Q4 2017 Earnings Call

Company Participants

- Clovis Poggetti Junior, Chief Financial Officer and Investor Relations Officer
- Eduardo Campozana Gouveia, Chief Executive Officer & Director
- Victor Schabbel, Investor Relations Director

Other Participants

- Alexandre Spada, Analyst
- Carlos Gomez-Lopez, Analyst
- Craig Jared Maurer, Analyst
- Gabriel da Nóbrega, Analyst
- Gustavo Lôbo, Analyst
- Jorge Kuri, Analyst
- Mario Pierry, Analyst
- Tito LaBarta, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and thank you for waiting. Welcome to Cielo's Fourth Quarter 2017 Results Conference Call. This event is being recorded and all participants will be in a listen-only mode during the company's presentation.

After Cielo's remarks, there will be a question-and-answer session. At that time, further instructions will be given. This event is also being broadcast live via webcast and may be accessed through Cielo's website at www.cielo.com.br/ir, where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event has concluded. Those following the presentation via the webcast may post their questions on our website.

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

Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Eduardo Gouveia. Mr. Gouveia, you may begin your presentation, sir.

Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Good morning, everyone. Thank you for joining us on this conference call to discuss our 2017 results. Today, I have you here with me Clovis Poggetti Jr., our CFO; and Victor Schabbel, our Head of IR. I am very happy to begin this call by saying that the recovery (00:02:00) of the retail sector in Brazil economy is really happening. Despite coming at gradual pace, we note that the signs of improvement can be seen in both CVA Index and Cielo's number.

Since August, Cielo Broad Retail Index has been recording increases in Retail sales after two years of shrink (02:19) figures. On our side, I've seen a worse in outcome by the end of 2016 and the weak start early last year. We finally had the first signs of mature improvement in third quarter, which were confirmed now in the fourth quarter.

As we're going to show in this conference call, Cielo's volume kept growing in the last couple of quarters, and more importantly, the pace accelerated. Some of the figures might not point in that direction due to the effect of migration from multivan to full acquiring model. Excluding this effect, as we are going to show our volumes not only grew but also accelerated in the last quarter of 2017.

On top of it, credit volume has also been doing better. I find that the economy environment is really improving. Also the pressure that we had in our POS base mainly at the beginning of 2017 seems to be easing with the number of terminal loss on a sequential base coming down. This overall more positive dynamic contributed to Cielo's net income result, which was again over BRL 1 billion in the quarter, allowing the company to report a BRL 4.1 billion net profit for the full year.

Although the natural competitive scenario that we have in our industry, we are confident that Cielo will continue to be not only the largest, but also the strongest acquirer operating in our market with unique cash generation, solid balance sheet.

Even though all the challenge (04:01) that we might have to face, we will continue to work hard to deliver better and better results through superior product differentiation and increasing efficiency. The idea is to do more for our clients in a better way, adding value to their merchant and their customers without forgetting about our commitment to cost control. This has been our commitment in the last quarters and will continue to be our commitment for the next and the next quarters and years.

In summary, we are working hard to deliver more. In our view, in an improving economy environment, there will be opportunities for new products and solution to be more easily implemented, helping our customers to perform better, better, and sell more.

On our side, the greater product differentiation partnership with our merchant, the better will be our performance and results. That's why two of our four pillars are clients and digital transformation. There is still a lot to be done, and we are only at the very beginning. We are excited about what is yet to come.

With that said, I now would like to hand the call to Clovis, who will discuss in more detail the trend seen in the last quarter. Clovis, please.

[0CCMKB-E Clovis Poggetti]

(05:26-06:05) modality and are now on Full Acquiring mode.

Within discounted, as we can see in the chart on the right, we recorded, for the first time in five years, growth of credit volumes higher than that of debit volumes. Here, the main factor responsible for the acceleration of credit volumes is the environment itself since we will have the effect of model (00:06:32) migration strongly impacting us most throughout the fourth (06:36) quarter of 2018. This is due to the fact that during the fourth quarter, we have rolled out our multivan volumes for Full Acquiring in only 20% of our Amex customers and 70% of our Hiper customers.

In the next slide, the graph on the left, we tried to isolate in a simple and clear way the effects of the model migration process. For this analysis, we only considered the volumes captured in the Visa and MasterCard brands. Through this analysis, we can identify the consistent recovery of our volumes, and we got to two basic conclusions.

The first one is that during the end of 2016 and early 2017, due to the combination of a more challenging market scenario and the process of market opening through the adoption of the multivan model, we had the company's most difficult times in terms of volumes performance.

The second conclusion we reached is that as of second quarter last year, we started a gradual recovery process, which was followed by a volume-led project expansion process, which also supports our view that the scenario is actually improving. This, by the way, is consistent with what we have seen in our Broad Retail Index.

The right-hand side graph showed a slow rate of decrease in our POS base, having contracted by 1.6% in the quarter compared to the previous one. As this was the third consecutive quarter where we saw the rate of decrease of POS terminals slowing down, we expect that soon we will start to see sequential expansion in terminal numbers.

After we have discussed in more detail our operational performance mentioned in volumes and terminals (08:41), we will now discuss net revenue yield evolution on the next slide. As we have been saying over the previous quarters, while PROC prices (08:52) did have an impact on lower yields, it was not the most important factor. Actually, of all factors pressuring the yield, price was the one with smaller influence.

On an annual basis, comparing the fourth quarter of 2017 against the fourth quarter of 2016, revenues that are not impacted by volumes, of which rent is the most significant, were mostly responsible for the drop. The lower rent revenues and the volume expenses throughout the year dropped a 9 basis point negative contribution to our yield.

Moreover, the increased participation of the Large Accounts segments over Retail and the increase of importance of (09:45) debit on our volumes dropped another 6 basis points (09:51). As positive contributions, we had the product Receba Rápido as the primary cause for our 4-basis point yield increase in this year. As such, lower price represented 6 basis points in the year being a portion, so not the most relevant one behind the 17 basis points drop in the yield in 2017.

In the quarterly comparison, the rent component remained the main factor responsible for the yield reduction, although revenues were stable in the quarter having grown marginally.

Their volume dilution reached (10:30) seasonally much stronger in the fourth quarter compared to the third, however, led to a negative contribution of 4 basis points. Following the mix effect here characterized by a greater participation of Large Accounts in comparison to Retail once debt (10:48) and credit grew in a very similar way, contributed negatively with 3 basis points. The Receba Rápido (10:56) receivables rather added 2 basis points and thus, the 7 basis points drop in the quarter had the price (11:07) only by 2 basis points.

It is important to highlight that in this analysis, once the profits were (11:15) more sequential quarter-by-quarter, we choose not to include here the effects of the new brand recommendations (11:22) structure in order to assure (11:24). The general message is that price was not the main component, although it had, in a way, contributed to the drop of REO (11:34) both in the quarter and in the year.

On the next slide, we highlight expansion (11:41) recorded in our EBITDA margin. Due to the strong cost control that we had implemented over the last quarter, we were able to record a 5% year-on-year decrease in our total expenses, although we had a small increase in the quarter of 3% related (11:59).

As a result, the company's EBITDA margin increased by 60 basis points year-on-year and by 1.1 percentage points quarter-over-quarter. As a result, we were able to deliver net income 3% higher than the fourth quarter of 2016 with like (12:15) margin expansion of nearly 2 percentage points.

In the next slide, we briefly highlight the major contribution of Cateno. Following a trend seen in quarters, volumes continue to accelerate which positively influenced our revenue performance in the quarter. In the face of cost and expense reports with optimization of customer services, import and (12:43), for example, we were able to present a robust profit growth in Cateno, which expanded 24% year-on-year. As a result, Cateno's contribution to Cielo's cash income was 13.9%, up from 10.1% in the previous quarter and 4.2% in a year earlier.

Now for the sake of the time to keep a short and direct call with more time for the Q&A, let's move to next slide where we present our guidance. We expect for 2018 a growth of 5% to 7% in our volumes. To do so, we must adjust the 2017 data by the volumes of Elo captured in the multivan mode (13:30). Once this adjustment is done on a comparable basis, we should grow between 5% and 7%.

On the total expense side, we should show growth in line or below inflation. Therefore, as we had the increase of the brand fees as of third quarter last year, we must adjust the entire year of 2017 for the BRL 130 million incremental in this line. From there, we should grow between 2% and 4% our total costs and expenses.

And finally, CapEx should be higher than 2017 since our POS base should grow again sometime in 2018, in the same way that the share of high-value added terminals such as LIO should also increase our investment needs. With this, our CapEx must total between BRL 300 million and BRL 400 million in the year.

With all said, let's move now for the Q&A section.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Jorge Kuri, Morgan Stanley.

Hello (15:07).

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. Two questions, if I may. Can you comment on the regulatory news items that came out in the press over the last couple of weeks? First, there was a piece about the government thinking about putting a cap on debit MDR or switching it to a fixed fee rather than a percentage of value. What do you think is driving that? What do you think the likelihood of that is?

And then there was another piece on the banks wanting to eliminate installment purchases. And can you comment what's your view about that? Is that happening or not? We've heard from the banks that it's not the case. But if you have any color on exactly what's driving those commentaries and what is really happening and what type of products are really being discussed, that would be great.

And then my second question is on your guidance for volumes. Given the volumes that you achieved last year, which were a little bit ahead of the guidance and around 7% according to adjustments that you made, is it fair to say that your guidance this year has upside (16:24)? It does seem that last year was a significantly more challenging year for your business and the economy, and so you can potentially do a little bit better this year. What do you think is holding you back? Thank you.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Thank you, Jorge. It's a pleasure to talk with you. About regulatory, we began to see some movement with regulators and (16:52). But it's very mutual discussions. We don't believe in the end of the sales and installment reduction interest rate (17:04). The decision does not make sense. We are discussing about a new way to improve the sales in immersion using a much short-term (17:17) payment for the immersion (17:23) rate for the users. Then, again, (17:30) beginning of the process we are discussing with the regulators that we don't have anything (17:35) landscape.

A - Victor Schabbel {BIO 17149929 <GO>}

And also, complementing here what Gouveia mentioned, we also don't have anything concrete about, for example, something that was highlighted by some articles in the press in terms of capping MDRs or interchange fees for certain transactions like debit, right? So there is nothing really concrete being discussed.

As Gouveia said, we only have preliminary discussions about the way that regulation might help develop the market (18:14), increasing the penetration of cards (18:15) in general in the industry. But this would be something more for the medium to the long term than anything for the shorter term.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

It's an important point Victor mentioned is the penetration in Brazil continues to – development industry (18:32) in Brazil, which is (18:36) something about 30% of penetration consumption in Brazil. And we believe this kind of – the new products that we can offer to improve the sales can improve the penetration, improve the development (18:50) industry.

About the volume, about the guidance of volume, we have not changed about Elo, the brand Elo (18:59). Until this year, we have this – the last year, we had the Elo passing through the Cielo (19:14) Full Acquiring process. And this year, 2018, we will lose (19:22) the part of this debt really of Elo (19:25) brand here in Cielo. We are very conservative in this guidance, but we believe that we have a modern (19:38) process to see the Elo brand (19:44) in these markets?

A - Clovis Poggetti Junior

Hi, Jorge. I don't think the advantage of (19:49) at this point, it's very, very important in order to avoid misunderstanding, and exactly what Gouveia just said. We had two different and tough years to compare, 2017 and 2018, okay? In 2017, given that the move given (20:04) the change from the VA and to Full Acquiring mode started on the fourth quarter so the point is that we had for nine months, volumes that we may say captured by other players, but that appeared in my figures because we will process (20:23), okay?

And then, the point is that for 2018, we are considering the 12 months of the Full Acquiring mode. So that's why what we say is take the (20:36) volumes for 2017, eliminate exactly the volumes that were captured by other guys. The multivan volume that is, let's say, stated in our release. And then, you have, let's say, a base to take into consideration and applying this 5% to 7%.

Of course, something that is very important also to take into consideration is, we are considering market for 2018 growing 9%. If you believe that this 9% may be conservative, of course, our 5% to 7% can also be considered conservative, okay?

And the point is, why the difference between the 9% to something between 5% and 7%? There is, let's say, impacts of the competition in new players still getting what can be considered fair in terms of share for them, but also the point that – that goes back to the fact that Full Acquiring mode start in the fourth quarter, we still have, let's say, some market share to lose. The point is that we start the year January 2018, and what cannot be considered the fair share for Elo, okay? So this effect (22:04) in terms of losing a little bit more and reaching the fair share for Elo is also included the effect in our 5% to 7% guidance that we are giving to you all. Okay?

Q - Jorge Kuri {BIO 3937764 <GO>}

Thanks, everyone. That was very clear. Thank you.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Thank you.

Operator

Our next question comes from Craig Maurer, Autonomous Research.

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

Yeah. Hi. Thanks. Could you discuss – when it comes to the newer competitors you're dealing with in the market, which of those competitors do you see having achieved some solid footing versus those which you think are still essentially unprofitable except for prepayment; like we heard First Data is doing pretty well down in your market. But I'm just trying to better ascertain what the competitive landscape looks like.

A - Victor Schabbel {BIO 17149929 <GO>}

Thanks for your question, Craig, here, it's Victor. Well, we have basically two types of new entrants in our market. One that is basically trying to assess the clients that we are used to work with, so would be small- and mid-sized merchants, right?

So they are basically trying to replicate what the incumbents already had in the market. So trying just to approach these clients' offering price, right, in terms of a way to basically buy market share. But for those trying to do it, the challenge has been on the distribution side, right? So in order to attack these clients that are already quite well served by the incumbents without an appropriate distribution channel and also supply chain for you to offer the appropriate maintenance and all the logistic support the clients' needs, it's quite tough. Those are the ones facing greater difficulties, right, so probably not making money.

If making any, probably mostly driven by the prepayment, which, as the banks come back, probably we'll see some pressure on the use (24:34).

The other type is basically the ones that are trying to sell terminals for very small clients, most of them individuals in the informal market without providing any support. Those found out a niche to explore. By selling the devices, they basically avoid the delinquency, avoided the fact that they needed to provide that support in case a rental were to be offered. And these ones are being more successful for now. The incumbents, obviously, are going for this segment as well, selling terminals as well in order to explore a market that was not explored before.

So these are basically the two. I think the latter (25:33) is being more successful than the first one that I mentioned, but even the latter (25:40) will now face greater pressure coming from the incumbents going forward.

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

Okay. Thank you.

Operator

Our next question comes from Tito LaBarta, Deutsche Bank.

Q - Tito LaBarta {BIO 20837559 <GO>}

Good morning and thanks for the call. A couple of questions also. First on the outlook that you gave (26:07) understand, maybe trying to understand the relationship with revenues, right? We saw a lot of weakness in revenues in 2017, so we saw the decline. Now, this year do you think that relationship holds or should it be a better outlook for revenue this year we can grow a bit more in line with volume?

And then second question in terms of Stelo, which you recently announced you're applying (26:30) the 100% of it, how relevant do you think that business will eventually be for you? If you can maybe just give some color on how important you think that will be. Thank you.

A - Victor Schabbel {BIO 17149929 <GO>}

Tito, we got your first question. Could you repeat the second one, please?

Q - Tito LaBarta {BIO 20837559 <GO>}

Sure. The second question was about Stelo and the recent acquisition of the remaining 70%. Just how quickly do you think that will grow and how relevant will it eventually be for you?

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Tito, hi, it's Gouveia. We expect that the improvement in rental revenue. We saw in the last three, four months this rental revenue flat to a little bit more better in the last month. Then when we compare improvement in the rental revenue with the volume in this space really is that the fee in the next quarter's improvement with this relation between volumes and (27:47).

A - Victor Schabbel {BIO 17149929 <GO>}

And I would also add, Tito, the neat effects (27:53), let's say, comparing 2017 to 2018 given that credit should perform better because of the market situation, and also in our case, the fact that now in the first - in the beginning of the year, we start having (28:07), so the proxy between volumes and revenues in 2018 should be better compared to what we had in 2017.

And moving to your second question, Tito, about Stelo, until we get all of the regulatory approvals that are needed for us to consolidate the company 100%, Stelo will keep operating based on its strategy. In the previous months, Stelo has been working with its partner in banks selling devices in basically trials that they have been carrying out in a couple of cities (28:48) in Brazil. So the idea is to explore the banking channels going forward.

And even the demand that the banks have been saying that they have, this is a business for - reach something like 100,000, 150,000 clients a year, right? After we get all the regulatory approvals, then we will be able to consolidate the company and think about other channels and other alternatives. Until then, Stelo will be running as it is, okay?

Q - Tito LaBarta {BIO 20837559 <GO>}

Yeah. Thanks. Very helpful. Maybe just one follow-up, I guess, on the revenues. I understand that the relationship should be better this year. So is it safe to assume that we should see revenue growth this year with the low single digits? Is that a fair assumption?

A - Victor Schabbel {BIO 17149929 <GO>}

Well, in terms of the revenue growth, although we don't provide a guidance for that, it should be slightly below the volume growth that we expect given the macro compression that we have every year in terms of MDRs.

So the good news is that after a year, that's where we have greater pressure on prices than the normal or than the pressure that we had in previous years. Now we should resume having a much softer pressure in terms of prices benefiting from the mix, as Clovis highlighted. So, if we are talking about a 5%, 7% growth in volume, our revenue at Cielo Brazil should follow up that, similar but below this threshold. So you are right. So something like low single digits make sense.

Q - Tito LaBarta {BIO 20837559 <GO>}

Got it. Thank you very much.

Operator

Next question comes from Mario Pierry, Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. I have a question related to your (30:58) product, the one that you paid the retailer in two days. We see that this is already about 7% of your regular purchase of receivables. So just wanted to understand here if you could discuss the profitability of this product, how big do you expect this to get and which clients are being offered this product? And my question is why wouldn't everybody switch to this product instead of the regular receivable payment?

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Hi, Mario, it's Gouveia. Yeah. Thank you for the question. We see an opportunity. We're talking a little bit here about the – we have the (31:42) business and we have (31:44), depends on the kind of the custom for the small guys (31:47) (31:51) simple way automatically. For us, it's a little bit cheaper to sell.

Then we believe that the combination of these two products will increase our revenue of Retail (32:08) business. Then we put a lot of focus to sell this new way (32:18) to penetrating the (32:22) the small one of the – the small customers of Cielo, then we believe that is only process to offer for some kind of these new (32:37) of the customer. And we believe that we will increase the total volume of this operation (32:46).

Q - Mario Pierry {BIO 1505554 <GO>}

So do you think, Gouveia, that this product could eventually eliminate the – completely eliminate the receivable...?

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

No, no. No, no, no. No, it's a complement. We believe that sum about the Retail (33:02) business plus (33:07) bigger than (33:10) the last year. It's a complement of offer that we are putting in our portfolio.

(33:19)

A - Victor Schabbel {BIO 17149929 <GO>}

Sorry, Mario, (33:23), it's just another product, right, that we are offering to serve specific needs of certain type of clients that we have, right? So, for example, if you simplify, right, this analysis, if you look at the very big merchants, do you believe (33:41) they don't have needs to prepay anything. If they do, it's from time to time in specific situations. Then you move down in our pyramid. You have the medium-sized merchants.

These are guys that more often require money and go for the prepayment. The regular one should prepay certain amount, the sales of the previous two weeks, the sales of the last month and something like that, just to boost the working capital needs because they know that these have a cost for them, right, the prepayment rates that they have to pay.

And then you have the smaller guys, the very small clients that once you have a very simple and straightforward operation, they are not sophisticated, and they want to receive their money fast. For these guys, the Receba Rápido or quick receivables products makes a lot of sense, right, because it's incorporated into the service that we are offering, and they receive their money quickly in a very simple way, right?

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And how does the profitability of this product compare to the regular purchase of receivables to you?

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

It's better. It's better.

(35:00)

A - Victor Schabbel {BIO 17149929 <GO>}

Smaller clients.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Smaller client, yeah.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay, because - okay. And then on the question on all the regulatory noise that we've been hearing, you mentioned, right, that you think it's unlikely that they kept the debit MDRs and things like that, but what about the payment cycle? Has that been discussed, again, about reducing the payment cycle in Brazil from the 30 days?

A - Victor Schabbel {BIO 17149929 <GO>}

No, Mario, what we have been seeing is that the market has basically been working on a market-oriented solution, right, for basically payment cycle as you have more players working with payments in two base (35:46) through products like us with Receba Rápido, (35:51) you already basically addressing the working capital constraints that impact mostly the small and less sophisticated clients, right? These are the ones that are mostly hit by the 30-day settlement period, right? So they need money. They don't have the appropriate sophistication to deal with all the managerial skills needed to run a business. So these are the guys more impacted by the settlement period.

Those moving up in our pyramid, for example, they are more sophisticated. They have other sources of funding. They are less exposed to the settlement period, so the market itself, the industry itself has been working to address the situation of the (36:43) products, right? So it has been more like a market-driven solution than a regulatory one.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Thank you, Mario.

Operator

Next question comes from Carlos Gomez, HSBC.

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

Hello. Good morning and thank you for taking the call. I wonder if you could give us some guidelines for your Cateno business, which included in particularly wealth, and then you have (37:13) (37:15) conversations to perhaps expand it to other financial institutions.

Second, you are now seeing a decline of POS of 15%. What is your expectation for 2018 and 2019? Thank you.

(37:31)

A - Victor Schabbel {BIO 17149929 <GO>}

Can you repeat just the second question? We got your first about Cateno, but we unfortunately didn't get the second.

Okay. Let just start with the first one then.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

About Cateno, we are seeing better (37:51) results the last year. We saw improvement in some process of issuing cards and printing (38:04) the statement.

Then we worked hard to control costs in Cateno and improve the heaviness and the cost (38:12) of this company. We work in a strategic planning of Cateno, and we believe that you have new lines of business of this company, as you know every well (38:24), although Cateno is, for us, is a good business that – without seeing (38:33) our results...

A - Victor Schabbel {BIO 17149929 <GO>}

And just to build up on Gouveia's comments, always worthy to remember that we, with regards Cateno, are delivering exactly what was promised when we announced the deal. That was exactly (38:48) having a positive contribution from a cash base concept – in (38:51) 2016 and 2017 accounting base concept.

And despite all the, let's say, challenges in terms of the macro (39:00) because Cateno was also affected in terms of the top line, given the effort in the costs and expenses, the bottom line is accordingly to what was, let's say, expected previously. So it's something that we are very proud of, and I would like to highlight here.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Excluding (39:17) Cateno that we exposing the issue with us and jointly for quite a (39:22) business that we had in Retail. The needs of – to have Cateno here, which is something to mitigate risk of the business.

A - Victor Schabbel {BIO 17149929 <GO>}

Unfortunately, we got Carlos disconnected, so we couldn't hear the second question. We are going to move forward.

Operator

Our next question comes from Gabriel da Nóbrega, UBS.

Q - Gabriel da Nóbrega

Hi, everyone. Thank you again for the opportunity. I actually have a follow-up on the Cateno business. We have seen that over the past quarters, this business has actually represented a growing share of your net income. I just want to understand if you have AM (40:11) level in mind that you could reach?

And my second question, it's relating to your prepayment business. We have seen that volumes actually – sorry, that revenues actually decreased in this quarter. And as we move into 2018 with a lower interest rate and also an improvement of the economy, how are you evaluating these new trends on this business line? Thank you.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Well, (40:42) the first question. Cateno, there is no specific margin. The idea is to, let's say, benefit the most we can and doing divesting (40:51) in the best way possible.

And the second question...

A - Victor Schabbel {BIO 17149929 <GO>}

Yeah. On the prepayment side, Victor here, I'm going to answer you generally. So we should probably keep seeing the penetration of our prepayment business between mid-teens to high-teens in 2018. Probably, as you said, with lower rates and the banks coming back offering more credits to clients, there should be some gradual decline in our spreads. So this is something to be expected.

But these gradual declines of spreads might be offset by the fact that these penetrations that we are going to sustain will be on a bigger base, right? As the credit, as we saw in the fourth quarter, is accelerating, is doing well, and given the share that we should lose in Elo, which is mostly valid, should outpace (41:56) in our case, right? So we are going to see these credits growing probably well through 2018, and these should definitely help us offset the lower rates in the prepayment business.

Q - Gabriel da Nóbrega

Okay. That's very clear. Thank you.

Operator

Next question comes from Alexandre Spada, Itaú BBA.

Q - Alexandre Spada {BIO 16687974 <GO>}

Hi, gentlemen. Good morning. Thanks for taking my questions. I have two, actually. First one is as per the numbers shown in the presentation, one of the key components of the revenue (42:29) contraction in 2017 was the mix between large and small margins. So, do you believe this trend of seeing the mix becoming more concentrated in those large margins will be reverted in 2018? Or do you think it's fair to assume that because of Cielo's strong franchise and because of the behavior of the competitors, it is more likely that Cielo's mix will continue to shift toward the large margins (43:01) in 2018? And then, I'll come back with the second one. Thank you.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Thank you, Spada. We believe that you have (43:09) improvement in this mix, larger content, small account merchant. And if the market continues to (43:22) increase and be better in the future, it'd be better for us. And we saw some banks showing (43:29) the results and show to the market that they improved the (43:36) line for the small business. And we believe that we will have, in 2018, a gradual improvement in the mix between small accounts compared with big accounts.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. Thank you, Gouveia. And if you allow me a second question, I just want to confirm if I understood correctly the cost guidance. So, you've said that in order to reach the total costs and expenses expected for Cielo Brasil and Cateno, we should start from the 2017 number, deduct BRL 130 million approximately, and then add the 2% and 4%.

Now, the question is, should we annualize the BRL 130 million and add on top of that 2% to 4% to reach the total number for our 2018 or that's not necessary?

A - Clovis Poggetti Junior

Well, so let's start with the first one. You are correct. Okay. So, to make it clear to everybody, the costs and expenses that we post in 2017 eliminate BRL 130 million. That's exactly how much we had in terms of the – because of the new stricter (44:50) price for one local brand, okay? And then you apply the 2% to 4%. So, that part is correct.

The second one is, well, should we, let's say, take the BRL 130 million, given that is (45:04) and multiply it by 2? The answer is no because as we mentioned in a previous question, we start January (45:13), let's say, above what can be considered our fair share for the Elo brand. We expect obtaining debts (45:23) natural to lose a little bit volume in terms of Elo, reaching in a certain moment this year what can be considered fair in terms of the market share to the Elo. That's why it's not correct to take the same – (45:42) multiply it by two, take that as a proxy.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. But anyhow, we should add something that will be related to those incremental fees you are paying, right? It's not simply plus 2%, 4%; it's plus whatever will be this number.

A - Clovis Poggetti Junior

If you've mentioned what is going to be posted and stated comparing post in (46:03) 2017 with what is going to be posted, figures will be slightly different, okay? What we are trying to help you all and what we are guiding is, let's say, what can be in a more regular basis.

Q - Alexandre Spada {BIO 16687974 <GO>}

Yeah. I understood, so apples to apples. But then, the real number will have something else, right? That's the point.

A - Clovis Poggetti Junior

Exactly. Perfect.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay.

A - Victor Schabbel {BIO 17149929 <GO>}

The problem – the reason why we did that way, Spada, is because since this is related to brand fees regarding this specific brand and we are going to lose share in this brand, we are also going to spend less with these brand fees going forward. So, the amount that we have spent in the second half last year cannot be annualized and cannot be used as a pure reference going forward. That's the problem. So the best way for us to help you guys out was, okay, let's exclude the BRL 130 million from 2017 and think now about the 2% to 4% growth with something extra coming from the brand fees.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Below the inflation (47:14).

Q - Alexandre Spada {BIO 16687974 <GO>}

So, let's say, if you lose 20% of the Elo volume, it should be like 130 times 2 minus 20%? Can we think about it that way? Just thinking about modeling for our modeling procedures now.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Yes. Yes.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. That's clear. Thank you.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Thank you, Spada.

Operator

Next question comes from Gustavo Lôbo, JPMorgan.

Q - Gustavo Lôbo

Hi, everyone. I have two questions. So the first one is regarding marketing expenses. It is most – a good quarter of the decline in expenses in 2017 was related to marketing. And we are seeing that you are losing market share in small merchants, which could potentially put more crown to become clients (48:04) if there were more marketing expenses. So just trying to understand what should be the trend for this line in 2018? And then I have a second question afterwards.

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

Thank you, Lôbo. We are not saving the money (48:20) in the marketing media line. It's more related by partnership with banks and companies. Again, we are continuously investing in our position, and we changed it a little bit from the mass media to more online media, performance media. And we got a lot of good results in the brand's perspective there. Again, we are not saving money in our marketing. it's more related by its (49:00) campaign with the partnerships.

Q - Gustavo Lôbo

Okay. Understood. And my second question is regarding Merchant e-Solutions. So what's the strategy for this unit in 2018? Should we expect any big improvement in the results, or is a potential divestment in the agenda at this point? If you could just share a few thoughts on Merchant e-Solutions, it would be great.

A - Victor Schabbel {BIO 17149929 <GO>}

Lôbo, thanks for your question. Victor here again. So there is no big news there. So Merchant e-Solutions, as you know, was bought for us to bring the platform down here to Brazil. After that, we organized the company in the last couple of years moving it from the West Coast to Atlanta changing a little bit the structure to better reflect its market positioning, but that's it. Merchant e-Solutions continues to move forward there. There is no, let's say, big change to what we expect, or to what we have been doing there. Okay. There is no big news there.

Q - Gustavo Lôbo

Okay. Thanks for that.

Operator

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

A - Eduardo Campozana Gouveia {BIO 16447861 <GO>}

So thank you all for the conference call of the fourth quarter of Cielo. Thank you for the participation. Go ahead because we are very confident that we'll have a good year this year. Thank you.

Operator

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