

Q1 2012 Earnings Call

Company Participants

- Clovis Poggetti, CFO/IRO
- Eduardo Chedid Simoes, EVP of Products and Business Development, Strategic Planning and Projects Departments
- Paulo Guzzo, EVP of IT and Operations
- Roberta Noronha, IR
- Romulo de Mello Dias, CEO
- Unidentified Speaker, Unknown

Other Participants

- Carlos Macedo, Analyst
- Craig Maurer, Analyst
- Daniel Abut, Analyst
- Federico Rey, Analyst
- Henrique Caldeira, Analyst
- Jorge Kuri, Analyst
- Marcelo Henriques, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst

Presentation

Operator

Good morning. Welcome, everyone, to Cielo's First Quarter 2012 earnings conference call. At this time all lines are in a listen-only mode. Later there will be a question-and-answer session and instructions to participate will be given at that time.

(Operator Instructions). As a reminder this conference is being recorded. This conference call is being broadcast live on www.cielo.com.br/ir. We remind you the questions for the Q-and-A session may be posted on the website.

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

Actual performance could differ materially from those anticipated in any forward-looking comments as a result of macroeconomic conditions, market prices [ph]. And other factors.

Now I'll turn the conference over to Ms. Noronha, who will begin the presentation.

Roberta Noronha {BIO 20488075 <GO>}

Hello. Good morning. I would like to thank you all for joining us as we present our results from the First Quarter of 2012. With me today are Romulo de Mello Dias, our CEO; Clovis Poggetti Junior, CFO and Investor Relations Officer; Eduardo Chedid, Executive Vice President of Solutions and Business; Claudio Oliveira [ph], Executive Vice President for Major Accounts [ph]; Leopold Ribeiro [ph]; Paulo Guzzo, Executive Vice President of IT and Operations.

Also present are the finance and IR team. Now I'd like to hand it over to Romulo.

Romulo de Mello Dias {BIO 2054119 <GO>}

Good morning. Thank you for joining us for another results conference call. The start of 2012 was good for Cielo as you saw continuous growth in the commercial environment that you capture. But with resilient prices.

On slide 3, net income totaled BRL567 million, up 33% year-on-year, net margin 41%. Adjusted EBITDA was BRL944 million, up 38% over the same period of 2011 with margin at 67%. Year-on-year, our financial (inaudible) according to the three criteria we work with, the criteria used by the market where all installments are recognized at the time of purchase show volume growth of 27%.

By the accounting criterion volume was up 26%. This is the criterion we use to recognize our volumes and therefore, as always, our First Quarter captured the credit installments from Christmas sales resulting in a strong period.

I would like to state the ratification at this growth-rate level is not sustainable given that the comparison base has become more challenging and that current competitors will eventually increase their share besides new potential assets. Such facts does not worry us, since our focus is and will continue to be profitability.

In the same period credit volume was up 28% to BRL57 billion. Debit volume was up 21% to BRL31 billion. Our net operating revenues plus prepayment of receivables adjusted to present value was BRL1.4 billion, up 29% over Q1.

Revenue from equipment rental was up 21% of Q1, while unit rental price increased from BRL67 per month in Q4 to BRL71 in Q1.

In the First Quarter after a year-and-a-half of analysis of all tools available on the market, we announced an important strategic alliance with Cybersource, a global leader in

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supplying payment management solutions for the Brazilian release of the most complete global fraud prevention solution in e-commerce. Also in the quarter, we were named "Best Investor Relations by a Latin American Company in US market" by IR Magazine.

More recently we want to remind you that our Annual and Extraordinary General Meeting held on April 20 approved the proposed capital stock increase from BRL236 million to BRL500 million. This increase was carried out through the issue of new common shares with no par value that were distributed free of charge to shareholders as bonus shares in the proposal -- in the proportion of one new share for each group of five shares held at the close of April 20.

On slide 4, I'd like to talk in a little more detail about our highlights of the quarter. Here we have the breakdown of financial volume between Cielo and our main competitor. As you can see in this quarter we have reached our record market share of 60.2%. I'd like to reinforce that our focus is profitability and not the share per se.

On slide 5, we have more details about our First Quarter performance with the key indicators and quarter-on-quarter comparisons. The 26% increase in volume is one of the highlights of the quarter especially due to the stability of net MDR which was flat over the period we are comparing at 105 basis points. Year-on-year, revenues were up 29% and on quarter-on-quarter 1%.

We remain focused in increasing our operating efficiency and our total expenditures excluding subsidiaries and -- sorry, we remain focused on increasing our operating efficiency and our total expenditures excluding subsidiaries fell 4% and 15% year-on-year and quarter-on-quarter respectively. The main driver of this decline was marketing and sales expenses which as we'll explain later was impacted by our postponement of some initiatives.

Now I'd like to go to Clovis Poggetti who will take it from here with more details.

Clovis Poggetti {BIO 16529642 <GO>}

Thank you, Romulo. Good morning everyone. On our next slide, number 6, the upper left graph shows the 20% increase in the number of transactions as compared with the same quarter in 2011.

On the right we have the 26% growth in the transaction financial volume of credit and debit transaction during the quarter which totaled BRL88 billion. Here I would like call for your attention to the fact that in our case Fourth Quarters are always strong given the way we account for the credit installments, meaning in an accrued base.

On the left graph of this slide we have the number of active merchants which are those who have carried out at least one transaction in the last 60 days. And that reached 1.2 million, up 1% quarter-on-quarter and 12% year-on-year.

On slide 7, we have the evolution of our commissions and POS rental revenues. Revenues from commissions grew 26% or BRL193 million during the Fourth Quarter last year mainly due to the increased financial volume. I just want to highlight as well once more the resilience of our prices which were stable over the Fourth Quarter last year.

POS rental revenues were up 21% year-on-year with an 18% increase in the installed base for the fifth consecutive quarter and a 3% increase in the average rental price.

On slide eight we have some information about our prepayment of receivables operation which has grown gradually with stable levels of return. In the first graph prepayment of receivables generated BRL190 million in revenue in the quarter, up 57% over First Quarter last year.

On the second graph, we have the prepaid financial volume which grew for the 11th consecutive quarter totaling BRL5.3 billion or 9.3% of the total credit volume. The average term of these operations in the First Quarter this year was stable at 56 days.

On slide 9, let's look at our cost performance. The cost of service provided increased BRL399 million in the First Quarter, up 28% over the same quarter of 2011. But down 2% over Fourth Quarter last year. We have a cost analysis here where we eliminate the impact of our subsidiaries and additional brand fees.

Just to remind you, (inaudible) to compare Cielo's performance in cost reduction on an equivalent basis. As a result of this analysis, we can see that absolute cost is up 17% year-on-year. But down 3% quarter-on-quarter.

Analyzing unit cost by the same method, costs would have fallen 3% year-on-year.

Finally, if we exclude depreciation to eliminate the effect of the change in the POS mix, the unit cost reduction will have been a significant 6%. Under the same analysis. But compared to the Fourth Quarter last year, the unit cost was stable and without depreciation it would have fallen 4%.

On slide 10, we have our operating expenses. These reached BRL130 million in the Fourth Quarter this year, down 7% and 38% year-on-year. And quarter-on-quarter respectively. The decline in both the year-on-year and quarter-on-quarter comparisons is chiefly due to marketing and sales lines as we didn't carryout some campaigns, especially with partners as the quarter is traditionally is lower.

For 2012, we still expect that marketing and sales expenses will represent about 4% of total net revenue. So the direct implication here is that marketing and sale expenses will be significantly higher in the next quarter than they were in the First Quarter this year.

Adjusted EBITDA shown on the left of slide 11 totaled BRL944 million in the quarter, up 38% over the same period of 2011. EBITDA margin in the First Quarter this year was at 67%.

Net income total BRL567 million in the quarter, up 33% over First Quarter last year. And 12% over Fourth Quarter last year. Net income margin was at 41%.

Now I'll go back to Romulo.

Romulo de Mello Dias {BIO 2054119 <GO>}

I'd like to close with a few words about Cielo and how we do business. In the previous conference call I had mentioned that we don't believe that there's only one model for the acquiring business and we are very satisfied with the model that we have chosen.

With this model we have a broad distribution network, not just through our own sales force and those of (inaudible) dealers. But also from our partnerships with various banks, including our shareholders. The fruit of this partnerships is evident in our economic [ph] growth.

We consistently invest in a differentiated service for our customers. Customer satisfaction is really key in our business.

Speaking about corporate governance practice in the relationship with our controlling shareholders I've said repeatedly in various forums we believe that we can't eliminate conflicts of interest. But we can manage them. Our controlling shareholders, Bradesco and Banco do Brasil have a history of respecting minority shareholders. And at Cielo we have installed a governance model that will address issues like controlling shareholder interest with un-conflicted board members.

For example, negotiations with Elo, Amex [ph] in standard contracts and others, the board members that vote are the un-conflicted board members. It's worth noting that our Board of Directors is composed of 10 members, four of whom were nominated by Bradesco. And four by Banco do Brasil, with two independent board members. One is a former CEO of CVM the local SEC. And the other one is a former CEO of Bovespa.

I want to stress that Cielo's executive board and Cielo's Board of Directors work for all of the Company's shareholders. With regards to our results for the (inaudible) function of this business model we are satisfied and will remain focused on continuously improving efficiency to ensure our sustainability.

Just as a reminder, Cielo's mission is to be an international reference. And for that we will continue to invest in innovation for new products, technologies. And differentiated service. And renew our POS vehicle. Most importantly people -- and competent people and committed people are key in our business.

We have challenging quarters ahead of us due to some of the things we mentioned in the presentation. But we are confident that we will deliver.

Thank you for your attention and look forward to your questions. Operator, please.

Questions And Answers

Operator

Thank you. We will now begin the question-and-answer session. (Operator Instructions).
We will pause momentarily to assemble our roster. Craig Maurer, CLSA.

Q - Craig Maurer {BIO 4162139 <GO>}

A couple of quick questions for you. First, the tax rate was a bit higher than I had thought it would be in the quarter. So I was wondering what your outlook is for the remainder of the year? And then if you could also comment on how the launch of Elo is going? And you had mentioned competitors. I just wanted to get your view on how new competitors are starting to build momentum in the market, thanks.

A - Clovis Poggetti {BIO 16529642 <GO>}

Regarding the tax rate, these refers to let's say some events and provisions that we made in First Quarter that are not, let's say, considered when we are calculating the real amount to pay in terms of corporate taxes. You can -- you may consider for the whole year the same level of taxes that we had in 2011, close to 33%. Given the fact that the tax that we had in the First Quarter may be offset in the following ones, okay?

Q - Craig Maurer {BIO 4162139 <GO>}

Thank you.

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

And Craig, about the new competitors, we are seeing the players that are in the industry, they are taking some share. They -- and we do respect what they are doing. There are also other companies that announce that they will be ready in a couple of months. So I would say that probably one year from now you have two more, or maybe three more players coming to the market.

Q - Craig Maurer {BIO 4162139 <GO>}

Okay. And regarding Elo's launch?

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

Elo's launch is going well. We today have more than 2.5 million -- I was just corrected, that we reached -- we're at 4 million cards. So the number is increasing so fast that we have to be updated all this.

Q - Craig Maurer {BIO 4162139 <GO>}

Okay. And when was that officially launched? I just was looking for the time-frame that that 4 million cards were reached.

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A - Eduardo Chedid Simoes {BIO 16447904 <GO>}

Yes, I think -- this is Eduardo Chedid. The (inaudible) actually began about January last year. I think that the good news of our almost reaching the 4 million milestone is that out of those 4 million about 1.5 million were actually issued in the past two months, which just shows that the speed and scale of issuance has been growing now at a very good pace.

Q - Craig Maurer {BIO 4162139 <GO>}

Okay. And are the issuing banks actually replacing Visa or MasterCard, or are they issuing new cards as companions to those cards?

A - Eduardo Chedid Simoes {BIO 16447904 <GO>}

It's both. I think it's -- they're issuing cards to new accounts as well as issuing some cards to old accounts. So I think there is not one formula. And as you have three different banks, each one has a different strategy.

Q - Craig Maurer {BIO 4162139 <GO>}

Okay, thank you guys.

Operator

Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

I have a couple of questions. First one is the market share gains that you saw this quarter, what expense do you think they're driven by? Maybe Redecard is not as focused on the market as they were in the past, given what's happening with takeover by Itau. And to what extent do you think you can continue to capitalize on this, if it is correct for the rest of the year?

You mentioned that the growth rates that you're seeing now are not sustainable. What do you think is the full-year number that we should expect for volumes in credit cards and debit cards for 2012?

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

About market share gains we do believe that we setoff initiatives that allows Cielo to be in front of the clients and offering the best offer, at least in our opinion, to the customers.

So we have distribution, we have products, we have service, we have managers that are known by the clients. We have a logistical operation. We have something that at the end of the day together help us in this regards to gain more market share. Even though, as I said, we do not believe it's sustainable in the long run considering not only the actual competitors. We will probably gain some market share. But also take into consideration the new players that will come to the market.

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On the other hand about the growth rate, the point is the following. We -- I think the industry is in good shape. Check and cash will continue to be replaced by credit card. But at the end of the day, if Cielo is the leading company, the leader of the market and if you reach the 60.2% which is the highest level that you have in our -- the 100% of the history of Cielo, it is really more difficult to try to continue to have the same penetration because of the reasons that I have pointed.

And the baseline is also important because when people talk about growth rate, it's always important not to forget the baseline of the last year just to have a better understanding about the trends of the Company.

Q - Jorge Kuri {BIO 3937764 <GO>}

The question is if the current growth rates are not sustainable, what do you think the sustainable level is for 2012 on transaction volumes for credit cards and debit cards? I'm not sure that you mentioned that.

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

Probably a little bit lower than the pace of the market.

Q - Jorge Kuri {BIO 3937764 <GO>}

Okay. All right, thanks.

Operator

Daniel Abut, Citi.

Q - Daniel Abut {BIO 1505546 <GO>}

First just a quick follow-up on the market share issue. And you showed in slide 4, Romulo, how you've been gaining share against your main competitors, not just in the last couple of quarters. But throughout the last year-and-half.

You mentioned as well that the new competitors have started to get some traction. Have you quantified how much they gained as a group and how much more you would expect them to take even when you expect new players? You said two or three more players will come in as well. Have you any quantification on that?

Second on your margins. We have seen a big improvement in your margins, both EBITDA margin and net margin in this quarter. Do you think the new level of margin that we have seen in the First Quarter are sustainable or would you expect them to be back and with what timing?

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

The level of EBITDA that we reached in First Quarter is not sustainable due to the fact that we -- let us not forget our First Quarter is always a bad one compared to the industry

because of the accounting policy that we use. Remember that the Christmas effect -- Christmas did not affect the result of Cielo in First Quarter.

Second point is about some -- the postponement of some expenses that we have, that we usually -- just to give you a number -- a rough number, we continue to believe in terms of our soft guidance that the total cost plus expenses is BRL.041 of that transaction for the whole year of 2012.

About the new players, I would say considering dynamics in Santander in the numbers that I mentioned, Santander, Al Avon [ph], Global, I would say probably they would take up -- together they would take -- it's difficult to have a prediction. But in two years from now, probably between 15% and 18%.

Q - Daniel Abut {BIO 1505546 <GO>}

And how much have they taken already?

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

They just published their numbers. Unfortunately, I didn't see. I was informed that Santander published today. I remember that on last quarter, if you people can help me, in the last quarter they reached 2.55% with the First Quarter; if you can help me with the calculations, did they provide numbers?

A - Roberta Noronha {BIO 20488075 <GO>}

They didn't.

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

No, they didn't provide the numbers for First Quarter. So what I tell you Daniel, they are increasing their penetration in SME, small-medium business. They are also beginning to be -- to work, begin to work with large merchants and that's how it stands today.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you, Romulo.

Operator

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

I have a question, Romulo, about an outlook for the market. I mean, it's a follow-up of what we are seeing. But a little bit longer term maybe. In the documents that were filed for the tender for Redecard, Rothschild provided an outlook for the market that was provided by Redecard management that showed net MDR is declining -- or continued to decline at a slightly quicker pace and rental revenue is still fairly robust down the road.

I was wondering how does that compare to the view that you have? Do you believe that net MDRs will continue to fall throughout the next few years, maybe reaching something like 80 basis points for credits in four or five years down the road, or is the view that you have that they might be a little bit more resilient like they have shown to be over the last two or four quarters?

And second question is related to expenses, if you can give us some more color on the admin expense line and how that did in the quarter and what should we expect to see in that line going forward. Thanks.

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

Hi Carlos, in the long run, it's difficult to say and to project anything. So we -- I think these projections should be -- discussions should be (inaudible) and why the haircut (inaudible) should be in this level. What we said in the last conference call, two months from now. And 15 months from now, maybe 5 basis points reduction, 7 basis points is the, let's say, the expectation that you have.

About the long -- about the second question, about the expenses, I will ask Clovis to help me.

A - Clovis Poggetti {BIO 16529642 <GO>}

Hi Carlos, regarding expenses, again we had some postponement in this First Quarter, okay, mainly in terms of marketing. And that's why marketing failed. That's why we are here enforcing the soft guidance that we gave in the previous conference.

For the whole year in terms of cost plus expenses with no effect from controlling company, we may say unit basis 41% of reais, okay, while we comment in the Portuguese conference that be sure that cost and expense controls, something that we take on a daily basis, okay, continue therefore in the sense. And we work hard in terms of reviewing the process to optimize use of time, use of resources. And let's not forget as well one way that we may benefit in the renegotiation with suppliers.

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

And one point that I'd like to stress and to add that some of these expenses, a big portion of them are related to sales. I strongly suggest you guys not to -- not only to take a look on the expense than cost side. But to see the effect in terms of the revenues.

Of course, the Company's completely concerned about the level of expenses and cost. And as you can see in First Quarter therefore the expenses are not -- if we don't see a result of the effort that you are doing in terms of distribution, you are not going to pay commissions to our partners. So some of the efforts -- some of the expenses are related to sales, some of the expenses are related to trade and marketing, some are related to Cielo loyalty. And fact of news [ph] that you have in the strategy of the Company. And it's the reason why you have a certain level of cost plus expenses a little bit higher when compared to the past.

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Q - Carlos Macedo {BIO 15158925 <GO>}

Okay, Romulo, thank you. Maybe going back to the first question, I will reword it a little bit. Which -- given the entrance of the new competitors and given again may be the view that Redecard made public, what does Cielo think is most vulnerable to competition in the medium term? Is it net MDRs or is it POS rental prices?

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

It depends on the strategy that the new players will follow. I would say that if they follow in some verticals considering that Brazil is really big, probably the net debt and MDR would suffer. But if we have a player that is you'll focus more on the small and medium business. And then the whole country the rent would be suffering.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay, that's great. Thank you, Romulo.

Operator

Henrique Caldeira, Barclays.

Q - Henrique Caldeira {BIO 16441196 <GO>}

I just -- well, given the important moment we are doing right now for the industry on the next (inaudible) I'd like to take the opportunity to make another question which was not made on both calls yet. If you look last week most shares of Cielo, they also suffered after the comments made by Itau which included a revision on the commercial agreement with Redecard, if of course in that scenario that the deal was not concluded and Itau just walks away.

But if this really happens, now, can you just give your view on what would happen to Cielo in terms of corporate governance? Can you just share some data points that would give us more comfort to us that you don't see the incentives concepts are also changing?

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

Yes, one issue that I mentioned during my speech was about corporate governance standards of Cielo. Cielo has two controlling shareholders, 10 board members, 2 independent board members. One as I said is a former CEO of CVM and another one is a former CEO of Bovespa. As now, we have a management team beginning with me that we are completely committed to deliver results to 100% of the shareholders of Cielo.

To give you more -- to clarify more what we're trying to say, when you have an issue that's necessary to be approved by the Board of Directors and one controlling shareholder has some interest in this -- in the issue that we have presented to the Board, this shareholder does not appear -- he does not appear and he does not vote. And with the example that I mentioned, we have the example of Elo, we have the examples of Amex, the examples of all the contracts that you have with the banks.

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So these concepts, when I have to present a concept that I negotiate with HSBC, we present, as said two independent board members and the management team of Cielo, myself. And my team will have the ability, the empowerment, to make what's the best for the Company. I don't know if you need more color on this?

Q - Henrique Caldeira {BIO 16441196 <GO>}

No, that's really helpful. But I imagine if the interest is shared by both Banco do Brasil and Bradesco, they won't have any problems to approve on the Board and even proceed on the two independent members.

So maybe now, if you -- just now in a very hypothetical situation that Itau charged a rebate for 15%, 20% on the MDR, would that put the contracts you have with the controlling shareholders in a very different level in terms of market prices?

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

The policy that we follow in our commercial strategy of the banks we don't disclose this -- the numbers. But what I can tell that we are always -- take a look what's going on in market, what are the current market prices. Since 2010, Cielo is paying commission to Banco do Brasil and Bradesco and as well to Caixa Economica Federal and HSBC. The contracts are not comparable because some of them are related to MDR, the level of MDRs, some of them are not related to the level of MDR. Some of -- they are all -- they are also related to the financial volume.

But we -- each contract has its own particularity, take into consideration what's the best for Cielo. And we are always seeing what's good if you need to bring forth or not the level of commissions that you paid to the managers of the banks.

And we're trying to work hard, really hard in a fine-tuning to coordinate more and more with the banks. So it's a constant approach that we have to address the best level of distribution that Cielo can reach.

Q - Henrique Caldeira {BIO 16441196 <GO>}

Thanks Romulo, this is enough. And again, this is just an hypothetical situation. I'm just trying to understand what shares of pricing last week. Thanks again.

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

Okay.

Operator

Mario Pierry, Deutsche Bank.

Q - Mario Pierry {BIO 1505554 <GO>}

Congratulations on a very solid quarter. Let me also ask two questions. One, Romulo, one you mentioned that you expect the growth rates to decelerate. You mentioned you were talking about debit and credit cards.

But what about POS terminals? We're actually seeing a significant acceleration in the number of POS terminals for the Company. Do you also expect this growth rate to slow down and why?

And then the second question is related to your prepayment business where actually you continue to make progress in developing this business in line with what you had told [ph] market. But we recently heard from your competitor that the prepayment business should eventually be shifting back to the banks. Is that your opinion as well or do you expect to maintain prepayment levels near 9% of credit card transactions? Thank you.

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

Thank you, Mario, for your comment. About the prepayment of business, if you remember, when we began this line of business in September 2008, if I'm not mistaken, we said when we also launched that deal that we would pursue this business and we wouldn't expect to reach the same level that the market had at that time. And why we said that?

Because there is the un-performance sales. And the name in Brazil is Kumaza [ph] un-performance sales plus performance sales that the bank can provide money for the merchant. And we as a Company, we are not a bank, we cannot do un-performance sales. We cannot provide money based on behavior.

But on the other hand, we continue to be -- stick to our speech and to our deal that we wouldn't see many reason why the level of penetration between Cielo and the industry has wouldn't be so different. So in other words what I'm trying to say that we do think that with the level of information that you have today, that the level that you reach is sustainable. I don't know why our main competitors have a different opinion about that.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. So we should expect this level to be maintained around 9%?

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

We -- the level that you reach, we expect to have a higher penetration compared to the level that we're reaching first of all.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. But could we actually see this business going to 15% or higher or do you see a limited upside from current levels?

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

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I prefer not to comment on that, Mario, because we need to understand more about the next trend of the industry. But with the level of information that we have we didn't -- we don't change one word what we said in the whole life of Cielo. And we continue to increase, we try to work each quarter. And to see what can be done, what cannot be done.

But don't forget that because it's a advantage that the banks have. They can do their performance sales. They can offer \$1,000 in performance sales plus \$8,000 in un-performance sales. So at the end of the day \$9,000 that the banks go to the merchant and they offer \$9,000, the merchants prefer to work with the banks. But for us this line of business is very important and we think there is still room to grow.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay, perfect. And then the question about the number of POS terminals?

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

Number of POS terminals will continue to go up. We're seeing more and more a strong demand from GPRS. I will ask Paulo Guzzo to compliment here my comments. But GPRS is one thing that we together with (inaudible) that works for retail, it's something that the market really wants to work with.

A - Paulo Guzzo {BIO 16447955 <GO>}

Just what Romulo comments, what I can say to you is that our POS, GPRS, or wireless POS base will increase a little bit more. Now we are having -- achieving at least 35% of this base and the demand has been very huge for now on.

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

And some of them are exchanging the fixed POS via GPRS, okay? So it's important to sell service, to sell other products that you have. So we have a strategy considering the level of the GPRS.

We are also working with broadband. We are also working with broadband even though that broadband needs to be more paced [ph] with the market. We are more excited about GPRS when compared to the broadband, is that right?

A - Unidentified Speaker

Yes, that is right.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay, thank you very much.

Operator

Marcelo Henriques, BTG.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Just two questions. One is a quick one on CapEx, what are the estimates for the year, it seems like the First Quarter is pretty low. So I'm just trying to understand how this will evolve through the yearend.

A - Clovis Poggetti {BIO 16529642 <GO>}

I think you are getting the number from our cash flow statement and I think this is the opportunity to clarify the following. We already mentioned that a 100% of our purchase in terms of POS are being financed by the NBS [ph] in a credit line named Finami [ph], okay?

And how does it work? The money, the proceeds of the purchase goes from the bank, the NBS, straight to the supplier. This money does not pass through our cash flow and that's why it's not stated in our cash flow statement.

The number that you are getting there is close to 5.9 [ph], if I'm not mistaken, does not refer to POS. But other items of our capital expenditures such as computers, furniture, something like this. If you want to get the right number in terms of POS CapEx, please refer to our explanatory note number 33, the explanatory note that describes non-cash items and in that note you are going to see that CapEx for the First Quarter amounted BRL69 million, okay?

Q - Marcelo Henriques {BIO 17385475 <GO>}

Thank you for the clarification. The second question is looking more long term about the profitability of the industry and you keep saying about the competition is coming and that you want to grow with profitability. Just if it's possible for you to say what does it mean exactly because you're running what are now in excess of a 100% and your -- compared of your shareholder service that this level is unsustainable.

And so what does it mean to grow profitability because one could argue that maybe 50% are we -- or 60% are we just -- it is good enough to operate. So maybe it's a tough question. But what do you see that -- what is the need for you to grow profitability, what does it mean, if you could clarify more on that?

A - Clovis Poggetti {BIO 16529642 <GO>}

Marcelo, I think ROE, if you allow me to say, is not a good parameter to consider profitability of this industry. And why? Because it didn't see alteration, was always -- was almost close to 100% in the history of the incumbents. So if the book value of the companies are not big, the ROE for sure is really big.

So to talk about ROE when we have a network, we have a book value, a sustainable book value, it's something that, okay. But if you pay 95% in dividend payout ratio, 100% ROE, for me is not a good metric.

Q - Marcelo Henriques {BIO 17385475 <GO>}

All right. (inaudible) is going to be a percentage. When it can grow with profitability, does it mean the same level or a bit more than that margin had today?

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

Marcelo, unfortunately we don't make predictions about this.

Q - Marcelo Henriques {BIO 17385475 <GO>}

Okay. Thank you.

Operator

Saul Martinez, JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

Couple of questions as well. First on POS rental outlook and I think you addressed it a little bit already. Can you comment a little bit on what your expectation over the next 6 to 12 months are for the rental business considering that perhaps you may see Santander and others come in and perhaps be aggressive bundling products and at the same time as you mentioned you are seeing a migration towards wireless terminals.

So I've been surprised the Brazilian service line and the fact that it's been continually gravitating up. And the second question is, just I guess a broader question also on profitability and the sustainability, profitability. And this might be a dumb question. But when you take a step back relative to where you were pre-end of exclusivity, the margins are, they're not that different or at least in the First Quarter, maybe a little bit lower if you take a broader view.

The pricing has come in a bit. But not that much in the grand scheme of things especially considering what a lot of the market was thinking about MDRs, certainly about -- the same thing about POS rental rate. I think you can may be say that the end of exclusivity hasn't produced the kind of results from a competition standpoint that many people including maybe the policymakers expected.

Is there any risk at all that you see -- and I don't know if there are any tangible things or at least I don't see it. But any risk at all from a policy perspective that things could reemerge and policymakers could start to look at the industry again and say, hey, competition really hasn't produced the kind of results that we thought they were going to produce.

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

Hi Saul, first of all we don't do dumb questions.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay, well, thanks.

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

And second, I would say that if you consider the level of net MDR in Second Quarter of 2010, if I'm not mistaken, please guys help me, it was around 130 basis points, 130 basis points, 125-130 basis points, okay?

People will confirm. Today we're tracking about 105 basis points. So there was a reduction in terms of the net MDR of around 25%. So this is one thing that I have a different view.

About -- as you know in this business it's really important to be big. So size of the company really matters because cost of processing, distribution, I will come back to a point that I just mentioned; from the north to the south if you want to be in the small-medium business, it's really important to have distribution.

And the guys that are -- the players that are in these industries, they are regarding the line of rental that you're asking about level of rent, they are some specific transactions, they're offering the POS for free for a certain period of time.

So it's difficult to predict. It's the reason why when people ask me about what's going to happen to this and this, what's going to happen to the level of EBITDA, what I can tell you that Cielo will be the price leader in terms of we've got -- we have a price premium because of the service that you provide and the this statement can be confirmed by the numbers that you are publishing.

We are also trying to develop and to provide other solutions to the customers in order for them to choose Cielo and to take a look at the other competitors. So this is my general comments about your questions.

There was a reduction in terms of the net MDR and also the level of rent, it depends on how big will be or not the level of production that the players -- the other players will play.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Is there anything that -- so you're not worried then that -- about any sort of policy dynamics emerging that could impact the industry or you don't see anything specifically being debated?

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

I couldn't say that. It's -- now the industries that we that -- the industries are where policymakers are policymakers.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. And on the POS rental business, can you just comment on the outlook, say over 6 to 12 month time, what you're seeing there some of the cross currents?

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

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We expect to have a good result from this line of business because the merchants as we said continue to prefer GPRS and GPRS -- the rent level for rent is higher when compared to the fixed POS because they don't pay the cost of the line of the telecom and so on and so forth.

And also because we -- they are -- they think it's amazing. The merchants like to have a new machine in their hands. And they prefer they see that they don't have the costs, they provide a good service, they can do other -- they can do lot of programs.

They can do, let's say, many things. So I would expect that this line on the coming 12 months continue to present a good performance with the level of information that you have and if the market does not change dramatically.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay. Can you just -- can I just ask you on that, you said -- was I right when you said -- I may have missed it, the wireless base is now 35% than the total terminal base?

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

Roughly.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay.

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

That's right, Paulo?

A - Paulo Guzzo {BIO 16447955 <GO>}

Yes, correct.

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

Roughly.

Q - Saul Martinez {BIO 5811266 <GO>}

Can you give us a sense again -- just remind us what the differences are in terms of rental rates broadly speaking for wireless versus fixed lines?

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

Both difference -- GPRS which are the mobile -- the wireless POS 30% to 35% more expensive than the regular one.

Q - Saul Martinez {BIO 5811266 <GO>}

And do you think that 35% will continue to go up, it will go to 40%, 50% in the next --?

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

It's very hard to say now. It depends on what's going to be the next steps of our major competitors and the new (inaudible) that we are forecasting.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay, all right. Well, thank you very much and congratulations on your excellent results.

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

Thank you, Saul.

Operator

(Operator Instructions). Craig Maurer, CLSA.

Q - Craig Maurer {BIO 4162139 <GO>}

Romulo, just wanted to ask your thoughts on the IBEX [ph] data these days and how representative you think that is of the market currently? Thanks.

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

The numbers of IBEX?

Q - Craig Maurer {BIO 4162139 <GO>}

Yes.

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

Craig, I think two quarters ago I said that the numbers of IBEX shouldn't be considered as a good projection for the market because they were working with past numbers. And as you know, if Cielo has 58%, big numbers of the total market, we didn't see the numbers of Santander; 58% was the number in Cielo, our main competitor. And Santander in Q4. You had 58%. So we are the guys that have more let's say to say.

So it is like for us it is a difficult situation considering that (inaudible) will not be public anymore to talk about the projections and the numbers of IBEX. So I would say that it's a number that IBEX provides. It is an important figure. But I wouldn't rely tremendously what they say because each company has its own projections, each company has its own expectation about the future.

Q - Craig Maurer {BIO 4162139 <GO>}

Okay, thanks.

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

I don't know if that address your point. But there is no yes or no about this figure.

Q - Craig Maurer {BIO 4162139 <GO>}

No, that's helpful. Thanks.

Operator

(Operator Instructions). Federico Rey, Raymond James.

Q - Federico Rey {BIO 21612520 <GO>}

I have a follow-up question on the MDRs. I would like to understand how you were able to keep the MDRs quarter-on-quarter stable, especially considering that you were able to take a significant share from one of your competitors. And considering that your expectation is of decline of 5 to 7 basis points going forward? Thank you.

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

Federico, you said about the stability of the net MDR and the share that you gained from the market. And what --

Q - Federico Rey {BIO 21612520 <GO>}

Yes. How you were --

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

-- was the point?

Q - Federico Rey {BIO 21612520 <GO>}

-- to maintain the MDR stable in a context where you are taking share. If you are able to take share not for a price with a price strategy, what's the strategy?

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

No, our strategy is not to take share using the price, never, never. But it doesn't mean that if the market is in another momentum that we not -- we need to adapt it, considering the new momentum of the market. But let's talk in the hypothetical situation.

So what you're saying that we try to be the first in innovation, in products, in distributions and service. So on and so forth. But we are not the first to reduce the price and we never will be. In another words, our main focus is profitability, net earnings for our shareholders.

Q - Federico Rey {BIO 21612520 <GO>}

Okay. Thank you, very much.

Operator

(Operator Instructions). I'm sorry, no further questions at this time. So that will conclude the question-and-answer session. I will turn the conference back to Mr. Dias for any closing

remarks.

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

I'd like to thank you all for your participation. And we look forward to seeing you at our 2Q -- Q2 conference call. Thank you. And have a nice day.

Operator

Thank you. This concludes today's presentation. You may disconnect your line at this time and have a nice day.

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