

Q4 2015 Earnings Call

Company Participants

- Clovis Poggetti, CFO & Director-Investor Relations
- Rômulo de Mello Dias, Chief Executive Officer

Other Participants

- Alexandre Spada, Analyst
- Carlos Macedo, Analyst
- Eduardo Rosman, Analyst
- Gerardus Vos, Analyst
- Jorge Kuri, Analyst
- Mario Pierry, Analyst
- Rafael Frade, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and thank you for waiting. Welcome to Cielo's Fourth Quarter 2015 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 is 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 macroeconomic conditions, industry conditions 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. Rômulo de Mello Dias. Mr. Rômulo, you may begin your presentation.

Rômulo de Mello Dias

Good morning. I'd like to thank you all for joining us today on this conference call in which we would talk about Cielo's results for the fourth quarter and year of 2015. Joining me are Clovis Poggetti, CFO and Investor Relations Officer, as well as members of the management, finance and Investor Relations teams.

Let's start on page three, presenting the highlights of the fourth quarter. The quarter's net income was R\$853 million, 6.2% higher than Q4, with a net margin of 28%. Adjusted net income, which excludes the amortization of intangible assets and we'll comment about in the next few slides, was R\$920 million; an increase of 14.6% compared to Q4. The EBITDA reached R\$1.3 billion, representing a 44% increase in relation to Q4 and margin of 44%.

With regards to the financial volume, it totaled R\$155 billion; an increase of 7.4%. Our net operating revenues ended the quarter at R\$3.1 billion; an increase of 44% compared to Q4 of last year. Considering no financial highlights, an event we celebrate in the company, it was a fact there for the third consecutive of the year we integrate the Corporate Sustainability Index, ISE.

Cielo was also recognized as the 11th most valuable Brazilian brand ranking by Interbrand. Also, we celebrate Cielo's recognition as the second place among all companies in Latin America by Institutional Investor.

Cielo also ranked among the best companies for shareholders in 2015 by Capital Aberto Magazine in the category of companies with market capitalization above R\$15 billion. We are the first place in financial sector on the price more value produced from Consumidor Moderno Magazine. Cielo ranked as the best in the category workers on their work is where conscious companies granted by IstoÉ Magazine.

Cielo was also recognized among the best in people management between 1,500 and 1,300 employees in the annual Valor Carrera 2015 by newspaper Valor Econômico and among the best companies to work for the 15th consecutive years in the ranking of magazine Você S/A.

On the next page number four, we present the evolution of the financial volume of credit and debit transactions. Compared to the fourth quarter last year, the financial volume capture increased by 7.4%, reaching almost R\$155 billion. The same comparison, the growth of credit volume was 3.6% and the growth of the debit volume was 12.9%.

With respect to the previous quarter, the total volume was 12.6% higher when the credit volume grew 10.5%, reaching R\$88 billion; and debit volume grew 15.4%, reaching R\$67 billion. In the year 2015, Cielo grew by 5.9%, whereas the credit growth was 2.5% and the debit was 11%. Regarding the product Agro card, the growth was 24% in Q4.

Moving on to page five, we present the number of capital transactions. There was an increase of 9.8% in Q4 compared to the same period of 2014, reaching 1.7 billion

transactions. Compared to Q3, the number of transactions increased 10.5%. And then in the year 2015, the number of transactions grew 9.5% to 6.2 billion transactions.

Speaking now of operational indicators on page six, we present the number of active points of sale under the criteria of one transaction in the last 30 days and the number of a solid POS. Compared to the fourth quarter of 2014, the POS installed base grew by 6.1% to 2.1 million units; and compared to the previous quarter, it increased 1.9%. The share of wireless equipment in Q4 reached 67.7%. The growth in active points of sales reached 11.2%, compared to the same period last year in comparison with Q3 grew by 5.2%.

I'd like now to turn the call over to Clovis Poggetti, who will continue with our presentation.

Clovis Poggetti {BIO 16529642 <GO>}

Thank you, Rômulo, and good morning everyone. On page seven, in accordance with the model adopted since first quarter last year, we present a frame with the managerial information related to Cielo's business. Regarding Cielo's consolidated numbers, as presented in table one, we can see that the net operating revenue totaled R\$3.1 billion in this quarter, up 43.6% from fourth quarter 2014 and 4.8% from third quarter last year.

The increase in net revenue is mainly related to the beginning of the consolidation of Cateno's operation as from February 27 to the effect of the dollar appreciation in the revenues generated in the U.S. to the subsidiaries Merchant e-Solutions, as well as to the ongoing business expansion. Our consolidated total expense was R\$2 billion in the fourth quarter 2015, 50.8% higher than the same quarter 2014; and the main offender in this comparison was the consolidation of the Cateno.

Compared to the third quarter last year, the amount is 9.6% higher, mainly due to the increase on cost of the subsidiary Merchant e-Solutions to the impact of dollar appreciation in the quarter, and to the continued business expansion and the controlled M4U result of an increase on mobile recharge sales.

On table two, we present Cielo's info, excluding Cateno, and the financial expenses incurred to start the company.

And on table three, regarding Cateno, we present the results including the financial expenses of the debenture is issued. As it can be seen, if we consider the expense with amortization of R\$96.4 million in the quarter, Cateno contributed negatively with R\$95.7 million to Cielo's consolidated results.

And finally, we also split Cielo Brazil on table four and other subsidiaries, Merchant e-Solutions, M4U and Braspag, on table five so that you can follow the acquiring business in Brazil and also to isolate the impact of exogenous variables to the business, such as exchange rate fluctuations impacting our U.S. subsidiary.

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Regarding Cielo Brazil, it can be noted that the net revenue presented an increase of 2% year on year. Total expenses presented a reduction of 3.8% and net income was 20% higher year-on-year. In relation to the total expense per transaction, it was R\$0.54 in the quarter, a reduction of 12.4% compared to the prior year. In relation to the prior quarter, presented an increase of 3%. Regarding the expenses per transaction for the year, the value was R\$0.52 per transaction with a 3% reduction compared to 2014.

Regarding the other subsidiaries, we should remember that we had a significant impact from the exchange rate. The average rate of the U.S. dollar in the fourth quarter was \$3.84, an increase of 51.2% and 8.5% over the fourth quarter 2014 and third quarter 2015, respectively.

In the following pages, number eight and nine, we present the numbers of factors. On slide eight, as previously done, in the table on the left in the first column we represent the numbers without considering the amortization. We can name this column business results. With this approach, we will have net operating revenue of R\$652 million, total expenses of R\$356 (sic) [R\$357.5] (10:19) million and net income of R\$212 million.

The accounting number in the second column considers the intangible asset amortization during the 30-year term resulting in an impact of R\$96.4 million. From this point of view, net income was R\$148 million. Analyzing the contribution of Cateno to Cielo after the impact of the financial expenses related to start a new company, we've reached a negative result of R\$95.7 million in the quarter, as shown in the same column slightly below and also shown in the previous slide. This number comes from a contribution of R\$103.8 million, which corresponds to 70% of the net income, net of financial expenses taken by Cielo plus taxes in the amount of R\$199.5 million.

It is important to note, however, that this result is impacted by the intangible assets amortization effect. When we perform the same analysis excluding these effects, that is, somehow in the cash basis direction, we come to figures presented on table on the right. In this analysis, the net income would be R\$244.7 million. Making the same analysis of Cateno's contribution to Cielo, that is, after the financial expenses, in fact we reach a negative result of R\$28.2 million in the quarter.

On page nine, we present the evolution of the main indicators of Cateno, excluding the cost of debt. We can see that the fourth quarter last year EBITDA was R\$295 million, with a margin of 45.2%. Net income was R\$148 million with a margin of 22.7%. It's important to remember that the scope of Cateno's business activities do not impose any credit risk or cost of loyalty programs. The activities that Cateno is responsible for are related to the transaction's operational aspect such as embossing of cards, which means screening the name and other information of the cardholder in the plastic, invoice screen, sending card and invoices to the cardholders, management and control of securities and payment of fees to the brands.

Among such activities, one that had greater representation in the cost structure and varies according to the volume of transactions captured is the payment of fees to the brands, above 40% of the total Cateno expenses.

On the next page, number 10, we highlight how to calculate the Cielo adjusted net profit. Before getting into the details on how, we would like to mention why. We're making such an adjustment in our net profit, and this is directly related to the difference of Cateno's contribution to Cielo between the additional accounting methodology and the cash basis due to the amortization of intangible assets in the new company (13:26).

The adjustment is done considering Cateno's cash contribution that is Celio's net income, excluding Cateno and related financial expenses, that totaled R\$948 million was added to Cateno's cash contribution calculated in the previous slide, which was negative R\$28 million in the quarter. Therefore, Cielo's adjusted net income totaled R\$920 million in the fourth quarter of 2015, an increase of 14.6% compared to the same period last year.

On page 11, we present indicators and results from the purchase of receivables operations. We can see in the table that the purchase volume increases 15.6% compared to the fourth quarter 2014 and 12.1% compared to the third quarter last year. The amount in the quarter totaled R\$17 billion or 19.7% of total credit volume with credit installment accounting for 68.4% and regular credit for 21.6%.

For the year 2015, the total purchase volume was R\$62 billion, an increase of 10.6%. Regarding income from purchase of receivables, it reached R\$601 million in the fourth quarter last year, 42% up from the result in the fourth quarter 2014 and 5% higher than the previous quarter.

In 2015, the result was R\$2.1 billion, 41.2% more than in 2014. As usual, we also present a managerial analysis of purchase of receivables revenue. In this analysis, as shown in the table, we apply a cost of funding of 104% of CDI in 100% of the financial purchase volume. According to this analysis, managerial result in the quarter was R\$345 million, an increase of 28% and 4.3% over the fourth quarter 2014 and third quarter 2015 respectively. In the year 2015, managerial result was R\$1.2 billion, 36.1% above 2014.

Regarding our financial performance on page 12, we present EBITDA in both absolute amount and margin. In fourth quarter 2015, EBITDA totaled R\$1.3 billion, 43.8% increase over the fourth quarter of 2014. The EBITDA margin was 43.5%, stable compared to the same period last year. Compared to the third quarter of 2015, EBITDA fell by 2.3% and EBITDA margin decreased three percentage points. In the year 2015, the EBITDA was R\$5.2 billion, 36.3% higher than in 2014 with a margin of 47.1%.

On the next page, number 13, we show that Cielo's net consolidated income totaled R\$853 million, 6.2% higher than the fourth quarter 2014 with a margin of 27.9%.

Finally, compared to the third quarter 2015, profit fell by 2.8% and two percentage points in the margin. In the year 2015, the income was R\$3.5 billion, 9.1% above 2014 with the margin of 31.6%.

Finally, on my last slide, number 14, I would like to comment on the current indebtedness of Cielo. The company's leverage at the end of fourth quarter 2015 was 1.6 times net debt to EBITDA adjusted for purchase of receivables.

Now, I will turn the floor back to Rômulo.

Rômulo de Mello Dias

On slide number 15, we present a distribution of dividends approved by the board of directors to be proposed at the shareholders meeting. For the period from the second half of 2015, we will be distributed the equivalent of R\$0.21 in dividends per share and R\$0.07 interest on capital, excluding that, which represents a 30% payout of income.

Referring to the result of the year 2015, the company will pay a total amount of R\$1.066 billion in dividends and interest on capital. Regarding 2015, we are proved to be more challenged than initially thought. However, despite the deterioration of the macroeconomic environment throughout the year, Cielo has business characteristics that make it more defensive at times such as we are experiencing. Some examples; first, the only fact that we have regarding the exchange rate is the purchase of POS; secondly, given the business model, Cielo is considered, to some extent, ahead against inflation; thirdly, the diversification of customers with more than 20 seconds (18:31) of the economy in our portfolio.

Ultimately, demand for purchase of receivables product in projects (18:36) such as the current one usually remains a good one. Because of these factors, we remain well positioned to face another year, which so far seems to be equally challenging.

On slide number 16, with respect to our understanding of the key variables for 2016, we expect that the financial volume for credit and debit for the industry should grow between 5.5% and 7.5%. Cielo represent a growth below industry's average. Regarding expenses, we're changing our cost per transaction soft guidance of Cielo Brazil to a range of growth considering Cielo Brazil and Cateno combined.

In other words, 2016 costs, project (19:23) expenses for those entities shall present a growth from 4% to 6%, taking into account an inflation of 7% for the full year, the industry reaching an increase of 6.5% with Cielo growing below this figure.

We should remember that Cateno's result will be present from an annual basis, that is 12 months ended compared to 12 months ended due to the fact that in 2015, Cateno contributes to only 10 months.

Finally, in relation to CapEx, with the purchase of POS terminals, the total amount shall be roughly R\$450 million. So, here I conclude my comments and thank you for your attention.

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

Q&A

Operator

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

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. Would you mind explaining in more detail the quarter-on-quarter jump in cost of services, I think, give us around 10%, which is higher than the 5% jump you had in revenues. To what extent this is driven by a higher rebate rate with the banks that do acquiring for you? And if there is anything else there that we should know? Thank you.

A - Rômulo de Mello Dias

Thank you, Jorge. Regarding the costs and the rebates that we paid to the banks, some of the rebates we paid reducing the line of revenues, as you know. And so there are some explanations about that. But I would pass to Clovis in order to explain the cost of sample or the cost of service that jumped during (21:40) the quarter.

A - Clovis Poggetti {BIO 16529642 <GO>}

Hi, Jorge. Let's say that most of the incentives that we paid to the bank, they are paid as an additional interchange, which means somehow they took the revenues of the company, okay. When we analyze costs and expenses all together, what (21:59) is the fact that in some cases when we have something that we may develop together with the banks a kind of, let's say, marketing campaign, in this case, this kind of expense is accounted as a marketing and sale expense, okay.

So we see that costs and expenses as a whole. Just remember that beginning of the year we gave a kind of soft guidance saying that this should be within R\$0.49 to R\$0.51 of Brazilian reais per transaction, okay. Then with the passing of time, after the second quarter, in the conference call regarding the second quarter, what we said is that given the deterioration of the market environment, we should be closer to R\$0.51. And then in the call regarding the third quarter, what we said is that, because of the deterioration of the market and also from one-off events such as the provisions related to chip-and-PIN equipment amounting in the year R\$27 million, we should be close to R\$0.52, okay.

Somehow what we said in - when we analyzed the whole figure, the figure for the whole year, excuse me, what we had is the R\$0.52 that we mentioned a couple of months before. The fourth quarter usually is somehow more expense because of - let's say, we have logistics when we grow and we fulfill the market with the POS, we have other costs related to the capture of the company. And also in terms of expenses, don't forget as well, we are fueling even some projects, okay, also and the fact that we expense most of the expenditures instead of capitalized. This also helps to understand what happened in the quarterly analysis or even in the year-on-year analysis.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thank you very much.

Operator

Our next question comes from Eduardo Rosman with BTG Pactual.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi, everyone. So I have two questions. The first one is, what you're expecting in terms of EPS growth in 2016? I know Cielo doesn't usually disclose the future estimates for net income. But if I'm not wrong, I think, Rômulo mentioned as something during the conference call in Portuguese earlier today that he expected the company to deliver EPS growth at double-digits this year. So can you please confirm that?

And my second question is related to another subject to the Itaú and MasterCard joint venture. Recently the Brazilian Antitrust Regulator is apparently, like, against the JV with the argument that it would be bad for competition. So what's Cielo's view? Do you think that the company's competitive position could suffer in case the JV is approved or not? So any color on that would be helpful. Thanks.

A - Rômulo de Mello Dias

Thank you, Eduardo, for your questions. First of all, I didn't mention anything about the double-digit growth for next year. What I mentioned was the following. I said that expenses plus costs would be in the range between 4% and 6%, which we changed because last year we considered the total expenses per unit fee. Let's remember that part of the expenses is more than 50% is related to the volume. So what we're trying to provide was a better, if you will, a better certainty in terms of the range that we need, let's say, to follow considering the microeconomic environment, considering the need to reduce the costs and expenses of the company.

We also mentioned that this range, if we bought in 6% nominal, it takes into consideration our inflation around 7%, market growing at 6.5%, and as well Cielo growing above the range of the market.

It's important to mention that (26:48) that we take into consideration because if the market grows (26:52) of course, the range would have a different perspective. So this is what we said. About a possibility to come back to double-digit growth, my colleagues is here, correct me when I said that Cateno would be accretive, I thought that I said that 2016 and people told me that I said 2017.

So on a cash basis, by the end of this year, Cateno will be accretive. By the end of next year, on an accounting basis, Cateno be accretive. So in other words, from 2008 considering that Cateno will be, let's say, providing good earnings for the company, and also some projects will be concluded. I would say that we are creating a foundation for a new company so we're going to have two more difficult years in front of us such as 2016, 2017, but by 2018, I would have more certainty, considering the level of visibility that you have today that we could reach double-digit growth.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay.

A - Rômulo de Mello Dias

And about this comment about the Itaú-MasterCard, I prefer not to comment. I don't know the detail. I think it's more appropriate to make that question directly to them.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay. Thanks a lot, Rômulo.

Operator

Our next question comes from Alexandre Spada with Itaú BBA.

Q - Alexandre Spada {BIO 16687974 <GO>}

Hi, gentlemen. Thanks for taking my question. This is actually a follow-up from discussions in the Portuguese conference call. There were several questions in that call on the behavior of the net MDR in the fourth quarter, which fell notably relative to previous periods. I understood that implied comparison (28:53) in the MDR was due to a combination of mix factors, change and interchange few rules and change in incentive given to banks effective since early 2015.

That all said, my question is the following. The market will have to adjust forecast for Cielo now that the 4Q numbers are out. So should we consider the implied MDR seen in the fourth quarter as the starting (29:20) in recurring point for the quarters to come or should we look at the average figure of 2015 as a starting point to forecast 2016 and the following years?

A - Rômulo de Mello Dias

Thank you, Spada, for your question. Yes, we said there were some explanations between the GAAP, between the total sales volume growth and the net MDR. And just for the ones that didn't have the opportunity to listen my answer, I would say the following.

Yes, it was (29:54) explaining by a more aggressive competition, a greater share of declines and capture volume. Second, a change in the mix of products with debit accelerating over credits. Thirdly, a height of sales in Agro card in Q4 growing 24% more compared to Q4 2014, and it's also important, as you mentioned, and to remember that at the end of 2014, we had a renegotiation of incentives with banks, which came into effect in January 1 of last year.

And last but not least, (30:35) to brands, rules revision, and the change on the mix of economic segments, which affects the interchange. So concluding my speech and answer rightfully your question, I would say that the net MDR, we shouldn't consider the fourth quarter as a basis in terms of a relationship between the net MDR and the total sales volume. The gap between one in an order, is this gap would continue as it was in Q4. I

would say, this gap is going to be lower, because of the fact that I mentioned and also because we expect a better, let's say, competition environment.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. So we would rather than...

A - Rômulo de Mello Dias

(31:33)

Q - Alexandre Spada {BIO 16687974 <GO>}

...look at 2015 rather than the fourth quarter.

A - Rômulo de Mello Dias

Yeah. The average, I think, say, is better, even though that we're not saying that the average couldn't suffer, again, a reduction in terms of MDR, but the average is better than the final quarter of 2015.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. I understand. That's clear, thank you. And I have two other quick questions, number one is on American Express, do you think there's a chance of American Express shifting out of the (32:03) MDR fee scheme in the future?

A - Rômulo de Mello Dias

To be very honest with you, I don't know. These are negotiations happening between the Max and Bradesco, and you should send this question to them. Right now, what you have on all the acquirers is (32:22) methodology. So you receive sense (32:26) for transaction when you capture transaction from Max. Bradesco gives as it is today at a broad (32:34) MDR.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. Thank you. And a final one, quick one, in fact. Do you expect the prepayment volumes to remain anywhere between 18% and 20% of the credit volumes going forward? Or are there any reasons to believe in a higher or lower number?

A - Clovis Poggetti {BIO 16529642 <GO>}

Spada, as I like to repeat always, we are foreseeing the growth of the profitability of the products. In some quarters, we said that we could keep between the mid-to-high teens, even though that's not our main goal. What is happening on the opposite side of the total sales volume growth is the fact that the banks are more cautious when they decide to provide credits.

With this regards, I'd say that to some extent we are being, I'd say, helped by the fact that the banks are not so - they don't have the same appetite about credit. So I would say that

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for sure, this project will continue to help the profitability of the company even though that and probably - it's something that I don't like to see percentage-wise, because I can have percentage-wise reducing the spread, and by the way, just for quick information or quick note considering some understandings that some analysts had their mouth (34:07), the spread that we present that the spread didn't - the spread was not reduced. What we have was the adjustment of the - that usually due by the end of the quarter. And the adjustment that you do in December is higher than September. Could you add some color please?

A - Rômulo de Mello Dias

Just to make it clear, some reports - some highly rated (34:30) questions regarding the more decrease in the spreads of the company. And what I believe is being considered by the analyst is that the net present value adjustment. And I ask you to take this into consideration. The net present value, the same effect happened since 2013. This fourth quarter, because of the Christmas sales, the net present value adjustment is higher compared to the third quarter. This happened in 2013, this happened in 2014, this happened last year, okay. I believe without this net present value adjustment, you're going to see that spread up flattish, okay. And why I'm confident (35:21) because knowing the price we sell, okay, let's say, let's use this word, this is flattish, and also, when we raise money to fund the prepayment that is also the same. So, let's say, there is no way to have this kind of decrease in this (35:40) in the spread having the selling price and the funding cost almost flattish.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. Thank you. So we can think - given that the banks are not very optimistic with the expansion on their credit portfolio, it sounds like 2016 may be another good year for the prepayment business, do you agree?

A - Rômulo de Mello Dias

Yes.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. That's really clear. Thank you.

Operator

Our next question comes from Gerardus Vos with Barclays.

Q - Gerardus Vos {BIO 3301062 <GO>}

Hi. Thanks for taking my questions. Two, if I may. Just first of all, on the cards usage, given the rapid increase in unemployment in Brazil, do you think there is a risk that you might see here of re-digitalizations actually less card usage for a citizen than the trends we've seen over the prior years? Just perhaps give us a bit of an insight in that.

And then, secondly, Cielo Brazil was quite light with just 2% growth in the final quarter of the year. Given the performance of retail data over the last couple of weeks, do you think there is a risk that actually will be in decline for the first part of 2016? Thank you.

A - Rômulo de Mello Dias

Gerardus, I understand your question. And for sure unemployment will produce, if the rates of unemployment increase, at the end of the day, the utilization of the card will decrease. But, to some extent, we are including, let me say, that we expect that the growth of the industry is going to be between 5.5% and 7.5%. We are including to some extent this kind of a new level of unemployment rates. About your second question, I didn't get very well your point. Could you repeat, please?

Q - Gerardus Vos {BIO 3301062 <GO>}

Yeah, sure. So my point was that Cielo Brazil was growing 1.7% in Q4 given the weaker retail data we've seen over the last couple of weeks. It looks that we're going to see a further deterioration from that growth rate. So my question was, is there a risk that actually Cielo Brazil standalone will be in decline for, let's say, the first part of 2016 or so?

A - Rômulo de Mello Dias

I understood. Plus, don't take it into consideration in your forecast about the next year and the coming years that Q4 as a base for the coming quarters. Let me explain why. First, I will provide you five answers between this gap between 1.7% in revenues against 7% around - against total sales volume. First about this length (38:46) on price, explained by a more aggressive competition, and which (38:49) share of the clients on the capture volume. Secondly, a change on the mix of the products with debit accelerating over credit. And as you know, the net MDR of debit is lower than net MDR of credit installments mainly.

Thirdly, a height of sales on Agro card in Q4, the growth was 24% compared to Q4 2014. Fourth, it's also important to remember that the gain of 2014, we had a renegotiation of incentive paid to banks, which came into effect in January 1 of last year. So there is nothing related to Q4.

And lastly, a highpoint (39:37) rules, revision, and the change in the mix of economy segments, which affects interchange. So these five factors together produce the blend in terms of the impact that's going to affect the performance between the growth of revenues against the growth of total sales volume. And just repeating myself, don't take into consideration that this gap is going to be, let's say, the same for the coming quarters. We expect a reduced - a reduction (40:19) between the total sales volume and the performance of the net revenues.

Q - Gerardus Vos {BIO 3301062 <GO>}

Right, sir. Okay. Thank you.

Operator

Our next question comes from Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Yeah. Good afternoon, gentlemen. Thanks for taking questions. One question really on the rental business. I think we've seen the number of merchants continue to increase at a fairly decent pace given the economy 11%, at the same time the number of POS terminals increasing 6% year-over-year. Could you comment a little bit on that? Is that a trend that you expect will keep on going - continue going forward? Could you talk a little bit about how the competition is affecting rental prices for your terminals? Has this deceleration in the growth of rental terminals offset the change in mix towards wireless, and basically we keep that revenues on those lines flat or how it has behaved? And also, I think, just to wrap it up, how much of an impact did that have in the fourth quarter for the overall revenue mix? And did that have an impact outside of MDR for the revenues that underperformed volume growth? Thanks.

A - Rômulo de Mello Dias

Thanks for the question about the rental business. Yes, we have - I would say that we could expect a decrease because of deceleration of the macroeconomic and also because of the multi-VAN (41:54) project. And as you know, they're in the year 2016. We began last year with 200,000 number of merchants, and this year a multi-VAN (42:07) which is any acquirer company will be able to capture any network. So in other words, Cielo will be able to capture (42:18) is going to be able - Cielo is going to be able to capture (42:24) going to be able to capture (42:28) as well and also other players in the market. So this, to some extent, will affect the evolution of the growth of the rental business.

On the other hand, I would say that there is a positive side which is GPRS, a wireless terminal. It reached 67.7% in this quarter. And we expect to continue to increase the penetration of GPRS, because the market continues to prefer GPRS in spite of the dial or in spite of the broadband.

Q - Carlos Macedo {BIO 15158925 <GO>}

Thanks, Rômulo. So a follow-up question. I mean, when you look at data from your competitor from where the - year-over-year the number of POS terminals declined, it is for December (43:20). Is that something that we could expect for Cielo in 2016? Or would it be too extreme given the transformations in the industry?

A - Rômulo de Mello Dias

Let's say we expect that nominal rent will grow, maybe depending on the reaction of the clients, in terms of their multi-VAN (43:48) projects and also in terms of the deceleration, and also in terms of the number of clients, that just is a fear (43:54) because they're suffering, because of the economic environment. I would say that maybe the number of terminals by the end of next year probably is going to be lower, but it's difficult to say considering so many, let's say, variables that we have to take into consideration when you try to project about the future.

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From our hands, from our side, what we are going to do is to continue to, I'd say, to accelerate, trying to pursue new segments that today are not participating in credit card business, which is very important not just to consider - it's important to retain the clients that you have, for sure, because churn is very expensive. But on the other hand, it's also important to add more clients that today are not participating in the market. So net-net, in terms of number of terminals, it includes not just POS, but also mobile, also dial also (45:01) which is part of the ECR solution, it's difficult to predict.

What I can tell you with the level of information that you have, even with the deceleration, even with the multi-VAN product (45:13) that by the end of next year, I would say, that we would have a growth in POS, rental - in, let's say, rental business including all the solutions that you have to provide to the clients.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. Thanks. Could you - before a follow-up question, could you - would you care to - I mean, can you provide us any idea of the size of the business relative to overall revenues in Cielo, say that last bucket that you have there in slide - let me just get to the slide, a second?

A - Rômulo de Mello Dias

(45:49)

Q - Carlos Macedo {BIO 15158925 <GO>}

As a percentage of the - in slide seven for Cielo Brazil, would - can you provide us an idea how big your rental business is relative to the revenue that you generate in Cielo Brazil on slide seven, the bucket four that you have there?

A - Clovis Poggetti {BIO 16529642 <GO>}

No, no, no. We provide the numbers together. You want to have the breakdown between POS, MDR, other revenues and as well other lines of Cielo Brazil. Is that what...

Q - Carlos Macedo {BIO 15158925 <GO>}

Just the range, just the range...

A - Rômulo de Mello Dias

No, no. What I can tell you that, we expect that - in terms of operational revenues, rental business represents a growth better than MDRs, and also financial revenues which is prepayments even with the (46:50) 4.65%, it will also present a better performance than operational revenues.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So just the second question on those. When you talk about the multi-VAN (47:05) project, what is the impact? Let me put it this way, assuming that both take on the same volume, what's the different in revenue generated by POS and multi-VAN (47:17), and the

POS versus Cielo (47:19). I mean, will there be a decrease in revenue going to multi-VAN (47:24) or will it be roughly the same.

A - Rômulo de Mello Dias

First of all, let's try to quantify what is multi-VAN. Multi-VAN (47:30) can be - we're going to offer to the merchants the possibility to choose. If they want to choose Cielo in spite of choosing (47:41) Santander or other acquirers they will have the option to say, okay, once (47:52). But they also can decide to have two acquirers or three acquirers, which is very common in Brazil. The fact that the multi-VAN (48:03) is in place and (48:05) will be concluded by the mid of next year doesn't mean at all that the number of the terminals or - all the merchants will choose just one acquirer.

So we have some surveys, we have some studies here, we have some research. We do a lot of this kind of surveys in order to know what's going to be the reaction required to offer other services in order to create more stickiness with our customers. We also try to avoid the churn with other policies that you have.

But as I said, it's not a question - there are many variables that one goes one direction, another one - one goes to the north, one goes to the south, one goes to the southeast, northeast, so and so forth. The result of these variables with the level of information (49:04) that I said allows me to say that we expect a growth in the gross revenues of rental business is what I can tell you even though that this growth is not going to be the same that you had in last year because of the amount of deceleration that probably is going to be close to the same deceleration that you had last year, and also because of the multi-VAN (49:33) projects.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. My question was more, because I understand that some of the transactions that go through the multi-VAN (49:41) platform will be (49:43) transactions and not for acquiring. So just to get an idea of what you expect, do you think there will be an impact on MDR that will come from having (49:54) transactions versus the current model that you have?

A - Rômulo de Mello Dias

Yeah. You're right. At the beginning in terms of the multi-VAN (50:01) it's going to occur like you said, but when the, let's say, the new model, let's say in different model that is not multi-VAN (50:11) with the same amount of money to be shared among the acquirers, I would say that this question that you just raised is not going to be necessary.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. And so just a final question and follow-up on that. When you report volumes for multi-VAN (50:35), we know that the volumes report for VAN (50:38) and not part of the volumes that you report generally. Are you going to report that as part of your full volumes or would that be separate and we'll just look at volumes that comes from acquirers?

A - Rômulo de Mello Dias

Until it's done, yeah, we are going to report.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay.

A - Rômulo de Mello Dias

When they could change the model, not anymore.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. So it could be that mid-way through the year, we see a big bump-up in volumes that would be volumes that will be shipped from VAN (51:02) to full acquiring?

A - Rômulo de Mello Dias

Yes, in terms of MDR, in terms of the rental business, of course, it belongs to us, okay.

Q - Carlos Macedo {BIO 15158925 <GO>}

Yeah. Of course, of course. Okay. Thank you for being clear, Rômulo. Thank you, Clovis.

A - Rômulo de Mello Dias

Thank you.

Operator

Our next question comes from Mario Pierry with Bank of America Merrill Lynch.

Q - Mario Pierry {BIO 1505554 <GO>}

Hi, everybody, good afternoon. Thank you for taking our questions. Let me ask you two questions, Rômulo. The first one, I'm trying to understand is the relationship between the company and the banks seems like what you mentioned that the interchange fee was changed seems like in favor of the banks that you gave bigger incentives to the banks than in the past although this was renegotiated before.

Also, there were press reports in Brazil saying that maybe some of your controlling shareholders could be interested in purchasing Elo brand (53:02) from Citibank. So I'm trying to understand, right, we're seeing the banks here facing significant revenue pressure, problems with asset quality, so I wanted to understand better, how do you see the dynamics in the relationship that you have with the banks? That's the first question.

A - Rômulo de Mello Dias

Thank you, Mario. About the relationship between company and the banks, we have corporate governance standards, which set up some rules such as if we change the

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incentives that you pay to the controlling shareholders that are also our channels, one of the big channels that you have, this kind of incentive needs to be approved by the independent board members.

And, by the way, what happened for the year, by last year, you should understand by December 2014, we approved a new incentive increasing in beginning on January 1, 2015, and there was no new agreement signed between us and the banks regarding 2016. Also there is no additional incentives paid, to be very precise, to Bradesco and Banco do Brasil in Q4 that explain the difference between the gross - the total sales volume and the net revenues.

What you said about the interchange is something related to all the banks doesn't have anything with Bradesco and Banco do Brasil. In other words, it's welcome and also, and this thing happens also from time-to-time in other markets.

We see that a merchant was classified as MCC A or be classified MCC B, and who set up the rules, the networks, these are must according (54:10) to others. And from time-to-time, they setup new rules, and they say, listen, there are some steps here that need to be - and we do our - let's say, Cielo does also, if you will, our self-regulated process trying to fix it when it appears, because we have many channels that captures merchants for Cielo.

We have - Cielo - we have even - also the banks more than 10,000 branches are choosing which should be the MCC for that specific merchant. We also have agents (54:53), dealers so on and so far. This is - so in other words, this is the normal process, and in this year, it happened by Q4, an additional incentive paid to all the banks. I'm trying to be very precise here that this was setup by the rules and these rules which are responsible for his roles (55:21). MasterCard and Visa and this does not have anything with an increase, overall increase in all the interchange was something to fix with some sectors or some companies that were not very well defined.

It's also important to note that also their order acquirer (55:44) need to do the same thing. Cielo consider the fact that it's a public company and that we provide many more information in their orders. We need to explain what's happened in Q4.

So in other words, what I'm trying to say repeating considering the question that Alex Spada made at the beginning that their main explanations, why - Gerardus, sorry, when Gerardus asked about, between 1.7% in the growth of the total sales volume. There were fine explanations about that. There were not additional incentives to Bradesco and Banco do Brasil in Q4. So this is I think answer your first question. Regarding the second question, I don't have information about that. I think you should ask this question directly to Banco do Brasil and Bradesco.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Okay. No, I wasn't referring specifically to your controllers, but just overall, the banks in Brazil were facing some problems here. So I would imagine that some of these changes will be interchange maybe...

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A - Rômulo de Mello Dias

No, no, no, no, no.

Q - Mario Pierry {BIO 1505554 <GO>}

...as well as trying to get if it was forced by the banks that they approach Visa and MasterCard.

A - Rômulo de Mello Dias

No. No.

Q - Mario Pierry {BIO 1505554 <GO>}

No? And if you can give us...

A - Rômulo de Mello Dias

I got your point. No, no, no, no. Let me be very precise here. There was no pressure regarding the banks trying to have a higher interchange - I was receiving 1% indeed, in a separate (57:27) market, I want to receive 1.1% if these had happened. What happened was fixed some MCCs, merchant category calls and interchange as a result, because some of this were not very well fixed. We're not very well classified let us say. So it was necessary to fix it. And this correction happened in Q4.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Just if you can give us an idea of how many basis points of an impact there was.

A - Rômulo de Mello Dias

It was not basis points, but the amount of money that was paid to 100% of the issuers that work Visa and MasterCard (58:15).

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Okay, so let me ask you another question here Rômulo is more related to the integration of merchant fee solutions here in the local market, all right, this is a transaction that took place 2012, if I'm not mistaken. I think you're still having some expenses related to this. In the past, you used to talk about expenses related to (58:39). Any color you can give to us when do you expect the platform to be fully integrated, when do you expect this costs to come down?

A - Rômulo de Mello Dias

You are right. When we bought the company, by the end of 2012, with the support of very important, two important consulting companies. We provided a sub guidance when the product would be ready. And as it normally occurs, unfortunately, it had been a delay okay?

And as I said, we have two important companies, let's say, most recognized companies in strategic and operation, so on and so forth, and there was - we are expecting the conclusion of the projects by the end of 2016 and it didn't happen. So it had been a delay and also had been a delay because of the beginning - two different cultures trying to adapt it and took more - we just let's say, Brazilian people took the leader, took the leadership one year later.

So what we're expecting right now that the benefits of Bob (01:00:05) or the name of the new platform which is called Star (01:00:09) is going to begin next year. Right now, you already have some small clients using the platform, and it could migrate around 50% of the current accounts of the current merchants and we decided not to do to migrate the current merchants, because let's say, to some extent, towards freeze (01:00:37), the current offer that we can offer to the merchants.

So we decided to postpone for the retailers, the small and mom-and-pops. In order to have, let's say, the - another release, which will allow us to begin to offer to the retailers by the beginning of next year, and to conclude the migration by the end of next year with the big merchants, okay. And just to remember why big merchants is more difficult, more complicated when compared to mom-and-pops is because there is an inter - we continue to release with the small and medium merchants without being necessary to ask (01:01:28) company to make some adaptation.

So it's a maiden (01:01:33) what we have developed, I was participating in a conference last week, and I met the CEO of a big bank in Pakistan, and he said I would like to see what Cielo developed for the small and medium retailers, because you can release another version of software without being necessarily to go there (01:02:01). And we cannot do this. Could you help me? As we can have some conversations.

In the case of big merchants, the reason why we are saying that by the end of 2017, two years from now, is because there is a need to evolve and to call the interference of the software house such as software spreads orders, such as data selling orders (01:02:22) in order to make that - and also in terms of IT, in order to migrate the legacy platform to Star (01:02:33) the legacy platform to the product called (01:02:36) okay. I don't know if I answered your question about that.

Q - Mario Pierry {BIO 1505554 <GO>}

Yeah. No, that was very clear. So basically, your cost base should only really come down in 2018 once you fully migrated all of your clients, right?

A - Rômulo de Mello Dias

Yeah.

Q - Mario Pierry {BIO 1505554 <GO>}

I would imagine as long as we have one client and one platform, we have to keep it fully operational?

A - Rômulo de Mello Dias

Yes. You're right and it comes to the point that I mentioned, when Eduardo Rosman asked me the question about, will we expect, let's say, a reduction. If you remember, I mentioned in previous quarter that you have (01:03:11) business as usual (01:03:13) and strategic projects. So we're - the one that it's really (01:03:19) to continue as it is, because we need to continue to develop the new steps in order to differentiate ourselves as a service company.

(01:03:29), as I mentioned about, there's, to some extent, there is a duplication in terms of expenses and POS (01:03:34) for the next two years. And the third part (01:03:39) is something that, yes, there are some expenses that is not so important, so material that at the end of the day, we'll produce, let's say, a lower income for the company. It's the reason why, even with this challenge, even with the macroeconomic environment, even with the reduction in number of transactions, even with more competition, even with something that will continue to happen, I would say that we have two years ahead that we are going to be more critical.

But Cielo will continue to present our growth, its profits, it's our goal. Cielo will continue to be resilient. We'll continue to be much more - more than that the concern to be a service company, because we do have a feel about the future that's necessary to be a company that by the point of sale is different from the others.

But after this, mainly this year, and also next year, because we are expecting, for the next year, we expect a better economic environment. I would say that beginning 2017 and 2018, the growth of the profit is going to be another level. And to come back about the other point that is very important Cateno. Cateno is going to be accretive even with the levels to meet that you're not expected, when we decided to buy the company, on a cash basis, by the end of this year, I was wrong regretting myself, because my teams here said that somewhere (01:05:29) I said 2017.

In 2017 - by the end of 2017, on accounting perspective, Cateno will be accretive. So on a cash basis, by the end of each year Cateno will be well positive. And the company in 2018 is going to be a much stronger company than it is today, because of the projects that we decide to begin on some years ago and also because we're preparing this company for the future, not for the next quarter to present in two quarters a better result.

I also like to say that it could reduce the cost of the company if I decided to stop other projects, if I decided to fire 20% of the head count of the company and the EBITDA would grow in a percentage wide - even a percentage wide even though that's not our target at all. And at the end of the day, the accounts will be paid by the next CEO, if you will or by the next management.

So what we're saying that this company is doing what's necessary to be done in order to have a company for the future. And we're going to pass this winter, this perfect storm that's affecting results. And even during this period, even during the storm that you are suffering, in Brazil, in 2017, we'll present the growth in earnings. Even - and a better result in 2018 and a better result - a much better result in - sorry, a good result or better

compared to what's happening in the economy of FY 2016, a better results compared to 2016-2017 and a moderate results better in 2018, because some projects will be concluded and also because that we're going to capture 100% of the earnings that comes from Cateno.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Rafael Frade with Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi guys. Just a follow-up on one of the last questions. Rômulo, you mentioned that the increased interchange that we saw was related to changes in rules from all the brands, all the networks, I'd love to confirm this?

And the second that was not clear for me. You mentioned that the world has changed (01:07:58) in the (01:08:03) is one of the merchant quotes, it's not only clear, it was something that is started in the fourth quarter or also in the fourth quarter was speed (01:08:14) related to best quarters, just to be clear about this?

A - Rômulo de Mello Dias

Let me answer the first question, increasing to change, (01:08:24) markets, they do not act together, we're very precise on this. We have a lot of concerns about anti-competitive trust, anti-competitive behavior. So what we're saying that there is a - how we call, (01:08:46) that says these merchants should be classified. They don't have any specific rules, necessarily with the rules that are setup by the networks.

So there is a man who that says that, this is a supermarket, this is a not a wholesale, this is a construction, this is a restaurant, this is a fast food, this is - so there is an ISO which sets the rules, that this company should be classified. There is a discussion between (01:09:19) so on and so forth.

What happened considering the fact, there, the rules also are, who are responsible for, say, to see if the rules are correct. If from time-to-time, also in Brazil and also in other countries, these are going to change. These are the networks. And this interchange will increase not only by Cielo, but also well by the others, because we have different rules, we have different mistakes compared to other acquirers and they have other mistakes that we didn't have. So I don't know what it is. What happened that it was something that we had to do in Q4. Was I clear?

Q - Rafael Frade {BIO 16621076 <GO>}

Yeah, yeah. But so just to be clear, so there it was established, this new ISO or the classification of this new ISOs were made more clear in the first quarter, and obviously,

the new classification going forward, is now something that was under discussion the last couple of quarters and now there were a...

A - Rômulo de Mello Dias

It was a discussion – of course, the discussion happened between some quarters before, but it was setup a date to fix the things, (01:10:45) ISOs, it's not independent sales organization. It is more, 9001, International Standard of Organization is what I see. This is something internationally speaking a common rule that happens around the globe. This discussion happened before but action happened in Q4.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay, that's perfect. Thank you.

Operator

This concludes today's question-and-answer session. I'd like to invite, Mr. Rômulo de Mello Dias to proceed with his closing statements. Please go ahead, sir.

A - Rômulo de Mello Dias

I would like to thank you all for your participation, and we hope to speak to you for the conference call regarding the Q2 – the Q first results. As usual myself, Clovis, Roberta and the team we're available to take additional questions that we may have them to clear (01:12:00). Thank you very much 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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