid our receivables with the issuer banks. According to the managerial analysis, net revenue was BRL 218 million for the quarter, increase of 52.4% and 14.2% compared to the second quarter last year and first quarter this year, respectively.

Additional indicators regarding the prepayment of receivables operation are show on slide 11, where we can see that prepaid volumes show an increase of 28.2% year-on-year and a slight decrease of 0.4% quarter-on-quarter. The amount in the quarter totaled BRL 13.6 billion, or 17.9% of the total credit volume.

On slide 12, we have our financial performance with EBITDA in both absolute amount in March. EBITDA totaled BRL 955.5 million in the second quarter of this year, up 9.3% year-on-year. EBITDA margin was at 51.9% in the second quarter. EBITDA margin was down by 2 percentage points over second quarter last year. Compared to the first quarter, EBITDA declined by 4.6% and margin decreased by 3.2 percentage points on EBITDA margin.

On slide 13, we show that our net income totaled BRL 796.8 million, up 25.9% year-on-year, with a net margin of 43.3%. At this time, I would like to extend out (14:35) that the annual growth of our recurring income would have been 20.1%, because it's important to remember that we had a one-off impact of BRL 30.5 million (14:49) relating to an impairment to goodwill of Paggo in the second quarter last year.

Compared to the first quarter, net income presented a slight drop of 0.7% while margin presented at 0.9 percentage points. Now, I'll go back to Rômulo.

Rômulo de Mello Dias

Our focus is continued to be guided by maintaining our leadership position as the largest and best with (15:20) service with brands, multi-channel companies in the Latin America acquiring markets. That is what I want to share to you, and thank you for your attention.

Now we are ready to take your questions. Operator, please?

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from (16:04) Carlos Macedo Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thank you. Good morning, Rômulo, Clovis. Thanks for the opportunity to ask questions. I have a couple of questions in your results. But first, it's a question on just the general competitive environment in Brazil, vis-à-vis the growth that you're seeing. I mean, the growth decelerated. I wanted to just understand if you feel that that deceleration in growth, given that we don't have industry-wide data yet, was more of a factor of a deceleration in the market, the World Cup and the impact that it has on your volumes. Or are you seeing more pressure from competitors currently now, given that they had been a lot more quiet in the beginning of the year?

The second question is related to the revenues that your subsidiaries presented with a sharp increase in the revenues for your Brazilian subsidiaries. All of them actually increased quite significantly in the quarter. I want to understand if there's anything that we should read into that if they have achieved a different level, if they are now going to grow at a faster pace or was that something that just happened in the quarter specifically and that we shouldn't model outside of the seasonality in the second quarter or should we model (17:21) going forward? Thank you.

A - Rômulo de Mello Dias

Hi, Carlos. Thank you for your question. Regarding your first one, the general competitive environment, I would say that it's much more related to this, a little of bit of deceleration than competition. Competition continues to be, I'd say, as we explained last quarter. So, I would say that even though that competition is always a concern, more and more players are participating in market. I would say that we have - if we have to give a higher percentage, I would give the higher percentage to as a little bit of deceleration due to World Cup and other things.

A - Clovis Poggetti {BIO 16529642 <GO>}

And hi, Carlos regarding your second question, nothing special I would say to you with the ongoing business expansion. So, it would be a new level.

Q - Carlos Macedo {BIO 15158925 <GO>}

And so, I mean, at the - of course, there's seasonality in the first quarter downwards, but a little bit less so maybe there. But revenues were still up 37%. That's not sequentially. So, should we consider the amount of revenues that this company's posted in the second quarter to be a new base?

A - Clovis Poggetti {BIO 16529642 <GO>}

Yes.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thank you, Clovis. Thank you for your answers.

Operator

Our next question comes from Tito LaBarta with Deutsche Bank.

Q - Tito LaBarta {BIO 20837559 <GO>}

Hi. Good morning. Thank you for the call and taking my question. My question is on expenses. I just want to get a little bit more color in terms of your expectations going forward with the integration of the MES platform and an improvement to 19 (19:06), and I think that's in fact you're making (19:07). I just want to get your outlook for the rest of the year and maybe into next year on expenses. And then also the potential benefit that you think that these investments that you're making can bring in the future. Thank you.

A - Clovis Poggetti {BIO 16529642 <GO>}

Okay. Hi, Tito. As we mentioned in our previous call, we did already expect an increase in our total expenditure, which means total cost plus expenses per transaction, okay? And this is due to higher expansion expenses with projects. We have projects such as BOB (19:46) okay, that you are already aware of, which means the localization (19:51) of Merchant E platform.

And during the current development phase, we did file (20:00) some additional requirements. And it's also important to say with regards this BOB (20:06) project that we expect to have the expenses and investments until 2016, okay? Besides, we have projects related to customer service, which we believe we will strongly contribute to our leadership position.

And regarding this project, the expenses and investments will be taking place mainly in the second half this year, okay, but will also impact, but in a smaller proportion, the first half next year. This implies expenses not only with IT, but also personnel, professional services, consulting, which impacts the cost line, payroll, G&A, and other lines. We keep our soft guidance between BRL 0.75 and BRL 0.78, but expect it to be in the bottom of the range.

Rômulo, do you have something to add?

A - Rômulo de Mello Dias

Just to - about the rest of the year, this year into the next year, some investments that we're doing this year will benefit - will bring some benefits in the future, as you mentioned. And some of the products that we're doing this year will not be repeat next year. And by investments, in terms of how you treat, let's say, in terms of accounting policy, we are - or a big portion of them are considered as expenses.

So these expenses related to projects (21:48) are not being capitalized, with the exception, of course, regarding infrastructure and other things that we cannot use this method. So for the next year, we expect a lower range regarding when you make a comparison between the range that Clovis just mentioned.

Q - Tito LaBarta {BIO 20837559 <GO>}

All right. Thanks. That's very helpful. Maybe just to add to the BRL 0.75 to BRL 0.78 per transaction, you said you'd be at the lower end of the range, and then do you think you'll be below that next year, or below like...

A - Rômulo de Mello Dias

Yeah.

Q - Tito LaBarta {BIO 20837559 <GO>}

More like...

A - Rômulo de Mello Dias

Yeah. What you're saying that, for this year, we expect to be in the bottom of the range. And for the next year, we expect that the range will be lower than the range that we present for this year.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Good. Thank you very much. That's very helpful.

Operator

The next question comes from Geraldo Cos (22:49) with Barclays.

Hi. Good morning. Thanks for taking my question. Just two, if I may. First of all, I just want to come back to slide 7. I missed the point you made on that slide. Are you guiding us that the second half should follow a similar kind of pattern than what we've seen in 2012?

And then secondly, I have a question around the change in regulatory environment. Now, also the card schemes where you have less than 25% market share will be opened up. I was wondering what kind of impact have you seen from that. Thanks.

A - Rômulo de Mello Dias

Geraldo (23:30), can you please repeat your first question with regard to slide number 7? The operational indicator, is that the right one?

Q - Operator

Yeah, sure. I missed the commentary you made around kind of slide 5. And I was wondering, did you try to make the point that the volume growth should follow a very

similar pattern in 2012, so we should expect Q3 and Q4 to be below what we've seen this quarter? Thanks.

A - Rômulo de Mello Dias

Yeah. We just tried to make a comparison between year 2012, 2013 and 2014. As we said during our last conference call, we said the inclination should follow the same standard, the same pattern, that we experimented in year 2012, because the comps are more - are tougher when compared to the comps that we had in year 2013. So having said that, and considering the size of the company, I think we are on track regarding what you said.

So - and the inclination of 2012 - the curve of 2012 in the second half is more related to the, let's say, more pressure in terms of price. And then as we try to position ourselves as the leading comp and with the (24:48) price - in the different price with data (24:52) service, we decide, let's say, to choose some clients that we - and not to choose other ones because of the price that would be backed by the market in year 2012 in the second half.

Did you get the point?

Q - Operator

Yes, sure. Yes, thank you.

A - Rômulo de Mello Dias

Okay.

A - Clovis Poggetti {BIO 16529642 <GO>}

And, Geraldo (25:16), my apologies, but can you also repeat your second question?

Q - Operator

Yes, that was regarding the regulation around kind of, let's call, the minor kind of card schemes where you have less than 20% market share which have been opened up as well. I was wondering what kind of impacts have you seen of that?

A - Clovis Poggetti {BIO 16529642 <GO>}

You'll see I think it's - the regulation will come to an end probably by the end of this year, beginning of next year. But we are, let's say, comfortable with the new environment. And for this, to say this kind of statement, it's necessary to remember what we did in 2010 when we began to work with MasterCard. At that point in time, we had zero. And right now, we are the first one acquiring with MasterCard. We are the first one with VISA. We also did all the investments related to (26:17) in the order of schemes.

So even though that we do respect a lot our main competitors, we also think that Cielo will continue to be the leading company in terms of innovation, in terms of size, in terms of many things. So it comes to the other points that the other brands, the other networks

that right now we cannot capture also will be available for us and as well for the other competitors. So this is something that at the end of the day will not change our lives dramatically.

Q - Tito LaBarta {BIO 20837559 <GO>}

Okay. Perfect. Thank you.

Operator

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

A - Rômulo de Mello Dias

Thank you all for participating in our conference call. And as usual, we are here to - during the quarter to answer further questions that you may have. Have a nice day.

Operator

That concludes 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.

This transcript may not be 100 percent accurate and may contain misspellings and other inaccuracies. This transcript is provided "as is", without express or implied warranties of any kind. Bloomberg retains all rights to this transcript and provides it solely for your personal, non-commercial use. Bloomberg, its suppliers and third-party agents shall have no liability for errors in this transcript or for lost profits, losses, or direct, indirect, incidental, consequential, special or punitive damages in connection with the furnishing, performance or use of such transcript. Neither the information nor any opinion expressed in this transcript constitutes a solicitation of the purchase or sale of securities or commodities. Any opinion expressed in the transcript does not necessarily reflect the views of Bloomberg LP. © COPYRIGHT 2022, BLOOMBERG LP. All rights reserved. Any reproduction, redistribution or retransmission is expressly prohibited.