

## Q2 2013 Earnings Call

### Company Participants

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

### Other Participants

- Alexandre Spada, Analyst
- Carlos Macedo, Analyst
- Craig Maurer, Analyst
- Jorge Kuri, Analyst
- Mariel Santiago, Analyst
- Mario Pierry, Analyst

### Presentation

#### Operator

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

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

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

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

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

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

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

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 earnings conference call. On page 3, we can see the highlights of the quarter compared to the same period last year.

Net income reached BRL623 million, up 13.6% with a 38.8% margin. EBITDA reached BRL859 million, up 22% with a 53.5% margin.

The transaction financial volume, according to the market criterion, reached BRL106 billion, 14% growth. In turn, the transaction financial volume, according to the accounting criterion, totaled BRL104 billion, 14% growth.

Net operating revenue reached BRL1.6 billion, up by 29%. Please note that since the Fourth Quarter of 2012, we are consolidating Merchant e figures.

The following are the awards received by Cielo in the quarter. We are very proud of these awards and motivated to maintain our quest for improvement.

Cielo was the best Company that services industry in the "Best and Biggest" ranking from Exame Magazine for the seventh consecutive year.

We were number one in financial service category among the most innovative companies in the customer relationship, according to ranking in the Consumidor Moderno Magazine/Dom Strategy Partners.

We were also among the 20 most valuable brands in Brazil, in researches wrapped by Istoe Dinheiro Magazine in partnership with BrandAnalytics/Millward Brown. And we won a Industry Highlight Award as the best in value creation in the financial services sector in 2012 according to Abrasca, the Brazilian Association of Publicly-Held Companies.

The Company was also chosen among the best places to start a career by the guide in Voce S/A Magazine for the third consecutive year. Another highlight in the quarter was the

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disclosure of our first sustainability report following the Global Reporting Initiative, GRI, guidelines.

The adoption of GRI standard in sustainability reporting allows comparability and transparency and also demonstrates the sustainability management held by the Company.

The report brings information on our social, economic and environmental performance and it stress our commitment to transparency with clients, employees, shareholders, investors, suppliers, society, government, and media.

For more information, please access our sustainability report on our website.

On the next slide number 4, we have the evolution of our transaction financial volume with credit and debit cards. Year on year, our financial volume grew 14.1% according to accounting criterion. The total financial volume captured in our network was BRL105 billion.

In the same period, credit volume was up 12.1% and debit volume 17.8%. Quarter on quarter, our financial volume grew 5.9% according to the accounting criteria as can be seen in the graph.

In the same period, credit volume was up 3.7% to BRL66 billion, while debit was up almost 10% to BRL39 billion.

On page 5, we present the number of transactions captured in Q2. Year over year, we see 10.4% increase in the number of transactions captured, representing 1.4 billion transactions in the quarter. Quarter on quarter, we saw an increase of 4.3%.

Moving on to operating indicators on page 6, we have the number of POS installed and POS merchants, which are those who have made at least one transaction in the last 60 days. Year over year, we can see that installed POS base grew almost 10%, with the wireless POS equipment at 52%.

The POS Merchants growth reached 8.4% in the same comparison. Comparing with the Q4, the installed POS equipment increased 0.3%, while POS merchants grew 2.5% in the same period.

It's important to point out that this quarter the POS equipment base remained practically stable quarter on quarter due to optimization of our supply chain in accelerating the un-installation process and equipment recycling.

Now I'd like to you -- to hand the call to Clovis, who will continue our presentation.

**Clovis Poggetti** {BIO 16529642 <GO>}

Thank you, Romulo. Good morning, everyone.

On page 7, we present our net operating revenues totaling BRL1.6 billion in the Second Quarter this year. Year on year, net operating revenues increased 28.9%, but it's important to note that here we can see the impact of consolidation of Merchant e-Solutions data, which have been impacting our numbers since the Fourth Quarter last year.

The growth in financial volumes does not include Merchant e transactions which means it represents the financial volume in the domestic market only. In the First Quarter of this year, we saw an increase of 3.7% in net revenues.

On the next page, page 8, we have our expenses. Total expenses reached BRL845.4 million in the Second Quarter this year, up 37.3% over the same quarter of 2012 and 10.4% over the First Quarter 2013. The cost of services provided was BRL609.9 million in the quarter, growing 54.1% year on year and 8.1% quarter on quarter.

It is important to mention that the consolidation of Merchant e-Solutions was the most significant impact on this line in a year-on-year analysis.

Our operating expenses represented BRL235.5 million in the Second Quarter this year, up 7.1% compared to the Second Quarter 2012, and up 16.8% compared to the Second Quarter. The increase is chiefly related to the impairment of goodwill related to Paggo in the amount of BRL30.5 million.

On the same slide, we can see total expenses per transactions, which increased approximately 25% comparing to the Second Quarter 2012, again due to the consolidation of the Merchant e-Solutions numbers.

During the quarter, total expense per transaction was BRLO.60. This was already expected since the subsidiary only impacts the expense line and not the number of transactions.

Quarter over quarter, we can see an increase of 6.5% compared to the total unit expenses related as well to the impairment of goodwill related to Paggo as we have already mentioned, and due to the higher logistics and maintenance costs given the penetration of wireless equipment.

Revenue from prepayment business we can see on page 9. In the Second Quarter of 2013, gross revenue was BRL268 million, an increase of 26.2% compared to the Second Quarter 2012 and 17.7% in relation to the First Quarter this year.

As of this quarter, we will present a managerial analysis of the product considering the cost of funding. In such analysis, we apply to the total amount allocated to prepayment of receivables the same cost of funding we incur when prepaying our flow of receivables with the issuing banks.

According to such analysis, the net revenue reached BRL143 million in the quarter, an increase of 6.8% and 14.3% compared to the Second Quarter 2012 and First Quarter 2013 respectively.

The difference in behavior between the growth rates of gross and net revenue is explained by the mix of clients of the prepayment business. This year the volume with large retailers is significantly higher than last year.

This can also be observed in the dynamics of the prepayment of receivables operations shown on slide 10, in which we can observe that prepaid volumes show an increase of 71.7% year on year and 27.7% quarter on quarter. The amount in the quarter totaled BRL10.6 billion or 16.1% of total credit volume.

On slide 11, we have our financial performance with EBITDA in both absolute amounts and margin. EBITDA totaled BRL859.1 million in the Second Quarter this year. Year on year, EBITDA increased 22% and EBITDA margin was 53.5%, down by 3.1percentage points. The year-on-year reduction in EBITDA margin is due to the consolidation of Merchant e-Solutions.

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

Quarter over quarter, we see a 1.8% drop in EBITDA. EBITDA margin declined by 3percentage points sequentially mainly due to the increase in the other operating expenses line.

In the next and last slide number 12, we see our net income that reached BRL623 million. Compared to the Second Quarter, net income rose 13.6% and net margin decreased 5.2percentage points to 38.8% impacted again by the consolidation of Merchant e-Solutions as explained earlier.

Compared to the First Quarter this year, we see net income down by 2.7% with a decrease of 2.6percentage points on the margin mainly due to the increase in the other operating expenses line. Now I'll go back to Romulo.

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

The Brazilian market still has a lot of room for growth in the payments industry. We believe we are well-positioned to keep leading the industry by offering merchants, banks, and customers our highly reliable service that promotes both (inaudible) and security, not only transactions, but in general.

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

## Questions And Answers

### Operator

Ladies and gentlemen. we will now begin the question-and-answer session. (Operator Instructions) Mr. Jorge Kuri, Morgan Stanley.

#### Q - Jorge Kuri {BIO 3937764 <GO>}

And my question is regarding your guidance. You had stated a guidance of net income growth of 7% to 10% I believe at the beginning of the year. First half numbers, you're up 13% year on year. The second half looks to have easier comps.

And just looking at your normal seasonality of your business, where if you look at the last four or five years roughly 47% of net income is in the first half, 53% in the second half, you're already annualizing roughly BRL2.65 billion net income which would be 16% growth year on year.

I just wanted to get your reaction on how does this compare with your -- I guess you haven't changed the guidance which is 7% to 10%, and do you think that that guidance looks conservative given figures that I just mentioned or is there anything that is going to change over the next six months that make you believe that your guidance is still relevant? Thank you.

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

Hi, Jorge, thank you for your question, I think you have a good point. After the results of first half of 2013, it can be said that the soft guidance provided at the beginning of the year became conservative. We will not provide new numbers mainly to the economic environment and competition, but you have a fair point.

#### Q - Jorge Kuri {BIO 3937764 <GO>}

All right, is there any reason to believe that the normal seasonality of your business this year is going to be different than previous years and hence that my expectation of at least 15%, 16% growth for the full year is wrong?

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

I don't think so. Christmas is always important in the whole year, it's been so. But we are comparing to another Christmas last year, but at the end of the day you are right when you say that the second half of the year is most -- is more important than the first half in terms of the total year.

#### Q - Jorge Kuri {BIO 3937764 <GO>}

All right. Great. Thank you, Romulo.

### Operator

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Carlos Macedo, Goldman Sachs.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

I have a couple of questions. The first question is if you can give us some color on pricing; let me give you the backdrop. If you look at your revenues and you exclude the revenues from the subsidiaries, both in Brazil and abroad, so taking just the revenues that were traditionally the Cielo revenues, and you divide that by transaction value, you get what I like to call yield, but either way, that yield has been decelerating and now it's actually contracting on a year-over-year basis.

Now this is -- this yield is composed of MDRs and rental. Could you give us some color on what is driving the contraction in the Brazil business excluding subs? Is it MDRs or are prices for the rental of POSs coming down, just so that we can get an understanding of where the market is going with respect to trend? Then I can ask a question on expense -- on costs.

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

I'll make a general comment here, Carlos, but the revenues if you allow me to say is not contracting. Of course there is, in the Second Quarter, a product that you have is (Agro) that was strong and this is very important in this year was more important and -- but because the subsidiaries of Cielo are not so important in terms of net earnings compared to the core. So I'll also ask Clovis to make additional comments on that.

**A - Clovis Poggetti** {BIO 16529642 <GO>}

No. I would say the same, Romulo, I think nothing new to add. Carlos, please don't forget to take into consideration in your analysis that this Second Quarter is impacted by the (sufferer), okay, the Agro product that makes our -- it will make the MDRs going down, but because of mix of products only.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

So I mean that hurts the MDRs and the mix from a negative side, Romulo, but typically the Second Quarter is strong in mix because of Mother's Day that has a stronger mix towards more merchants which have high MDRs. Does that -- did one completely offset the other or just to get an idea where the trends are a little bit stronger or a little bit softer?

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

Somehow offset, but also we have -- the way we account for the installments, Mother's Day for us, the same time that Christmas happens for us in the First Quarter every year, Mother's Day happens in the Third Quarter, not the second one.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

Okay. So basically the big impact that might have hurt would be the mix in terms of rural?

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

Yes.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

With (AgroCard)? Okay.

**A - Clovis Poggetti** {BIO 16529642 <GO>}

And also, Carlos, it's important to point out that the evolution of debit card and the net MDR of debit card -- of debit is lower when compared to credit. So this to some extent is related to the level of investments of the population. So you are seeing a better performance of debit when compared to credit. So this is important also not to forget.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

Yes. I mean, from what I can tell just looking at the industry, the top three acquirers because the data from ABECS doesn't go all the way to June, it doesn't look like debit is still growing much faster than credit. But -- so that also could be a factor you're saying?

**A - Clovis Poggetti** {BIO 16529642 <GO>}

Yes.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

Okay. Second question on cost, we did see an increase in cost in the quarter and cost per transaction. If you just look at the Brazil business excluding subs, it did go up. Is there a seasonality here from the First Quarter where it was much lower? Where should we expect these costs to kind of stabilize given the change in mix of the POS base and everything else?

**A - Clovis Poggetti** {BIO 16529642 <GO>}

Carlos, there is no seasonality effect. The main impact comparing the Second Quarter with the first one is the logistics maintenance costs. And these again directly related to the shift from the fixed to the wireless POS.

We ended the Second Quarter with 52% of our installed base wireless, and then the wireless product is more costly if we compare to the first one. Romulo mentioned in his speech that also in the Second Quarter we are still optimizing still the way the trading of some of our equipment which also in this particular sense hit our cost. Okay?

**Q - Carlos Macedo** {BIO 15158925 <GO>}

So we should consider the Second Quarter more of a run-rate for cost than the first?

**A - Clovis Poggetti** {BIO 16529642 <GO>}

Yes.

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**Q - Carlos Macedo** {BIO 15158925 <GO>}

For cost in transaction, sorry?

**A - Clovis Poggetti** {BIO 16529642 <GO>}

Yes. In the per transaction, yes.

**Q - Carlos Macedo** {BIO 15158925 <GO>}

All right. Perfect. Thank you.

**Operator**

Craig Maurer, CLSA.

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

Couple of questions for you. First the Paggo goodwill write-down, I assume that's complete, we won't see any recurring impact from that. And secondly, considering that ABECS no longer receives data from all the important card players in Brazil, I was hoping to get your view on the market trends as I know they're often different from what ABECS is saying. Thanks.

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

Regarding to Paggo, the write-down that you did, I think it's enough considering the level of visibility, the level cash flow that you can see for the coming years. We are -- we still are excited about the mobile, but in our opinion it will not happen as we were expecting when we did the investment.

Regarding the second -- and we are not expecting further write-down impairments. The second point about ABECS and the market trends, I think now we have -- we are more aligned with the expectation that ABECS has about the Brazilian market. We said at the beginning of the year that we were expecting between 15% and 18% for the market for the whole year, and that this is to some -- is much more in line with the numbers provided by ABECS.

If you take into consideration the growth of the Third Quarter, of the Fourth Quarter, and the First Quarter of this year compared to the same quarters of the last year, you are going to see a 16.5%. This quarter, Second Quarter the growth was 17.9%.

So to some extent an acceleration happened, but for the whole year, we still are comfortable with the information that we provided at the beginning of the year for the market trend between 15% and 18%. Of course, we are more close to the top of the range considering the Second Quarter.

**Operator**

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Mario Pierry, Deutsche Bank.

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

Let me ask you two questions as well. The first one is on your prepayment volumes. We have seen such a significant increase in volumes of near 70% year on year, and now the prepayment represents close to 16% of the transactions, and this seems to be higher than what you were guiding for before.

So just wondering why we're seeing such a big increase in prepayment volumes? Is it because the banks have become more cautious in lending? Is this a trend now that you expect to continue? Should we continue to see the prepayments near 16% of credit transactions or can this number increase?

Then the second question is related to your guidance at the beginning of the year. Like you mentioned, it was a soft guidance of earnings growth of 7% to 10%. You're running closer to 15% now. Just wondering from your perspective what has been better than expected? Is it that the pricing environment is more rational? Is it that the competitors have not been as aggressive as you thought? If you can just give us an idea why do you think that the numbers are coming better than you anticipated? Thank you.

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

Thank you, Mario for your questions. Regarding prepayment volumes, as was explained by Clovis during his speech, we have a presence, a much higher presence with the big clients, and this is helping us to reach the 16% in the Second Quarter. The previous two quarters we were around 13%.

It's early to say if you're going to keep or not this 16%. And as a matter of fact, we never mentioned any kind of indication in terms of penetration. But for me it's -- we are working better with the product. We know the challenge that you have. And at the end of the day, it help us to reach the 16% penetration.

Regarding the soft guidance, as I said, when we had -- when we provided the soft guidance at the beginning of the year, it was with the level of information that we had. What happened, that at the end of the day with more visibility and with the evolution of the market, we have a more rational market. We are seeing -- we are now comfortable to say that the soft guidance provided at the beginning of the year is not -- is today a conservative number.

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

Okay. Just to go back then, Romulo, when you said the higher presence of the bigger clients, but why are you able to -- how aggressive are you seeing the banks trying to penetrate those bigger clients in terms of granting them credit? Is it --

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

I think --

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

Yes.

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

No, no, I think it's business as usual, Mario. I don't see the banks less aggressive because this is a kind of lending that's a very good one for them. If they lend with the guarantee of the receivables, it's something that they like to do.

The same thing about (inaudible) and mortgage, if they lend without the receivables because they can lend \$1 with guarantee by the receivables and \$5,000 without the guarantee of the receivables, it depends. If you consider that as a (combo) if they see -- if they are considering the level of lending that is not guaranteed by receivables, maybe they are more -- they are not so aggressive as they used to be.

But it's a normal evolution of the market because what we do is related -- we don't anticipate things that are not sold. So this portion of the business is still available for the banks if they want. It's just a matter to ask for and to look in and you're going to be able to do the transaction.

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

Okay. And just to complement here the second question with regards to why you're coming ahead of expectations, because again like you said, the industry volume growth of 15% to 18% is coming roughly in line with your expectations, so is it fair to say that the beat that you're showing is coming primarily from the prepayment business while the credit, debit, and POS revenues are coming roughly in line with your expectations at the end of the -- at the beginning of the year?

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

The Second Quarter, the growth of the industry was almost 18%, 17.9%. So the growth was on the top of the range. So this has helped the industry as a whole. And also all the lines -- all the products that you have, we had a better performance as you were expecting when we did our forecast.

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

Okay, so it's across the board. Okay. Thank you very much.

**Operator**

Alexandre Spada, Itau BBA.

**Q - Alexandre Spada** {BIO 16687974 <GO>}

This question relates to the recent announcement that BTG and Banco (inaudible) will be joining the acquiring business in -- the acquiring market in Brazil. What's your take on this announcement? Then I'll come back with a follow-up question. Thank you.

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

We do respect what our competitors are doing. We saw this announcement as a normal course of business. We do respect what they can do, what they can deliver in the future, but for us it does not change dramatically our view about the future.

**Q - Alexandre Spada** {BIO 16687974 <GO>}

Okay. We know that Caixa Economica Federal has a large stake on Banco (inaudible), so from 1 to 10 what do you think are the odds or chances that Caixa will eventually join these new acquirer and then cease or reduce dramatically their affiliation efforts for Cielo?

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

I think you should ask this question to Caixa Economica Federal, but on the other hand I would say that in our field, they will continue to work with the current players. It doesn't mean that they could consider other possibilities. But I think you should ask this question to them.

**Q - Alexandre Spada** {BIO 16687974 <GO>}

Okay, that's fair enough. Thank you.

**Operator**

Mariel Santiago, HSBC.

**Q - Mariel Santiago** {BIO 16478669 <GO>}

I have two questions; one is can you give us some color on the status of the pending regulation for mobile payments? And my second question, I think it was answered, it was on the prepayment business.

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

Okay, Mariel. The pending regulation for mobile I think will come together with the whole regulation that we expect to be released in the coming months. Mobile is something that the government is concerned in order to provide another source mainly to small and medium enterprise -- mainly to small merchants. It's a way to capture transaction in a more effective way in terms of costs.

**Q - Mariel Santiago** {BIO 16478669 <GO>}

Okay. Thank you.

**Operator**

(Operator Instructions)

**A - Roberta Noronha** {BIO 20488075 <GO>}

Here is Roberta speaking. We have a question from the web from James Friedman from Susquehanna. He is asking what's our CapEx growth for the year.

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

Okay James, we are still considering them and that was mentioned in the previous conference calls and considered BRL300 million ballpark number. Okay?

**Operator**

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

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

I'd like to thank you all for your participation. We look forward to seeing you again in Q3 conference call. Thank you. And have a nice day.

**Operator**

This concludes Cielo's audio conference for today. Thank you very much for your participation. Have a good day. And thank you for using Chorus Call.

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