

## Y 2019 Earnings Call

### Company Participants

- Gustavo Henrique Santos de Sousa, CFO and IRO
- Paulo Rogerio Caffarelli, CEO

### Other Participants

- Craig Maurer, Analyst
- Jeff Cantwell, Analyst
- Julie Chariell, Analyst
- Mario Pierry, Analyst
- Mohammed Ahmad, Analyst
- Neha Agarwala, Analyst
- Tito Labrta, Analyst

### Presentation

#### Operator

Good afternoon everyone and thank you for waiting. Welcome to Cielo Fourth Quarter of 2019 Results Conference Call. With us here today, we have Mr. Paulo Caffarelli, Gustavo Sousa and Jean Leroy. This event is being recorded and all participants will be in a listen-only mode during the company's presentation. After Cielo 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 website at [ir.cielo.com.br/en](http://ir.cielo.com.br/en), 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 post their questions on our website. They will be answered by the IR team, after the conference is finished. Before proceeding, let me mention that forward-statements are based on the beliefs and assumptions of Cielo 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 Mr. Paulo Caffarelli. Mr. Paulo, you may begin your presentation.

#### Paulo Rogerio Caffarelli {BIO 7429811 <GO>}

Thank you all of you for taking part of this conference. I think that my main message for the investor, for the analyst is Cielo is back on the game. We can emphasize this by the

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first thing is, we gained market share on the first and second quarter in '19. These didn't happen since the first and second quarter in 2014, almost five years. The second thing is relating to the volume. We grew 12.6% year-over-year. For us it's very important, it means, in Brazil, almost 10% of the Brazilian GDP. The other thing is we reached at the end of the December 1.6 million in terms of customer. These didn't happen in Cielo since March '17. It's very important for us to maintain a consolidated base in our portfolio because we have the -- all the products and services for providing these kind of customers.

The first thing is we have sold 1.3 POS in Brazil -- 1.3 million POS in Brazil. This is important because since 2018, Cielo didn't sell POS. We started to do this in the end of 2018 and now we have have these could -- emphasize this could reinforce our basic customers. The fourth thing is relating to the SMEs, entrepreneurs that we have a growing -- SMEs and entrepreneurs, we have growing faster than large accounts since last June. For us, it's very important when we analyze our portfolio, our mixed portfolio, it's very important that you can increase more SMEs and entrepreneurs than large accounts because large accounts can bring us volume, can bring us data but in fact the name of the game nowadays in Brazil is SMEs. We need to focus on SMEs and try to increase our participation in this segment. We defined 2019, for the year of customer relationship these could interfere in our results in the customer satisfaction. In this case we define that NPS will interfere 30% in terms of participation in the variable compensation for the total of employees in Cielo. It's very important because up to this figure used to be just 40% -- just 5% in terms of participation. We are doing very hard work in terms of call center to develop our call center, try to establish a new kind of commitment and we can improve the decisions and definitions for to be more -- to provide more support to our customers in terms of customer satisfaction. Yet we define it that we need to be much more effective in terms of -- to provide equipment to establish the maintenance and other things. The most complete product portfolio we have in Cielo, this is very important because I think that we are the only acquirer in Brazil that has a lot of the products in terms of -- from entrepreneurs to big companies. Another thing is relating to the e-commerce. We are nowadays the leadership of this market in Brazil. More than 50% in terms of market share. This is important because it's a -- another kind of disease that we have, we don't -- are just we don't have -- we don't focus on just on US but we are looking for another kind of development from equipments and solutions that we can provide to our customers like [ph]J Code, like links, et cetera. The other thing is I can reinforce to you that Cielo is already in all the segments in acquired -- Brazilian market. In this case, we are working hard from entrepreneurs to big companies in Brazil. And now, as I told you before we intend to be more -- more emphasizing, more present in terms of retail. We have developed in 2019, 17 new kind of strategic partnership with a lot of big companies in Brazil. And then can bring to Cielo other kind of opportunities to be forward in terms of business relating to the payments, but other kind of business. We defined three kind of business unit in Brazil -- in our company. Large Accounts, retail, SME and entrepreneurs. It's important because, each kind of this segment, we need to focus in a different kind of strategy. I think that we did the right job in this case, because in 2020, we can see the first results among these segments. Another thing important is related to ZBB. We defined one range to be involved in ZBB in Cielo and you can reach in this year, almost BRL300 million. It means more than 10% of our total budget that you can interfere in terms of to cut expenses. And relating to hunters. We have 1,000 hunters nowadays working out of our offices and this is important because even we have the bank channels, Banco Bradesco cash, we can be much more involved in terms of to our own channel when we

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decide to have this 1,000 hunters. For us it's very important because concomitant with the business development in the channels, we can be evolved with the hunters, with the farmers and these segment needs to improve much more in Cielo because it's important to establish our balance relating to the banks and relating to the our own channels. The other thing that we need to follow this year and for us it's very important is increase our participation in terms of prepayment. Nowadays our penetration is 22% and when you analyze and compare this with another competitors, I think that we can reach this much More because a lot of them has more than half in terms of penetration in terms of prepayment. We have a very large room for to being forward in these prepayment. At the end of the day MDR rental and prepayment work together in terms of price. In this case, our main challenge this year is to develop prepayment Cielo. Now I ask to Gustavo do the presentation and after that we can come back to the Q&A. Thank you.

### **Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

Thank you, Caffarelli. Good afternoon, everyone. Starting our presentation on slide 4. We have a snapshot of our operating results. So we have a financial volume in the fourth quarter of BRL190 billion and that's a 12.6% increase year-on-year and 10.7% increase quarter-over-quarter. Our client base achieved 1.6 million clients. That's roughly 18% growth in the year. Our credit volume paid in two days, totaled BRL21.5 billion in the quarter. Our net revenues totaled BRL2.9 billion and our net income totaled BRL242 million.

On slide 5, we see the evolution of a few metrics, financial volume reaching BRL190 billion, a 12.6% growth year-on-year. Our client base with a close to 18% growth, totaling 1.6 million clients at the end of the year and also our credit volume paid in two days, totaling BRL21.5 billion in the quarter, which is an 18.8% growth year-on-year. On slide 6, we have a look at some highlights of our income statement, our net revenues totaling BRL2.9 billion and that's a 1.2% contraction year-on-year, our EBITDA margin of 22.9% and that's 13.5 percentage points decrease year-on-year and a net income of BRL242 million and that's a 68% decrease year-on-year.

On slide 7, we see our revenue yield, which is the most important component in the explanation of net income contraction. The price change is the main contributor for the revenue yield compression over the quarters. In this slide, specifically, we have a comparison of the revenue yield of the fourth quarter versus the third quarter and also versus the fourth quarter of the previous year.

We can see in both graphs that the price change was the main contributor for the decrease in revenue yield and I'll talk about this in the upcoming slides with a little more detail. On slide 8, we show the three sections that we will approach as highlights of our 2019 performance; the recovery of our presence in SMEs, also highlights on customer experience related to improvement in quality of service and also brand recognition. Moving to slide 9. What we see in this graph is the evolution of revenue yield for Cielo's portfolio. We see that since the first quarter of 2018 we have seen decreases of revenue yield quarter after quarter. And I know we have talked a lot about this in our meetings with analysts and with investors. The -- in the second quarter of 2019, this was the most pronounced drop of prices that we saw in our market and Cielo followed that. But after

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that, we continue to see a pressure in terms of prices. Another important information that we have in this slide and now relating to Cielo's retail portfolio to Cielo's SMB portfolio is the fact that now 75% of our retail portfolio has been repriced. Moving to slide 10. We have some comments on our new sales model. We hired 1,000 new employees categorized as hunters as employees that have the sole job to pursue new clients and we see in this slide how quarter after quarter the work of the hunters has evolved. So in the first quarter, we see an immediate contribution in terms of in addition of clients of new accounts that were brought in for Cielo. Starting on the second quarter, we started to change to adapt this model prioritizing the size of the client, the volume that the client brings to Cielo and not prioritizing the actual amount of clients they're brought for Cielo. As a result of that we see that over the quarters the contribution of the hunters to the total volume of the retail portfolio of the SMBs portfolio has increased. We finalized the fourth quarter with 12% of the SMB portfolio that was brought in by this work of the hunters. On Page 11, we see that as a combination of more competitive prices and the work of this new sales model, we have now a continuation of a trend that started in June of this this year which is the fact that the segments of SMBs and entrepreneurs have outpaced the growth of large accounts inside Cielo. Now moving to customer experience on slide 12. In the last year, we presented significant improvement in client services. This happened mainly due to improvement in systems and processes related to chronic problems. Additionally -- and we have talked about this, I believe in the last call, we implemented a new call center model with incentives for the call center operators to prioritize client satisfaction and first-call resolution. Their compensation is tied very heavily to these two specific metrics. As a result of all of that, we showed an 87% decrease in the time it takes to solve complaints that are raised by clients. We saw a 53% decrease in the number of calls in the call center. We saw a 16% decrease in the number of complaints in the call center and we also saw a 60% decrease in the number of calls due to technical problems. Moving to slide 13. We have a highlight in terms of brand recognition. Cielo has traditionally been the top player -- that top of mind player in this segment. And throughout the -- over the fourth quarter we also reached the number 1 position in terms of Internet searches on Google. And finally, moving on to slide 14. I'll talk briefly about 2020. We can see in this slide a pyramid of the client segmentation inside Cielo. In the Large Account segments, that we see intense competition with very narrow margins. We have adequate pricing for this segment and we will not pursue clients at any cost. And when we look at the bottom of the pyramid, the Entrepreneur segment, we see that there has been an escalation in competition mainly seen in the increase of equipment subsidies. For 2020 we won't add to this increase of subsidies. We will look at subsidies within certain limits for Cielo. Our priority for the year will be the absolute focus on SMBs. We already have competitive prices that we have seen in the previous slides. We have competitive products for prepayments. We have a robust sales model and we have shown improvements in terms of quality of service. With that I finalize the presentation and open the Q&A session. Thank you.

## Questions And Answers

### Operator

Thank you. The floor is now open for questions. (Operator Instructions) Our first question comes from Mario Pierry, Bank of America.

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**Q - Mario Pierry {BIO 1505554 <GO>}**

Good morning, everybody. I have two questions, the first one is related to the outlook for prices. You show that your revenue yield has been under pressure, you talked about the competitive environments remaining intense. However, considering the rebates that you renegotiated with the banks, considering that your volume mix is improving as you're focusing on SMEs rather than large corporates, is it fair to assume that are -- your average revenue yields next -- in 2020 should be similar or higher than in 2019. That's my first question.

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Thank you for the first question. I'll be very brief in terms of comments about the future because this comment has embedded in it a view in terms of price in the competitive landscape. So what to -- I'm referring to now is our view of a continuation of pricing pressure. So even with the items that you mentioned, I don't see to the best of our knowledge -- from what we had seen in terms of prices at the end of the year and now in the beginning of the year, a slow down in terms of price competition. So we are likely to keep seeing a pressure on margins and also a pressure in revenue yields. Even with other items that may offset that. But that being said, we are still concerned about price and revenue yield compression.

**Q - Mario Pierry {BIO 1505554 <GO>}**

Okay, that's helpful. Second question is related to volumes in 2020, given your focus then on SMEs and less focus on large corporates, is it fair to assume that you should lose market share in 2020 when we look at our overall volumes?

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

Mario, that's Caffarelli here. In fact, when you to decide to migrate from big companies to SMEs, our intention is to improve our margins. In this case, we want to accept any kind of offering from the big companies relating to the price. In this case, perhaps we can lost a part of the market share in this situation.

**Q - Mario Pierry {BIO 1505554 <GO>}**

Okay. And just a follow-up on the question then now Caffarelli. You show in your presentation that you're able to grow volumes again that you're growing your client base but at the same time right, you are sacrificing profitability. Your return on invested capital is down to 6.6%. Your ROE is down to 16.7%. So I was just wondering how do you look at profitability. What do you think is the appropriate level of returns for this business?

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Mario, that's -- Gustavo here -- that's a very tough question because, if you look at all of the metrics that you mentioned ROE, EBITDA margin, revenue yield and all of that, our concern in terms of prices is based on first a continuation of this trend of price pressure. That's what we see day-after-day and also when you look at our industry, which over the past few years has been characterized with a reduction of barriers of entry and also a reduction in IT costs, processing costs, there is still room for new players to join this

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industry, which will put pressure in terms of margins and we are not talking about pure acquiring players, we are talking about FinTech companies that may want to enter the acquiring arena to create a digital bank. We may be talking about big retailers and big tech company. So that being said, even though we traditionally look at the main financial indicators, it's hard to establish where is a hurdle for -- where the competition pressure will take those indicators too.

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**A - Paulo Rogerio Caffarelli** {BIO 7429811 <GO>}

And Mario if I may add something, when you're talking about the SMBs, actually we decided last year or two to reduce pricing in order not to lose market share in one of the most, if not the most profitable businesses, which is SMB. So the price went down, but we think continue to have a kind of 30% share in the SMB business, making debt aware that -- it's not a stable picture. It's a very aggressive and competitive landscape. So sometimes we have to put a little bit pressure on pricing, which was the case in SMB, not to lose market share in a business where the profitability is the highest. And then in the future, you compensate by higher gains.

**Q - Mario Pierry** {BIO 1505554 <GO>}

Okay, thank you very much.

**Operator**

Our next question comes from Julie Chariell, Bloomberg Intelligence.

**Q - Julie Chariell** {BIO 17144999 <GO>}

Thanks for taking my question. I have -- I have a couple, firstly I wanted to ask about the new contract with the controlling shareholder banks. And I guess, just fundamentally, I want to understand the changes in this contract compared to your prior relationship. What are the banks going to be providing to Cielo now that they had in the past or is this more just a change in the financial relationship?

**A - Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

Thank you for your question Julie. In terms of the rationale for the contract and in terms of the services rendered by the banks, it's similar in nature of services which has to do with the indication, intermediation, maintenance and the relationship with the clients that have their account with those banks. So it's not only introducing new clients, but also maintaining the client base that has accounts with those banks. So in terms of the basic components those are the ones that are included in the new version on the contract and also in other versions -- older versions of the contract.

In terms of the economics, in the new contract we announced that we will pay 10 basis points on a volume that has a qualification. There is eligibility criteria for this volume to drive this payment to be eligible for this payment. One important criteria is a minimum profitability metric that is embedded in this contract. This is one of the differing aspects to the old contract. In the old contract, there was a given fee that was paid in total volume of accounts with those banks without this qualifying minimal profitability metric.

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

Julie, in fact I'm may add, it's important, this time because the most important thing in this negotiation is to adapt this kind of contract in our current time in Brazil in terms of acquirers, because when we compare this moment now and when we compare this 10 basis points, it's completely different that used to be in the past. It's not the same in reality that we are facing nowadays. In this case, it's very important for us to adapt this and I can assure to you that we are in most best conditions that when used to be before.

**Q - Julie Chariell {BIO 17144999 <GO>}**

As you say there is -- it's not going to be a fee that Cielo has to pay for clients who are just not sufficiently profitable for Cielo?

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

That is a fact. In this contract there is a minimum profitability level.

**Q - Julie Chariell {BIO 17144999 <GO>}**

And do you see that the banks in this case becoming a source for credit business for lending for Cielo maybe for some of the smaller clients who the banks wouldn't take on?

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

That's an important question, so I may be long-winded here. So -- and I'm sorry, if I talk about some things that you haven't asked. Okay so that I have to paint the full picture here. So competition in the acquiring industry is open competition where in terms of prepayment product, the acquirers compete with the banks. So this is an open arena. So whether we are seeking a client that has an account with these two banks, true controlling shareholders or with other banks, any bank and any acquirer can try to offer credit or a prepayment solution to that client. So this is how the -- this industry is established in Brazil. Even though, we have this agreement with the banks we compete with them in terms of prepayment product. We currently don't have a fully launched credit product. We did run a pilots of a credit product in 2019 and we're likely to fully implemented in 2020, but always competing with any bank with the true controlling shareholders and with any other bank in the system.

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

So actually it's a total competition. It's not a pick and choose way to be dealing with the customers.

**Q - Julie Chariell {BIO 17144999 <GO>}**

I see. So you'll continue building your credit business of that pilot presumably over the course of this year but this particular contract has nothing to do with that deal, just part of the ongoing competition?

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

That's right. This contract does not interfere in any sense in terms of our efforts to expand prepayments penetration in our client base and even if we decide to fully implement this pilot of a credit product that we have done in 2019, it also is an independent decision in terms of its relationship with this contract.

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

Even though, Bradesco and Banco Do Brasil are controlling shareholders, they are basically a channel for us and we don't have any type of limitation to be acting with the customers, even if they are from Bradesco Banco Do Brasil Banco, it's totally open.

**Q - Mario Pierry {BIO 1505554 <GO>}**

Okay, great. Is there a sort of a natural segmentation that goes on here though, where smaller clients -- SMB clients may be more likely clients for Cielo given your knowledge of their accounts on the acquiring side or is the larger account may be more likely targets for the banks there natural segmentation.

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

I wouldn't say that there is a natural segmentation, but there is a difference in terms of level of penetration, because of the way the product mix for the different clients is structured. So for microentrepreneurs for example, it is natural, not only for Cielo, but for the competition to have very high penetration rates in the prepayment product -- penetration rates around 70% and this is because these clients they prefer to receive the cash right away. So usually when you create the product, the combo that you're going to offer so that client you already sell you offer prepayment as a function and they take it. So with that inside Cielo you see, and that is also common for the market a higher penetration in entrepreneurs are close to 70%. Any of the other segment inside Cielo a penetration that is closer to 22% to 20% but this has to do with the preference of the client.

**Q - Julie Chariell {BIO 17144999 <GO>}**

Got it. Okay, very helpful, thank you so much.

**Operator**

Our next question comes from Tito Labrta, Goldman Sachs.

**Q - Tito Labrta**

Hi, good morning, thanks for the call. Couple of questions also. First you mentioned that you're going more with SMEs for its large accounts. But then if we look at the prepayment volumes they were down to 14% of total volumes and also you mentioned that was impacted because of larger accounts. So if we look at the trend it seems like you're actually growing more with larger accounts or at least in this quarter, even on a two-day prepayments that was down compared to last quarter. So I just want to understand was that just a quarterly thing given you focus more on SME for its large accounts or why did



the prepayment volumes fall so much as a percentage of total volumes? And then I have another question after that.

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Thank you, Tito. So on your question. So specifically in the fourth quarter and I would like you to visualize the decrease that we saw in the basic interest rate in Brazil. So we had a decrease in the basic interest rate, which led to tighter spreads for Cielo and a decision to do a capital allocation strategy prioritizing the higher yielding segments. So for the larger clients we have repriced our prepayment product which led -- bear in mind that when I refer to larger clients, I'm talking about clients that had big tickets. And if I lose a number of clients from 5 to 10 clients, this impacts this metric. So this decision for Cielo to prioritize higher yielding segments in prepayments led some clients to get their prepayments financing alternatives somewhere else outside of Cielo which led to this compression of the volume that was -- that we had in terms of prepayments.

Just to give you some color in terms of numbers related to that and I'm going to refer to the balance of prepayments of the end of September versus the end of November. At the end of September, we had BRL11.3 billion in prepayments, that's the balance.

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

and the balance at the end of December was BRL9.7 billion. So, bear in mind that in the fourth quarter it is a seasonally strong quarter. So it would be normal to see an increase there. But because of this repricing, the privatization of the Retail segment of our portfolio, we did see a contraction in prepayments in large accounts.

**Q - Tito Labrta**

Okay, so that was a contraction with large accounts, not because you grew more in larger accounts that they need the prepayment. Correct?

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Correct.

**Q - Tito Labrta**

So this is like 14% of total volumes that are prepaid, is that sort of like a new normal. Is that what we should expect going forward?

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

I would -- it's hard to say. It's hard to quantify, because it has to do so. These products have a very short term. We're talking about average terms of 50 days. So this cycle is through quite fast. So, it has to do with -- what pricing policy we are likely to implement. So I'm not going to answer your question directly, because I do not have a guidance on this for the full year. But what I can tell you is that the pricing policy that we implemented that led to some client's doing prepayment outside of Cielo, is still in place. We are still prioritizing higher yielding segments.

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## Q - Tito Labrta

Okay, so understand. This is the focus on profitability. And so I guess that sort of leads into my second question. Before you mentioned that you expect the revenue yield to continue to fall given pricing competition and I assume this is even with the new rebates from the banks. So, is the way to read that that margins or earnings can still fall like this BRL240 million in net income that we saw this quarter. I know, you're not giving any guidance, but is there still downside risk to that because of pricing pressure, your costs are still high, even though you're trying to focus a bit on that or have we neared the bottom in terms of earnings.

## A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}

Tito, thank you for providing you with the context for the answer. So, I cannot give guidance, but I can share with you what our concerns are. So our Number 1 concern for 2020, is still price pressure due to competition. And even though we have initiatives in terms of cost reduction of higher penetration of credit products, the combination of increasing brand fees, a change in mix that has more credit, which makes brand fees more heavy and this concern of still compressing margins, are

## A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

at the backdrop of our view for 2020. Our initiatives to offset that may not be enough to compensate for the margin pressure that we are seeing this, but -- this all may change according to what price market we see during the year.

## Q - Tito Labrta

Okay, that's helpful color. Thank you very much.

## Operator

Our next question comes from Craig Maurer.

## Q - Craig Maurer {BIO 4162139 <GO>}

Yeah, hi, thanks. Two questions, but the first is when we talk to competitors in the market, whether that's, Stone, First Data, [ph]Edgy, Santander, you name it. Everybody says they're gaining share in the SME or the middle market. So considering that the SME or middle market is a finite number of merchants, help me understand who Cielo is now gaining share from again to increase their share in middle market because the commentary from all the players doesn't add up. And secondly, if you could comment on aside from Cielo specific pricing changes what your expectation is for the market in terms of prepayment pricing now that Edgy has decided to go to 0% prepayment without the need for a bank account domicile the detail. Thanks?

## A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Great, thank you for two questions. So starting with the second question in terms of prepayment margins, you are correct there's competitive environment and this change in terms of a key competitor leads us to believe that we will have a tougher environment in

terms of margins for prepayments. That's a fact. And I'm saying that and I can tell you that even though we haven't seen a significant change in terms of requests from our clients, our clients leading Cielo because of that offer, but I understand, it's an important offer that will put pressure on prepayment margins.

And now I'm going to try to do my best to reconcile market share movements on the retail from what you hear from us and also from what you hear from the competition. Okay. So first of all, bear in mind that when we talk about Cielo regaining its presence in retail and we put that into perspective, we take, we look at a long victory here. So we lost significant market share on the retail. In our calculations roughly 20 points of market share of the retail in the years of 2017 and 2018. What we were able to achieve in 2019, was a stabilization of this. By stabilization, so our first item to celebrate this year was listen, we are at a given a level of our estimate of market share and we are still around this number. This number fluctuated upwards on the second quarter, where we gained share from most of the players and this fluctuated downward on the third quarter, but still when we look at 2019 for the retail our job was we preserved our market share. We stopped a trend that was happening two, three years back of bleeding clients stressed on the retail. So that's how I try to reconcile the different arguments that you get from us and from the competition. And looking at 2020 it will be an important battle for all of the acquirers on SMEs. I follow your comment. Yes. Everybody is prioritizing that.

**Q - Craig Maurer** {BIO 4162139 <GO>}

Okay. And if I can just ask one follow-up. Historically, Brazilian regulators have monitored Cielo's market share looking to have new competitors, gain share in Brazil. How is the -- how are the conversations with the regulators these days in terms of Cielo's overall market share and Cielo's ability to be aggressive to regain momentum in share in the market? Thanks.

**A - Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

Thanks for the question. Our interactions with the regulators haven't built specifically or let me say better, a heavily in terms of this specific concern (Technical Difficulty). Cielo does have a market share that is now above 40%. It used to be above 60% in the past but our recent interaction with the regulator in Brazil, hasn't weighed heavily on this specific target. We talk about everything with the regulator their plans for open banking, their plans for continuous payments, their plans for providing a platform for prepayment, for providing better transparency and access to clients in terms of prepayment options. But I would say, I don't want to say zero, but I would say way less in terms of a threat to competition because of the market share of Cielo.

**Q - Craig Maurer** {BIO 4162139 <GO>}

Okay thanks, very clear. Thank you.

**Operator**

Our next question comes from Neha Agarwala, HSBC.

## Q - Neha Agarwala {BIO 17722501 <GO>}

Hi, thank you for taking my question. Sorry I came in late, so apologies if I'm making you repeat any of your answers. I have three questions. First is on the credit product, how has the experience been in the credit product? Has your asset quality been tougher than you imagined? It seems like the rolling out of the credit product is on the slower side. My second question is in terms of regulation. Could you update us on the creation of the marketplace for receivables? I believe we'll receive the first guidelines in August of this year and what is the impact that you estimate from the creation of the marketplace. Any rough estimate or any guideline I would be helpful. And my last question is on your focus area. We understand that the SME market is not a focus area. But what about your strategy in the micro merchant segment. Do you -- should we expect lower focus on that -- in the micro merchant segment. And if so, what is the rationale behind that? Thank you so much.

## A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}

Okay. Neha, thank you very much for your questions. Okay. So in terms of the credit product. So we created a product, a pilot of a product here inside Cielo that went throughout the second half. That was what the Brazilian market calls [ph]Formosa, roughly translated to smoke which doesn't describe the product at all. So let me try to explain to you. Because the acquirers having relationship with the clients, they can forecast how much that given client will sell over the upcoming months. Based on that projection credit is offered. So this is what the market in Brazil calls Formosa. This credit product is very heavily associated with acquirers. Okay.

That being said, we created a methodology where the most important credit criteria is our projection of churn of that given client. So if our projections indicate that we have a strong likelihood to remain with their client, we are comfortable granting debt credits. This experience was successful on the second half. We are now -- but we ran it as a pilot. We are now preparing systems procedures to do a full implementation of that. We are not ready to implement it yet. As soon as we launch it will let the market know.

Going to your second question in terms of the marketplace of receivables. Yes, the first stage of this project will be launched in August. Right now, all of our attention is to have all the operational aspects compliant with what the Central Bank is requiring of the acquirers. I do not have projections related to that. Subjectively, this represents a threat and an opportunity, represents a threat to our portfolio because it will be an open platform, but also an opportunity to reach out to other clients into other prepayment alternatives, but unfortunately at this point, I don't have a projection to make on what our prepayment -- how our prepayment will be affected by that. And in terms of focus. When we look at the micro merchant segment, we saw an increase of the percentage of the value of the cost of the equipment that is subsidized to this type of client. Up to a certain point, we followed this competitive behavior. Its competitive pattern from the industry. We think that now at average levels of close to 70% this subsidy is quite high. So, we will look at 2020 limiting our level of subsidies. It's still a segment with high margins with clients that -- as I mentioned in one of the previous questions, seek prepayments. Right? But still, because it's an upfront cost that depends in terms of a future performance, where viability depends in terms of future performance, will be more cautious in this segment, which leaves the SMB segment as our top priority for 2020.

**Q - Neha Agarwala** {BIO 17722501 <GO>}

Okay, thank you so much for the explanation. Very helpful.

**Operator**

Our next question comes from Mohammed Ahmad, FGP.

**Q - Mohammed Ahmad** {BIO 18064109 <GO>}

Hi, guys. Thank you very much for taking my question. I just want to focus a little bit or understand the cost side of Cielo Brazil, a little bit more. Could you, given that -- it's going to be a fairly challenging environment on the revenue side, can you give us a little sense of what part of your costs or what percentage of your costs is something that you could address and control and perhaps curtail versus what portion of the cost is directly linked to just volume and will grow with it -- with limited control on your part.

**A - Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

Mohammed, thank you for your question. One of the items that we referred to in these types of interactions with analysts and investors is the fact that, if we look at our cost base in 2019 and I'm talking about a round number of close to BRL4.5 billion. If we look at items, there are directly actionable I don't want to say manageable, because every cost in the long term is manageable and you have some influence over that. But if you take outside of this calculation, cost such as brand fees, depreciations and others, we will be left of this BRL4.5 billion with close to BRL2 billion of items where we have a direct influence in that cost on that given year. So this is why when we look at the evolution of costs at Cielo we see increasing variable costs, mainly driven by higher Brent fees. Brent fees have been going up because of two things, both as a function of an increase and I'm going to call it, the headline price of the Brent fee and also because of a change in mix. Over the best periods we have seen an increase of the credit component. So there is a more heavy -- a heavier weight of the credit in the mix and also a heavier weight of the brands they have higher fees, which leaves us with BRL2 billion or 44% of the total costs that our nation with an ability to maneuver around I'm referring to, close to BRL700 million in personnel expenses and also costs related to telecom, processing and other administrative costs. So this is why it's tough, but it is part of our job to try to offset price pressure and increasing variable costs with a more efficient structure.

**Q - Mohammed Ahmad** {BIO 18064109 <GO>}

Sorry, did I understand this correctly, you said BRL2 billion is manageable of that BRL700 million is what, I didn't quite -- catch that.

**A - Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

Personnel payroll.

**Q - Mohammed Ahmad** {BIO 18064109 <GO>}

BRL700 million is payroll.

**A - Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

Yeah.

**Q - Mohammed Ahmad** {BIO 18064109 <GO>}

Just my other question on the subsidiary side, we've noticed last year, obviously, the subsidiary losses ex Caetano and Cielo Brasil spiked up a little bit that historically have been sort of close to breakeven on average. Can you give us a little sense of what you can do there. Can you realize some value there. What should we expect in 2020 there?

**A - Gustavo Henrique Santos de Sousa** {BIO 17683157 <GO>}

If we look at other subsidiaries. So we have improving performance from Cateno that's the most important contributor for Cielo's total earnings at this moment. So there is -- we are confident that we will keep seeing improvement -- improving performance from Cateno. In the other subsidiaries there is one that has a very strong focus of attention from management and from the Board, which is Merchant e-Solutions, that's our subsidiary in the US where in April of 2019 we changed the management and the new management has done a few things. First, they completely change the cost structure. They reviewed the number of locations of merchandise presence across the United States, the number of offices. They also reviewed the number of employees. They did some cuts in terms of headcount there. They proposed and they are developing a roadmap of products and solutions and throughout the first quarter, when we will -- this management will present their proposal of a turnaround of Merchant e to our Board. So we still improving there. At this point, we have done the basics, which is efficiencies in terms of number of offices and headcount. The product portfolio is being worked on. But the final path for turnaround, the alternatives will be presented to our Board throughout the first quarter, as soon as we have finalized a strategic view for that asset we'll let the market know.

**Q - Mohammed Ahmad** {BIO 18064109 <GO>}

Okay, thank you. Thank you, guys.

**Operator**

Our next question comes from Jeff Cantwell, Guggenheim Securities.

**Q - Jeff Cantwell** {BIO 18876343 <GO>}

Hi, good morning and thanks for squeezing me in. Most of my questions have already been asked, but I have a question that is related to the increase you're seeing in your active merchant base, which is now 1.6 million versus the 1.3 million the same quarter last year. So that looks pretty good to us and we heard you talked about some changes in your strategic focus using the hunters, which you outlined on slide 10 and that also looks positive. So I guess the key question is -- will this strategic focus ultimately cost net income growth to rebound and can you maybe talk to us about your thinking there. And then related to that. I also wanted to see, if you could talk about the new merchants you're adding over to past 12 months and how do they compare to your legacy merchants. Are they more profitable versus your legacy base for example or maybe

expect to see less churn from these new merchants. Any color you can give us there would be great. Thanks.

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Jeff, let me just rewind your question a little bit. I -- your call was a little chopped and I lost what you said before rebound, not the whole thing, the 10 seconds before rebound. Can you just contextualize that for me, please.

**Q - Jeff Cantwell {BIO 18876343 <GO>}**

Yes, Sure, the first is on thinking about your strategic focus right with your active merchant base and how that's increasing and whether that can ultimately drive a rebound in net income growth for you in 2020 and maybe even if you want to talk about 2021. And then the second is thinking about the merchant base, the new adds how they compare to your legacy merchants, are they more -- do you think they are more profitable right versus your legacy base or maybe you're thinking that there will be less churn from those merchants. I'm just trying to look for some color on the net adds that you're seeing.

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Perfect, Jeff. Thank you for clarifying. So, in terms of client base expansion net adds, came heavily from expansion in SMBs and most importantly in micro entrepreneurs. So when we refer to micro entrepreneurs it's a new segment, so those are new clients for us. I cannot draw a direct comparison from this portfolio in the past, is what portfolio that was more heavily built in the year 2019. When we look at the SMBs that were added to our base what we have seen on the SMBs portfolio as a whole was a stabilization in terms of churn. Up until the end of 2018 we have been experiencing increasing churn rate throughout 2019. We were able to stabilize that. So the new clients that were brought in, they gain -- they had this positive effect of stabilizing churn on the SMB segment. That being said, because we are talking about a 2019, with way more competitive prices, they had much lower profitability. We added clients with a different revenue yield. So not only, we added new clients with a lower revenue yield, but the clients from the legacy portfolio were also repriced. With all of that and with a view that price pressure will remain in 2020 it's very hard to forecast when this rebound in terms of net income will happen. Our job here is to still work with this stabilization of Cielo's presence, mainly on the SMB's portfolio, but still touching on some of the items that I discussed throughout the other questions; facing headwinds of price pressure, increasing variable costs because of brand fees and doing our best to become more efficient and to further increase our penetration of prepayments on the retail portfolio, on the SMB portfolio.

**Q - Jeff Cantwell {BIO 18876343 <GO>}**

Okay. And then you've got a couple of questions on your outlook for net revenue yields and we can see that came down by 5 basis points, this quarter. And you're highlighting pricing adjustments was a big driver of that. I guess, I just want to ask this in a slightly different way, which we are really trying to figure out directionally up or down, right. And I guess, the crux of my question is what would be the two or three factors that would cause net revenue yields to inflect positively for you guys, is there anything that you're seeing or

you can discuss with us that would give us a feel for a possible positive inflection, but we call it the next 12 to 18 months. Thanks.

**A - Gustavo Henrique Santos de Sousa {BIO 17683157 <GO>}**

Got it, got it. So, one of them is a stabilization in terms of prices, which is not our base case scenario. That's not what we see, but if prices were to stabilize that would be positive for us and The other one would be an inversion in terms of the participation of the segments, but that -- in order for that to happen in one year the SMB portfolio would have to grow way faster than the other portfolios, namely the Large Accounts portfolio. So I'm talking about what would drive this inflection in terms of revenue yield, in terms of market conditions would be stabilization of prices. And that's not our base case. And in terms of the mix of our products, a much stronger growth and/or deceleration in Large Accounts but because Large accounts are two-thirds of Cielo's volume, this change in mix takes some time. It's hard to see that in one year. Okay.

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

And also a possibility to grow more in credits that may be we are forecasting in order to grow the (inaudible) payments on a higher weight that we expected. So this is also a driver for us that makes us have a potential to grow more which is not the basic scenario, but it could be a good surprise.

**Q - Jeff Cantwell {BIO 18876343 <GO>}**

Okay, great, thanks very much.

**Operator**

Excuse me, this concludes today's question-and-answer session. I would like to invite Mr. Paulo Caffarelli to proceed with his closing remarks. Please go ahead, sir.

**A - Paulo Rogerio Caffarelli {BIO 7429811 <GO>}**

Thank you all of you for the participation. If you have any doubt, please do not hesitate to contact us okay. Thank you so much. See you soon. Bye-Bye.

**Operator**

That does concludes Cielo conference call for today. Thank you very much for your participation. Have a nice day.

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