Y 2020 Earnings Call

Company Participants

- Gustavo Henrique Santos de Sousa, Chief Financial & IR Officer
- Paulo Rogério Caffarelli, CEO

Other Participants

- Daer Labarta, Analyst
- Jeffrey Brian Cantwell, Analyst
- Jorge Kuri, Analyst
- Mario Lucio Pierry, Analyst
- Neha Agarwala, Analyst
- Sofia Viotti, Analyst

Presentation

Operator

Good afternoon, everyone. Thank you for waiting. And welcome to Cielo's Fourth Quarter of 2020 Results Conference Call. With us here today we have Mr. Paulo Caffarelli, Gustavo Sousa and Daniel Diniz. This event is being recorded. (Operator Instructions) This event is also being broadcast live via webcast and may be accessed through Cielo website and ri.cielo.com.br/en, where the presentation is also available. The replay will be available shortly after the event is concluded. Before proceeding, as we mention that forward statements are based on the beliefs and assumptions of Cielo management (inaudible) 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 condition related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements. Now I will turn the conference over to Mr. Paulo Caffarelli.

Mr. Paulo, you may begin your presentation.

Paulo Rogério Caffarelli

Good morning, everyone. Thank you for taking part in this conference. It's a pleasure to be here, sharing the Fourth Quarter '20 results with you. 2020 was a challenging and remarkable year for Cielo, mostly in two fronts. Cielo has consolidated its strategy for improving customer experience, ensuring profitability and potentialize and accelerate the digital transformation, which will enable us to strengthen even more our leadership in the segment. Despite being a tough year, the Fourth Quarter '20 figures confirm that Cielo achieved substantial outcomes as follows: 16% transactions volume increased versus the prior quarter; in retail segment, one of the main focus in our strategy, the growth was 13% versus Fourth Quarter '19. As I mentioned previously our target is to balance the corporate and retail levels till the end of this year. So far, we have reached 37%, an all-time high 33% in prepayment, which means Receba Rápido, which indicates we are on the right track. The commercial team productivity doubled along 2020, achieving 52% at the end of the year. The Net Promoter Score, NPS, remains growing steadily. It's worth pointing out that from June 18, June November '20, it grew 7.5x. Our financial and operational KPIs such as net operation revenue, EBITDA, EBITDA margin, net profit to controllers and net margin show an uplift versus Fourth Quarter '19. Further on, Gustavo will provide you more details about this.

EBITDA efficiency yielded BRL 170 million savings, mainly due to the structural adaptation related to negotiation and teams dimensioning for improving and adjusting the operation to the new competitive scenario. As a result, the quality of our services went up to a better level. Cielo sold its stake in Orizon at BRL 129 million. It was the first, but not the last, no core business assets to be sold. Having said that, all these achievements generated BRL 298 million net profit in the Fourth Quarter '20. It means 35% above Fourth Quarter '19. Cielo Brazil itself increased its results in 82% versus Fourth Quarter '19. The new structure plus the net profit will leverage Cielo's digital transformation, paving the ground to reach even better and bolder results in the future.

Regarding 2021, Cielo has 5 main objectives: building a data-driven ecosystem for providing more solutions and more information for our customers; widening Cielo's vision to our intelligent platform; evolving credit products and banking services; optimizing customer experience; and perhaps, the main important thing is focusing on adding value services and solutions to our customers. Cielo has already started this year an intensive investment in customer experience and quality of services.

These initiatives encompass cultural and structural changes that Cielo has been pursuing such as Cielo Digi concept that goes beyond POS machine. For this reason, Cielo has created a Customer Experience Vice Presidency that will merge IT and operational areas in order to provide more synergies, availability, development of systems, process, data, quality of services and customized products are a priority for a better customer experience. Likewise, all of Cielo's collaborators are assessed by NPS results. All of us. In order to achieve its technology and agile methodologies were key to support productivity and speed in our deliverables.

One of the positive consequences is 50% reduction in client's intention to churn in the past two years. Cielo has hired 500 new commercial executives who joined the existing 1,500 to strengthen the sales strategy model and to offer a more specialized service level focused on clients' relationship and loyalty. Beyond that, it's important to take into consideration that Cielo comps on a solid and wide asset of around 15,000 branches and collaborators from Bradesco Banco do Brazil and Caixa that trade our acquiring offers exclusively.

Brazil Central Bank, recognized as one of the best finance regulators around the world, has been working hard to implement solutions to meet today's needs in terms of inclusion and more competitiveness. So last year, they launched PIX, and for this year, there will be open banking and receivables marketplace. These solutions will set up new behaviors related to finance products and services consumption. Cielo, upon its 25-year history, is fully aware of the challenges and transformations undergoing in this moment and proudly accepts the challenge of keep on leading this promising future. Now I will ask to Gustavo to present our results. Thank you, so much. Have a good day. Thank you.

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

Thank you, Caffarelli. Good morning, everyone, and we will start our presentation on Slide 4. Our net income reached BRL 298 million, 35% higher than the same period in 2019. Cielo's TPV reached BRL 191 billion, 15% higher than the Third Quarter '20. Our SMB and long-tail TPV increased 13% year-over-year, and we also presented a new record in terms of prepayment penetration on SMB and long tail, reaching 33%. We showed a strong growth in the productivity of the commercial team. Our own channels, Cielo's commercial team represented 52% of Fourth Quarter 2020 activations. In terms of customer focus, we showed continuous improvement. NPS increased by 7.5x from the middle of 2018 till November 2020. We will talk about a new service model at the end of this presentation. In January of this year, we announced the closing of the sale of Cielo's stake in Orizon, receiving the amount of BRL 129 million.

Now moving to Page 5. On this page, we see 3 charts. Throughout the year, we used these charts to demonstrate how COVID impacted volumes in the Brazilian economy and in -- also in Cielo and Cateno. On the upper chart, we see the ICVA. As we can see in the first and Second Quarter, we had strong impacts of the crisis, but we saw a normalization of that on the Fourth Quarter. On the chart in the middle, we have the TPV from Cielo also severely impacted, mainly on the first and Second Quarters and with strong recovery on the Fourth Quarter. The same pattern is seen on the chart on the bottom, and that is Cateno's TPV.

Now moving to Slide 6. On this slide, we have the main financial metrics from Cielo. Our net operating revenue totaled BRL 3.023 billion in this quarter. Our EBITDA totaled BRL 768 million in this quarter, and that's a 16% year-over-year growth.Our EBITDA margin totaled 25.4%, And our net income totaled BRL 298 million, and that's a 34.7% growth year-over-year. Our net margin totaled 9.9%.

On Page 7, we can see the gradual recovery in all of Cielo's business units. We have a breakdown of Cielo into Cielo Brazil, Cateno, and that's Cielo's 70% stake in Cateno and other subsidiaries, mainly Cielo USA that is represented by our investment in MerchantE. We can see improvements in these 3 segments inside Cielo.

On Page 8, starting on the chart on the left, we have Cielo's TPV. We saw a 15% increase over the last quarter, over the Third Quarter of 2020, and a TPV that totaled BRL 190 billion. In the chart in the middle, we have our active merchant base. We totaled 1.4 million. We have a 1.4% reduction given the 7.6% contraction in our long-tail client base, and that's because Cielo has been very conservative in terms of granting subsidies for equipment sales for this segment. We also highlight the 4.6% increase on the SMB portfolio. On the chart in our right, we have our performance in prepaid volume. We saw a 52% increase and the penetration in the Fourth Quarter of 18.8%.

On Page 9, we have selected highlights of our SMB and long-tail portfolios. Starting with the chart in our left, we have an increase in the participation of the SMB and long-tail portfolios on Cielo's TPV. In the Fourth Quarter of 2019, these 2 segments represented 33.1% of Cielo's TPV, and they now account for 37.3% of Cielo's TPV. These 2 segments also shown -- have also shown increase in penetration of our prepayment products, going from 26% in the Fourth Quarter of 2019 to 32.7% in the Fourth Quarter of 2020.

On Page 10, we have an analysis of the revenue yield from Cielo, specifically in the comparison versus the Third Quarter, we saw a 0.04% contraction in revenue yields given the volume expansion that dilutes the types of revenues that do not vary according to volume, mainly the rental revenues. With that, our revenue yield went from 0.73% to 0.69%.

On Page 11, we have some highlights that show our efforts on operational efficiency. On the chart in our left, we have the normalized cost and expenditures where we can see that in this full year, we have shown a decrease of 10%. On the comparison of the Fourth Quarter of 2020, the same period of 2019, we have an 18% reduction. The measures that allow us to show this improvement in terms of efficiency are listed in our right.

Now moving to Page 12, where we have a few metrics that show Cielo's liquidity and leverage. Cielo's total liquidity totaled BRL 4.2 billion by the end of December, and our investments in the purchase of receivables totaled BRL 4.7 billion by the end of December as well. With this increase in investments in the purchase of receivables, we saw a -- an increase in leverage that is completely positive. Leverage is controlled, way below the ceiling that we have in our covenants, and this increase is totally related to the continuous expansion of purchase of receivables.

Now moving to Slide 30 sic [ph] 13 [ph]. We will talk about Cielo's efforts in terms of digital transformation. In this new agenda, we intend to show you what we have done to transform our business. As shown in the previous slides, earnings grew year-over-year, and that happened for the first time since 2017. However we have a clear understanding that we should go deeper in our digital transformation agenda.

On Slide 14, we show that the digital transformation process already drives benefits both to Cielo and to our customers. We are implementing changes all over the company, people, structure and culture, and we shall keep evolving in this front. On this page, we show some examples of movements we've made as the change in structure combining 2 areas, IT and operations, to create a Vice Presidency focused on customer experience.

We also show important milestones, digital channels, which account for better NPS, keep gaining ground over traditional channels. And Cielo keeps its dominant position in e-commerce, which gained share in TPV, and this is a segment that has grown a lot during the pandemic.

Now moving to Slide 15. In this slide, we discuss the effects of the digital transformation in our customers. Over the last years, we have been working with many initiatives to address pain points of our customers. We revised processes all over the call center, the billing process and improved our channels and portfolio strategy. These initiatives have been showing results. NPS went up gradually and consistently, and the number of complaints dropped sharply. More important, we already see an important reduction in the intention of churn by our customers, which dropped by 50% over the last two years.

On Slide 16, we dive deeper in the changes we have been implementing in our commercial operations. The hunters initiative proved successful, and the productivity of the sales force kept improving, reaching a new level last quarter. This performance was key for the growth we saw in the customer base in the SMB segment, which reached 5% in the quarter. In 2021, we will keep expanding Cielo's commercial team. We have recently hired 500 new sales executives to add to the sales force.

On Slide 17. Although we saw an expansion of the sales team as an opportunity, our movements are not limited to hiring new people. On this slide, we show some key initiatives already in place that shall bring new gains in efficiency and also bring positive impact in customer satisfaction. We are deploying technology in the commercial operations with a highlight for analytics and the use of the Cielo Expert app to generate leads and increase the efficiency of negotiations. We are reviewing the last mile logistics, expanding the delivery of equipment in the same moment of the sale, and we also aim to implement a logistics team to deliver equipment and solve problems of our clients. Customer experience and activation rates are expected to increase.

Now moving to Slide 18. With all of these changes, the commercial teams will be able to focus more in the relationship with the client instead of addressing problems. On this page, we see that these movements are also enabling other changes in the commercial operations. Hunter and farmer will merge, and we will have business consultants that will handle both functions. The merger of these functions and the hiring of the 500 new sales executives alongside other measures will drive important benefits. The geographic scope of each salesperson will decrease and also the number of clients per portfolio. We will have conditions to strengthen personal relationships with our clients. We will also have more effectiveness and flexibility with the commercial team, focusing more on hunting or farming as we intend more adequate offering to our clients. The tests we have conducted in a pilot in some regions have shown good results in terms of activation rates and churn.

Now moving to Slide 19. On this page, we show some of the items that we had announced for our strategy for 2020 that were delivered, and we also see what we aim to achieve in 2021. In 2020, we delivered growth on the SMB client base and also an increase in penetration on the SMB portfolio -- of prepayment penetration on the SMB portfolio. We have shown a strengthening of our commercial performance and also an improvement in the quality of services. For 2021, we will maintain our priorities in terms of increasing the SMB client base and also the prepayment penetration on this segment. We will keep focused on operational efficiency, improving commercial performance and the sale of nonstrategic assets. We will have a greater emphasis on digital transformation in order to improve our customer focus, innovation, culture and also the expansion of data monetization initiatives. With that, we finalize the presentation and open for the Q&A session. Thank you very much.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mario Pierry, Bank of America.

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

Congratulations on the results. I have 2 questions, Gustavo. First one is on the penetration of your prepayment product, right, in the retail segment. As you showed, it increased from 26% to 33%, but it is still below what some of the new entrants are doing. So I wanted to get from you first, how were you able to increase this penetration? Is this just being more aggressive on prices or just being more aggressive in offering the product? Where do you think we can see this level of penetration in five years' time, especially considering, right, that we're going to have this receivables marketplace operational in Brazil later this year? Then my second question is related to all of the other products beyond acquiring, and how should we think about the opportunity in terms of revenues? And here, I'm trying to focus a little bit more on your credit product and on the monetization of this data that you talked about. How should we think -- what is the addressable market for you here?

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

Mario, thank you for your question. For your first question about the penetration of our receivables product, we have grown from 26% to 32.7% from the -- over the last year, and most of this growth came from new clients that joined Cielo. So we are faster in generating new clients that have a high adoption of the automatic prepayment product, the Receba Rápido, than in penetrating in old legacy accounts. That's just a function of the preferences of the client base. So we have been very effective in the conversion of new clients to the Receba Rápido. In terms of pricing, our price in the different segments on the retail is completely in line with the competition. So it's more of a function of prioritizing this offering on our commercial team and reaching clients that adopt our product. It's hard to talk about where it will be in five years, Mario. But this growth that you saw in terms of percentage points gains in penetration that we -- you saw in 2020, we want at least twice that in 2021, okay? So I believe that by the time we reach the end of 2021 and throughout 2022, we'll be very close to where the competition is today in terms of penetration on the retail. Mario, it's -- I believe it's easier for the market to keep projecting growth in penetration, to keep projecting efficiency gains for Cielo than right now to quantify the initiatives in terms of new revenues. So what we have right now are internal products -- projects. In terms of the credit products, we have recently created areas dedicated to that. We are right now initiating a project of data monetization. So it's hard for me to give you specific targets related to these new sources of revenue. So even though we know that in the future, we need to generate revenues, they are not in the traditional revenues of the acquiring business. Right now, it is a lot easier to project an improvement of the core business from Cielo, but as soon as we have visibility on these new sources of revenue, we will communicate that to the market.

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

Okay. Now that's clear. So -- but just a little bit more color then on your credit product. Exactly what are you aiming to do? And how you plan on funding the business? And hereon, what are you planning to do? Is it like working capital loans for SMEs? Is that the idea?

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

The idea. Mario, at least, let me repeat it because I think I got cut off here. So exactly, that's the idea. The starting point for the credit offering is working capital for small businesses, and we'll see after we implement this product, where we'll go from there, but initially, it is working capital lines. What we are seeing in the market right now in terms of funding instruments is a market that is open to many types and formats of the FIDCs. So we have seen FIDCs aimed at prepayment, FDICs aimed at credit. So that's -- conditions are favorable right now. So I think those are the most likely funding instruments that we will use.

Operator

Our next question comes from Jorge Kuri, Morgan Stanley.

Q - Jorge Kuri {BIO 3937764 <GO>}

Congrats on the numbers. My first question is on market share. Where are you in stabilizing market share for the business? It -- you evidently lost a lot of market share over the past few years. You've done a lot of rework on the way you run the business, and where do you think that leads you for 2021? If the industry, according to our banks, is going to grow somewhere around 18% in terms of TPV, how close can you be to that growth rate or not? Where are you with those market share stabilization? Do you think it's fair that you can probably maybe grow half of the industry? That's my first question. Then second question is on operating expenses, which was very surprising to see the Fourth Quarter numbers down 19% sequentially, down 12% year-on-year. For the first nine months of the year, your operating expenses were up 15%. So what is the right level to think about for 2021? You talked a lot about a lot of expansion of the commercial departments, headcount additions, et cetera, how much do you think operating expenses should grow in 2021 altogether?

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

Jorge, thank you for your question. On market share, I'm going to give you a broad answer here because the TPV from Cielo, if we think of very big numbers, we're talking about still a reduction of TPV in large accounts as we have been communicating to the market. We are renegotiating prices in some of the largest accounts. In some of them, we are successful, and we are able to reprice and retain the clients. In some of them, we end up losing the business. So a continuation of that will likely lead to a reduction of TPV on the large accounts segment. Given it's close to 60% representation, participation of Cielo's total TPV, it's likely that Cielo as a whole will lose market share. But when we look specifically at the SMB portfolio, and that's where we are concentrating, even more energy and investments in expanding the sales force, providing them with new tools, we intend to grow faster than the competition. So in our proxies here of market share for SMBs. Over the last two years, we were able to stabilize our market share in this segment. We lost a lot of ground, and the market is very aware of that in 2016 and 2017 and 2018. Starting in 2019, we started to stabilize that. We now intend to regain some of that market share that we lost specifically with this addition of sales force and the change in the commercial model to make up for the lost time. In terms of OpEx, Jorge, what we have right now, and you're very right there is that we have a clear addition of costs, which is the increase in the sales force by 500 new Cielo employees. We are doing our best here. It's hard to quantify that we are doing our best here to offset that with efficiency measures. So it is our aim to keep presenting efficiency gains and reduction in costs, even with the addition of the sales team. We have some projects related to that right now. Projects that are related to reviewing contracts and processes in our call center, some of the mainframe contracts that we have and also some logistics contracts. We are still in the beginning of this activity here in the beginning of the year, but it is -- again our goal to offset the OpEx increase that comes with a larger sales team by continuing to provide efficiency gains.

Q - Jorge Kuri {BIO 3937764 <GO>}

Let me -- sorry, apologies. Let me just -- okay please go ahead.

A - Paulo Rogério Caffarelli

Go ahead.

Q - Jorge Kuri {BIO 3937764 <GO>}

No, no, please. Please, go ahead. Sorry.

A - Paulo Rogério Caffarelli

No. If I may add, Gustavo, in terms of market share. No, they see last year. Our choice between market share and results, we are focused nowadays on results because these that we are doing the balance between corporate and retail. And also to focus to increase the performance in retail that, for us, will be very important for establishing this kind of balance. You used to have 6 -- or 73% in terms of corporate against retail. Nowadays, we are in 63% in corporate and 37% in retail, and we intend to reach till the end of this year a half and a half. This is very important for our operation.

Q - Jorge Kuri {BIO 3937764 <GO>}

And let me follow-up on the expense side. I'm sorry to push a little bit on this, but the gap between the first 9 month number of up 15% on expenses, and the full year number of up 7% is quite big. So it will drive very different results in 2021, if you're closer to 15% than you're closer to 7%. So when you put it all together, your initiatives plus the efficiency that you're trying to gain in order to offset some of those investment efficient -- initiatives, where do you think you'll land? Is it closer to the 7% full year growth that we saw in 2020? Is it more? Just help us get a little bit better handicap around that.

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

Sorry, my phone keeps breaking up here. I'm sorry. It is our aim and that's a challenge for us because we are quantifying that right now to provide further efficiency and not a growth in terms of our costs, okay? We do our -- in terms of disclosure, Jorge, I ask you to look back at some of the disclosures that we do in terms of one-offs that we had throughout the year. The expression that we use of normalized expenditures. When we present that, we try to isolate effect in our cost base of variable expenses such as variable costs, such as branch fees, also the subsidies that we were still amortizing subsidies that were granted in 2019 and also another variable cost item, which is related to the service rendered by the banks that we have contracts with. When you look at that, and you also discount some of the one-offs, such as impairment losses related to POS, I believe you will arrive at a more stable number. But given all that, Jorge, the best I can tell you is that even though it's a challenge for us, and we accept this challenge, we have to present further efficiency gains even with an addition of a commercial -- given it's an expansion of our commercial team in 2021.

Q - Jorge Kuri {BIO 3937764 <GO>}

And you think about efficiency gains on a margin perspective? Or what does that mean? Or on an absolute growth of expenses? What exactly does that mean?

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

In total expenditures, when we look at total cost plus expenses year-over-year.

Operator

(Operator Instructions) Our next question comes from Tito Labarta, Goldman Sachs.

Q - Daer Labarta

I guess 2 questions, also following up a little bit on Jorge's question in terms of efficiency and expense. I guess maybe looking at more from the margin perspective, right, your margin background -- EBITDA margin back at 25%. So nice recovery from the loans. I know it's probably hard to give guidance, but even just in terms of direction, is there room to continue to increase that margin from here? Are these in terms of margin? Is this kind of a normalized level? I don't expect an exact number, but just direction from here. Is there more improvement? Or can you go back to where you were just a couple of quarters ago where you're around 20% or even below that? Then second question kind of somewhat related to that. Given the reduction in the marketing expenses, does that potentially impact your ability to grow and gain some market share even on the SMB side? And maybe even like on the micro merchant side? Just thinking about sort of the trade-off between cutting expenses and being able to grow and gain market share. How could that potentially impact you in terms of your TPV and revenue growth?

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

Perfect. Thank you for your question. In what -- on your cash of margin and EBITDA margin, we're very conservative in providing even a flat guidance on that because our margin is so dependent in terms of pricing on the market that that's the biggest unknown for us is how price will behave throughout 2021. Just going back here, just to give you some color on that. We, in our discussions with the market in our quarterly calls, at the end of 2019, we expressed this very clearly. The prices had been on a declining path for quite some time in a quite steep incline. Over 2020, especially until the Third Quarter, we saw a relative stabilization, very likely because the market was -- our competitors were also prioritizing looking after their clients during the crisis then in actually doing a price war to steal market share. We saw the beginning of a stronger price competition at the end of last year, the very beginning of this year. Depending on how this goes on in 2021, this can have a big impact in our numbers. So this is why the -- our biggest challenge, and this is something that we can control, is to deliver gains on the cost side because on the profitability, we will gain market share, on the retail that we are investing heavily on that. But still, ultimately, the price on the retail has to be competitive, and that is a function of market competition. You had another question. Can you repeat that?

Q - Daer Labarta

Yes. Then the question was in terms of your -- the expense, does that hinder in any way your ability to gain market share, particularly on the retail side?

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

Thank you very much for that. We don't think that the current marketing expenses level will be a constraint in terms of our distribution after our effort in reaching new clients. Reaching new clients, in our view, and that's what we are focusing on for 2021, will be the combination of an increased sales team, working on a new model and using a better technological tools, such as an app that generates better leads and is able to provide customized offers depending on the type of clients and also better logistics. So we believe that, that is key to reaching new clients. And also building on the fact, as we have presented here, that we have shown significant improvement in terms of our quality of service.

Q - Daer Labarta

Okay. That's helpful. So we can assume that the current marketing expenses you have are sort of sustainable in terms of what you're doing and the investments will come up in the other aspects you mentioned. Correct?

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

Yes. You can. Yes.

Q - Daer Labarta

Perfect. If I could ask just one follow-up on the pricing that you mentioned. Yes. I understand, difficult to predict. But I guess maybe think about it, all else equal, if pricing just kind of stabilizes where it is today does that mean you have room to increase your margins?

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

That's a big if, but yes.

Operator

Our next question comes from Sofia Viotti, Bradesco.

Q - Sofia Viotti {BIO 21483869 <GO>}

It would be really nice if you could talk a little bit more about your use of FDICs to fund the credit, the credit segment. Do you think it's suffice to scale up credit using only this source of funding? Or do you envision using a more robust deposit base in order to have a credit portfolio larger and larger every year?

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

Thank you, Sofia. We believe that the primary funding instrument for the credit activity will be FDICs. We're seeing a market for that, favorable conditions. You know that we already use FDIC for the receivables activity, not credit, right? We already use it for receivables. And as we expand our activity into credit, I believe that FDIC will be the primary instrument. We are not talking about taking deposits or any other related instruments, okay?

Operator

Our next question comes from Jeff Cantwell, Guggenheim.

Q - Jeffrey Brian Cantwell {BIO 15025614 <GO>}

I hope you're all doing well. Nice results here as well. It's good to see the cost controls are really becoming more intense here. I wanted to follow-up on the questions you're getting asked, and this is in reference to Slide eight of the presentation. So when we focus on your active merchant base, you have roughly 1.4 million merchants now, and it looks like 2Q was the bottom, and you've been rebalanced since then. And we've seen all the good strategic moves you've been making to turn this around. You're talking about increasing your focus on SMBs, lower churn, et cetera. So I guess I'm just curious, what are your thoughts on Cielo's ability to increase the total number of merchants from here? In other words, do you think '21, 2021 is a year where the merchant base expands? And do you think you can get back to that pre-COVID merchant base, closer to about 1.6 million merchants that we see on the slide there, which is where you were in the Fourth Quarter of last year? So just any color or any thoughts there. Any help for us on that would be great. I appreciate it.

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

Thank you, Jeff. I would kindly ask everyone to go to our Page eight of the presentation because this illustrates exactly what Jeff is talking about here. So when we look at our client base and what we saw from the third to the Fourth Quarter was a decrease on the entrepreneurs on the long-tail client base, a decrease of 7.6%. This decrease came from a change in strategic orientation from Cielo throughout 2020, and we subsidized equipment sales way less than we have subsidized in 2019. As a result of that, we are not adding clients onto the long-tail portfolio on the same pace that we were in 2019. So everybody is looking at this specific page that I'm referring to. This dark blue column is likely to keep going down. However on SMB, and that's our clear target, our clear priority here, we are likely to increase because of a change in magnitude of the 2 columns. It's more likely that the reduction of long tail will be in a greater magnitude than the increase on SMB, but bear in mind that in terms of TPV, the movement is completely the opposite. The clients in SMB have a larger average ticket, a larger average TPV, and that's why we forecast a gain of market share on the SMB based on our change of commercial model and addition of 500 new employees to the sales force.

Q - Jeffrey Brian Cantwell {BIO 15025614 <GO>}

Okay. That's great color. And congrats again on the results.

Operator

Our next question comes from Neha Agarwala, HSBC.

Q - Neha Agarwala {BIO 17722501 <GO>}

And apologies if I make you repeat any of the answers as I've missed the first half of the call. My first question is on the take rate. It appears that the take rate will likely be under pressure in 2021, given the price competition that you just mentioned. Which products or which part of the business are you seeing most competition in terms of pricing? My second question is on the SMB segment. You show in the chart on Page eight that you are gaining clients in the SMB segment. What are the drivers for that? Is it better service that you're providing, better pricing? Or is it something else? And are you mostly gaining customers from incumbents or newer players? Any color on that would be very helpful. And lastly, what are your plans for the credit business? How is the model going to be? If a client comes from the bank branches, is the bank going to be -- the parent bank going to be extending credit? Or is it going to come from Cielo? And how is it -- is it in the pilot phase? Or are you going to launch the formal product? Any update on that would be very helpful.

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

Yes. Thank you, so much for your questions. I'm just taking note here so that I don't forget. I'm sorry. Okay. On SMB -- I'm sorry, on take rates, right? So take rate for 2021. What we are waiting to see, and it's very hard to project that is, again the behavior from the competition. We saw through most of 2020, a relative stabilization in terms of price competition, but in the end of the year and the beginning of this year, we saw a little bit of an increase of competition, and of course that translates into a little bit of lower prices. When we talk about our focus, Neha, which is SMB, we're going to talk about the take rate of SMBs. The basic product offering is a combination of a few components, right? Naturally, MDR, the prepaid -- automatic prepayment products, Cielo's Receba Rápido and also rental. So Cielo and the competition as well try to combine these elements in a single offering that will be attractive for the client. So competition and take rate trends, they come from how everybody is pricing all of these 3 together. What we intend to do in 2021, and some of this depends on competition -- relative pricing will depend on competition. But what we intend to do in our take rate is to add the component of the prepayment product because again that's our clear priority, and we are increasing the penetration of prepayment products in our client base. And now moving to your question about SMB growth and what are the drivers related to that? Basically the combination of a new commercial model with the addition of 500 new employees and a new commercial model that is based in technological improvements, basically an app that will assist seeking new clients providing a customized offering for that given client and also better logistics. We are running a pilot where we will be able to deliver the equipment as we obtain that new clients. This pilot so far has been successful, and we plan to fully roll that out in 2021. I failed to mention one thing in the new commercial model, which is the fact that with this addition in the sales team, we are reducing the geographical focus of the business consultants, and we are also reducing the number of clients per portfolio so that each sales force member from Cielo can dedicate better attention and quality of service to our clients. Speaking of quality of service, we hope that we were able to demonstrate some of the improvements that we have made over the past two years in terms of improving NPS, level of complaints and so on. And finally, to your question of credit, where are clients coming from? Well the -- it is -- as we are finalizing the creation of a credit offering, the target client base will be Cielo's client base. So there is no segregation inside Cielo's client base, who we offer that to. We will do a broad offering. This client can have a banking relationship with a bank that is partner from Cielo on the commercial side or a bank that is not a partner from Cielo. The fact is that the credit product will be offered to Cielo's client base as a whole, okay?

Q - Neha Agarwala {BIO 17722501 <GO>}

Okay. So it doesn't matter if the client comes through, say the Bradesco branch. You can still run the credit business on your own book. It doesn't necessarily have to go Bradesco.

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

It doesn't matter where the client comes from, but of course clients can choose who they do credit with. They may work with a working capital line from a bank that is a partner from Cielo or they may choose to have a working capital line from Cielo, right? What we cannot do is to segregate the product offering according to where the client has their banking relationship with, right? But of course ultimately, if the acquiring entity provides a credit offering that is similar to the banking entity, it's up for the client to choose what is best, which one is best.

Q - Neha Agarwala {BIO 17722501 <GO>}

Perfect. And Cielo would be doing the underwriting for these loans? The credit risk analysis will be run by Cielo?

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

That's something that we're still working on, Neha. Whether -- what we are debating here as we create this credit offering is whether does it make sense as a first step to have the risk in some other entities, some other partner or for Cielo to hold some of that risk that is still under discussion right now. I believe this will evolve gradually. So probably, the likely scenario is that we will start by distributing a credit product, where a third-party holds the risk. And as we see that our models are working properly, we can then have Cielo as an entity that holds risk, but again this is still in the works.

Q - Neha Agarwala {BIO 17722501 <GO>}

And when can we expect this credit product to be rolled out?

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

That's -- we don't have a target date for that yet, Neha. I'm sorry for that.

Operator

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

A - Paulo Rogério Caffarelli

Once again thank you for taking part of this conference. Please, if you do have -- if you have some doubts, please do not hesitate to contact our RP department, okay? Thank you, so much. Have a good afternoon. Bye, bye.

Operator

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