Q1 2011 Earnings Call

Company Participants

- Clovis Poggetti Junior, CFO and Investor Relations Officer
- Jose Cionini
- Paulo Guzzo Neto, Executive Officer and EVP, IT and Operations
- Roberta Noronha, IR
- Romulo De Mello Dias, CEO

Other Participants

- Alexander Spada, Analyst
- Craig Maurer, Analyst
- Daniel Abut, Analyst
- Efraini Chavez, Analyst
- Everett Gong, Analyst
- Henrique Navarro, Analyst
- Mario Pierry, Analyst
- Saul Martinez, Analyst

Presentation

Operator

Good morning. Welcome everyone to Cielo's First Quarter 2011 earnings conference call. (Operator Instructions) This conference call is being broadcast live on www.cielo.com.br/ir. We remind you that questions for the Q&A session may be posted on the website.

Before proceeding, let me mention the forward-looking statements are based on the beliefs and assumptions of Cielo management and on information currently available to the Company. They involve risks and uncertainties as they relate to future events and therefore depend on circumstances that may or may not occur. Actual performance could differ materially from those anticipated in any forward-looking comments as a result of macroeconomic conditions, market risks and other factors.

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

Roberta Noronha {BIO 20488075 <GO>}

Good morning. I'd like to thank you all for joining us as we present our results from the First Quarter 2011. With me today are Romulo Dias, our CEO, Clovis Poggetti Junior, Executive Vice President of Finance and Investor Relations Officer, Paulo Guzzo, IT and Operations Executive Vice President, (Rogero Signorini), New Product and Development Director, and the finance team. Now I would like to hand it over to Romulo.

Romulo De Mello Dias {BIO 2054119 <GO>}

Good morning. Thank you for joining us for another results conference call. With the First Quarter numbers, we also have the results after nine months in the new multi-brand scenario. As we have mentioned in our previous conference calls, the competitive dynamic we saw was surprising. The aggressiveness of niche negotiations with the Group that were classified as large merchants impact the MDR more than we had expected, although, in our case, the impact was only perceived in the Fourth Quarter numbers.

After the big end of the year, we began to see the first time that this competition was letting off, which gave us more optimism with our future and also a strong market growth which, according to our (synergies), increased approximately 26% in the quarter. With respect to the variables that you control, chiefly costs and expenses, we are delivering that we had committed to do.

As for our market position, despite the relative newness of the multi-brand scenario, we're at work with major international brands that generate more dollar for retailers, Visa, MasterCard, Connect, and in addition with Japanese brand JCB. We also established partnerships with several regional and voucher brands. In addition, we continue looking for new avenues for growth outside our traditional scope, for example, non-card and non-payment transactions with mobile payment initiatives in Orizon, our subsidiary in the health industry.

On slide three, we have some highlights of the quarter, like our year-on-year growth of 19.5% in transaction financial volume. In the same period credit volume was up 18% and debit volume 22%. This growth left us very happy and shows that market growth is still resilient. But we should also remember that in the First Quarter we have the impact of (credit installments) from Christmas, which is partially recognized in this period.

Our net operating revenues, less prepayment of receivables in Q1, were BRL1.08b, up 6% over Q1 '10. Adjusted EBITDA was BRL684m, down 4% year on year. Net income totaled BRL425m, down 3.5% as compared to Q1 '10. Quarter on quarter adjusted EBITDA margin was up 0.8percentage points in the First Quarter. Following the same trend, net income margin was up 0.6percentage points in the period.

With respect to our brand portfolio, we announced the inclusion of new brands such as Mais, Bonus CBA, Cabal Vale, Verocheque, Banescard, Sodexo and Sapore. In addition, as of April, we began to capture and process all transactions and our POS network is already 100% ready for this.

And finally, we want to mention that our annual extraordinary general meeting, held on April 29 at our headquarters in Alphaville, approved a capital stock increased via 20% share bonus, followed by a reverse stock split in the proportion of three shares to one common share. The bonus shares were credited on May 2, which impacts this quarter two and the reverse split will take place as of May 30 and we will let you know about that.

On the slide four we talk about the macroeconomic environment that was the foundation of our performance. GDP grew 7.5% in 2010 in the most recent data available, which was the highest rate in decades. But 2011, according to data from the most recent Focus Report, GDP is expected to grow 4%. Retail sales slowed down but continue to grow significantly, both in sales volume and revenues. In February sales volumes went up 8.2% year on year. Driving this growth is basically the lowest unemployment in history and increased credit availability. In March loans to individuals increased 23% compared to the same period last year while default in this category fell to 5.9%. With this favorable element, the economy should continue to grow.

Now I would like to go to Mr. Poggetti, who will continue our presentation.

Clovis Poggetti Junior

Thank you, Romulo and good morning everyone. On slide five we detail our First Quarter performance and show the key indicators with year-on-year and quarter-on-quarter comparisons. As you can see, on the whole the indicators were up year on year with general and administrative expenses grew above revenues so that negatively impacting net income. Quarter on quarter we continue to see the impact of the increased competition on our numbers. However, the decline of important indicators, like the net MDR for credit transactions, has begun to taper off, reaching 122bps in the quarter.

On our next slide, slide six, the upper left graph shows the 14.1% increase in the number of transactions as compared with the same quarter in 2010. On the right, the 19.5% growth in the transaction financial volume of credit and debt transactions captured in the quarter, which totaled BRL70.2b. And in the last graph on this slide, we have the number of active clients, that is those that have carried out a transaction in the last 60 days, which reached 1.085 million compared to 1.129 million in Q1 '10.

On slide seven we have our revenue breakdown. Credit and debt commissions were responsible for 61.6% of our total revenue. Prepayment of receivables represented 9.8%, which is 3.9percentage points higher than the level presented in the First Quarter 2010. POS rental accounted for 22.5% of the total revenues, reflecting a less aggressive and more resilient competitive scenario in this segment. Other revenues also gained share as compared with Q1 '10, mainly due to the revenues from our subsidiary, M4U, which we acquired in August of 2010.

In the graph on the upper right we have the evolution of our net revenue, including the net amount of prepayment of receivables, which totaled BRL1.082b, up 6.1% on a year-on-year basis. Our revenue from credit card commissions, on the lower left in black, fell 3.1% to BRL539m, while revenue from debit transactions, in blue, was up 10.7% to BRL196m. On the bottom right we have the revenue from POS rental, which fell 8.9% in Q1 2011, with a 5% decline in the total POS days, and just considering these days, a 4% drop in the average rental price.

On slide eight, we have some information about our prepayment of receivables, which has grown gradually and maintained its level of return. In the first graph, prepayment of receivables generated BRL121m, no adjustments here in this quarter, up 64.8% over Q1 '10. The second graph shows the financial volume prepaid in First Quarter this year, which grew for the seventh consecutive quarter to BRL3.2 billion and represented 7.3% of the total credit volume. The average term of these operations fell from 66 to 63 days in the quarter.

On slide nine, let's look at our performance with cost and expenses. The cost of services provided increased 23.8% in the First Quarter as compared with the First Quarter of 2010, totaling BRL312m. The main drivers of this growth were additional brand fees and cost with our subsidiaries. Eliminating these impacts, costs would have increased just 4.3%, primarily due to the operating efficiencies gained after adaptation projects related to the multi-brand scenario.

Our unit cost per transaction in the quarter was BRL0.294, up 8.4% year on year. If we consider First Quarter 2010 -- the fee structure that was in place First Quarter last year and exclude the effect of our subsidiaries, the unit cost would have fallen 8.6%.

Operating expenses were up 41% on a year-on-year basis, mainly due to the marketing expenses, which were up 67.5% due to the increased loyalty programs for merchants and the institutional campaign to position the Company in the new competitive scenario. Marketing expenses represented 3.3% of net revenues, including prepayment of receivables.

Adjusted EBITDA, in the graph on the left on slide 10, totaled BRL684 million in the quarter, down 4.2% as compared to the same quarter in 2010 and 4.4% compared to the last quarter. EBITDA margin was 63%, down 7percentage points year on year. Net income fell 3.5% year on year and 4.2% quarter on quarter, with the margin at 39%, down 4percentage points over the same quarter last year.

Now I would like to hand it over to Romulo.

Romulo De Mello Dias {BIO 2054119 <GO>}

On slide 11 we have our strategy for the future. We trust our fundamentals and we will more than ever use our expertise and boost our competitive advantage to distinguish ourselves.

In the segment of traditional transactions with cards, Cielo relies on the first world needs of both transaction security and network availability, with a unique distribution due to our strategic position mainly through our partnerships with banks and other channels. We also stand apart for our brand portfolio that offers merchants the opportunity to capture a greater volume. And that's why we continue to establish partnerships in 2011, in addition to those already announced in this quarter.

We are leading the process in developing emerging payment technologies. We announced last year the acquisition of M4U (inaudible) develop the technological platforms for mobility solutions. We also announced a joint venture with Oi to focus on mobile payments. And we were pioneers in Brazil with the large application for payment with Apple devices.

In alternative transaction services we already position ourselves in the healthcare industry with our subsidiary Orizon and we are prospecting other B2B segments. Also in alternative services, for Cielo premier innovative service we believe that we will be well positioned to provide a loyalty too for our clients to use.

On our last slide, 12, I'm going to remind you of our dividend policy, our bylaw to guarantee a minimum distribution of 50% of net income for the fiscal year, but in fact we have distributed 90%. Moreover, we pay twice a year, in March and September, which allows the investors to have better visibility. Total remuneration paid relative to 2010 was BRL1.6 billion or BRL1.19 per share before share bonus.

Thank you for joining us and now we'll take your questions.

Questions And Answers

Operator

(Operator Instructions) Our first question comes from Mario Pierry from Deutsche Bank. Please go ahead.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, and congratulations on a solid set of results. I have two questions. First is can you give us any color on your forecast or on your expectations for net MDR evolution for credit cards? I think we're seeing the drop in your net MDRs. They're coming in about one-quarter lag relative to your peer so I was just wondering do you expect MDRs eventually to be in line?

And what do you expect for MDRs going forward? As we know, there might be a next round of negotiations starting in July. Can you just try to provide us with some indication of what you think will happen in the market?

And my second question is related with this, all these macro-prudential measures that have been introduced in Brazil, expectations now that the economy is expected to grow 3.5%, 4% rather than 4.5% at the beginning of the year. I just would like to hear your thoughts on how this could impact our volume growth this year. Thank you.

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

Thank you, Mario. About the trend in terms of net MDR, I wouldn't say that you have a quarter lag compared to our peers because we have, let's say, a different position in the north, in the middle of the country, and as well in other states that we are present.

Having said that, we are expecting to have a single-digit decline for the Second Quarter, but remember what we told you the previous conference calls. We are going to have a better visibility when we have -- at least we expect to have a better visibility when we finish and we publish the Second Quarter results. But considering the information that we now have in our hands, I would say that for the Second Quarter I would expect a single-digit decline in net MDR for credit card transactions.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Let me follow up. Just let me follow up, sorry, Romulo, because we've seen your net MDRs are 1.22% while your competitor's is at 1.13%. Do you think this difference can remain or do you think eventually the net MDRs for both companies are eventually equal?

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

No. I would say that the difference, maybe it will lower in the coming quarters, but I -- my expectation according to information that I have, that I wouldn't expect the same net MDR for crediting.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Then the second question then?

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

The second question about macroeconomic measures, macro-prudential measures, listen, we -- I think the government is trying to control inflation, as everybody knows, using macroeconomic measures and as well the interest rate. It seems to me that interest rates are going to be -- they're going to use more the interest rates. But regarding the macroeconomic measures, I would say that the economy will slow down due to the fact that some effects will be recognized by the economy in the coming quarters. But directly for our industry, we do not expect something that could affect directly our products, such as credit installments and other that you have in our hands.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Then in terms of volume growth, we're seeing for a while this is an industry that grows volumes about 20% a year. So you're saying that you expect this trend to continue?

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

It's a good question. To some extent the growth is surprising us. As you can calculate, the market grew 26% in the First Quarter. It was really amazing in terms of the total sales volume that the industry was able to capture. So I would say that I wouldn't expect the same growth for the coming quarters, even though that we do see good signs, we continue to see good signs in terms of our placing checks and cash and of course the total sales volume. But I would expect a lower number for the coming quarters. A lower percentage in terms of --

Q - Mario Pierry {BIO 1505554 <GO>}

That's great. Thank you very much.

Operator

Our next question comes from Daniel Abut from Citi. Please go ahead.

Q - Daniel Abut {BIO 1505546 <GO>}

Good morning, Romulo and Clovis. First, a kind of a follow-up to the prior one. In their own conference call your competitor said that some of the contracts that were negotiated last year with large merchants that they were expected would be implemented in the First Quarter after the Christmas season got delayed in their implementation and that they don't control when the merchant finally implement the new contract. So although that was good news because if we leave some pressure in the First Quarter MDR numbers, it may provide some kind of carryover effect into the Second Quarter.

I was wondering, related to the prior question, if we may see some of that in Cielo's numbers as well. You guided that the MDR declining credit that we may see in the Second Quarter will be single digit as opposed to a 10% -- 10 basis points that we saw in the First Quarter, quarter on quarter. But I wonder if we should also factor some kind of catch-up effect or carryover effect into the Second Quarter from contracts that were signed when the competitive environment was much more aggressive between you and your main competitor in December that didn't get implemented yet. That would be question number one.

Then question number two, which is somewhat related to that one, I want to get a sense of what should we expect in terms of your earnings growth capability going forward. I think you surprised everybody by posting this strong First Quarter results, which shows 4% year-on-year decline in the key metrics, net income, EBITDA, etc. The market consensus expectations were for this year, 2011, to show a more pronounced decline in earnings for you, more in the double-digit area, 10% to 15%. Why? Because you are comparing with a year that had a first half, an entire first half, where you still didn't have the new competitive environment.

Should we expect then here in the result that you achieved in the First Quarter compared to a year ago, only single-digit decline, 4% level decline, that that's the kind of earnings decline that we may see for the year as a whole or it's too early to say that?

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

Thank you, Daniel for your questions. Let me begin with the second question about the expectation about the future. As I said, considering the net MDR and information that you have in our range right now, I would say that the net MDR will decline one single digit because the competition is not so tough as we are facing three or four months ago.

About the quarter, we are trying to control expenses, everything, in order to deliver a better result for our shareholders. But I'm not comfortable to say to you that I would expect the same kind of decrease in the Second Quarter and the Third Quarter in terms of liquidity, in terms of earnings and EBITDA. I expect to have a better visibility when I publish my Second Quarter numbers. It's too early to say, to give you a more precise view about that.

Regarding the first question, how we stand in terms of the contracts, delays, so on and so forth, let me give you, let me try to answer you with some kind of numbers. We said in our previous conference call that 7% of our main clients were at conclude in terms of negotiation. Today we have around 80% to 85%. It doesn't mean that the remaining 20% of the big merchants that they are going to choose one or another. Maybe they are going to choose one or another. Maybe they have decided and they decide to keep both acquirers, or even in some cases three acquirers, but mainly two acquirers.

So the information that you have at this stage, because we are talking to these remaining 20%. And by the way, it's important to understand that segmentation that you have here in Cielo is not the same that probably our main competitor is using. It's the reason why maybe you can listen a percentage that's different on our side compared to the percentage that they have. But the message is, I would say, is probably the same in our case.

80% to 85% are at conclude the negotiations. Some of these negotiations were not migrating -- when you lose a big contract and you, of course, you gain and you lose, some of them didn't migrate so far due to technical issues that our clients have. So they need to make some adaptations at the front end. And I guess more merchants continue to be on the same path. They're trying to use the POS and other sorts of product services and SLAs to convince them that we should be the choice for them.

Q - Daniel Abut {BIO 1505546 <GO>}

If I understand the question -- the answer correctly, Romulo, you're saying that of the 80%, 85% that already negotiated, a portion of them they have not had implemented the new contract for technical issues. Can you give us a sense if that's a material number or most of them have implemented already? I'm trying to again get a sense of how much carryover effect of contracts already renegotiated aggressive pricing may still be in store for Second Quarter or even Third Quarter of this year.

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

No, Daniel, the 80% that are negotiated, the highest percentages have migrated. So in other words, probably 70% to 80% of the 80% have migrated their volumes to us.

Q - Daniel Abut {BIO 1505546 <GO>}

So of the 80% 85% that already negotiated, was the percent already implemented you said?

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

Yes. 70% to 80%.

Q - Daniel Abut {BIO 1505546 <GO>}

70% to 80% already implemented the new contracts. Okay, that helps. And by the way your answer to the other question I think was fair. We'll have to wait one more quarter to get more clarity there. I just thought I would give it a try.

Operator

Our next question comes from Saul Martinez of JP Morgan. Please go ahead.

Q - Saul Martinez {BIO 5811266 <GO>}

Hi. Good morning everybody. Congratulations on the results. Two questions as well. First on your unit costs, you had a nice reduction and you explained the reasons, some of the reasons in the release. But you did have a nice reduction in the quarter after having that increase meaningfully last year. I always see this business as one of economies of scale where over time you should have unit cost declining.

What's the outlook there on the cost side? Should we continue to see a sustained improvement? Because if I recall last quarter you guys kind of gave the guidance or the -- a hint that it would remain stable versus the Fourth Quarter level but you saw a big improvement. Should we expect that kind of unit cost improvement to continue going forward?

Secondly, continuing on the theme of competition, what kind of -- can you discuss at all what kind of price concessions either on the POS rental side or MDR side have been offered thus far to small and mid-sized merchants? Do we have a sense for where we are in that process? Have we seen any price -- any meaningful price concessions to merchants that are not large merchants because at the end of the day those merchants are still the lions share of your revenue? So I kind of want to get a sense for where we are with the smaller and mid-sized merchants in terms of pricing and competition.

A - Clovis Poggetti Junior

Okay. Hi Saul. Regarding the costs, it's very important and again we reinforce here the guidance that we gave in the last conference call, the conference call regarding the Fourth Quarter results. The costs plus expenses, so costs plus expenses both together, excluding the costs and expenses regarding our control of the companies, in a per unit basis these can be considered a good proxy for this year 2011.

Just to give you some figures, cost plus expenses on a per unit basis Fourth Quarter 2010 we have BRL0.406 per transaction and in this quarter we have BRL0.39, which means a decrease of 2.7%. So despite such a slight decrease we still believe that the Fourth Quarter is the best number to be considered in your models. Always -- reinforcing here again --- always cost plus expenses.

And the second question, Saul, if I understood correctly, you're raising, let's say, how is your thoughts about price concession regarding MDR and POS, that's right?

Q - Saul Martinez {BIO 5811266 <GO>}

Yes. But more focused on mid-sized merchants and small merchants. Not larger merchants, but where -- have price concessions been offered to merchants and to what extent they've been offered to merchants who aren't necessarily your key relationships, large relationships?

A - Clovis Poggetti Junior

Okay. About the mid-size, we have a division here that we consider, let's say, large merchants, 18,000 clients. We call them corporate entrepreneurs and as well exclusivities. But at the end of the day, if you just take the consideration mid-size and small companies, we are -- the main line of our revenues that we use after offering services, products and other things is the -- is POS rent.

We have -- I think you are familiar with Cielo Premier. Cielo Premier is something that allows the merchants to have -- to provide loyal, to provide service for their customers. And as well to provide all the kind of solutions such as reductions and everything that you can provide.

In terms of Cielo (inaudible), it's something that is also very important because for, mainly for the small merchants, with this service we can provide a variety of options to our small merchants. In other words, what I am trying to say, that the merchants have the options to choose if they want to reduce the cost of POS, if they want to reduce the MDR, if they want to reduce -- if they want to have access to a better service, if they want to have an access to buy a ticket to go U2 for instance, things like that that you are trying to provide to our customers.

I would like to ask (Jose Cionini) to give you more color about Cielo Premier and how it works in terms of providing services in terms of through internet and other things.

A - Jose Cionini

It's a standardization program where the merchant can accumulate points and then exchange those points for benefits. There is a huge variety of items that you can exchange on the internet. It's really simply. Just get in the internet, log in and then choose whatever he wants from a great variety of items.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay thanks. I guess just a follow up then. Do you -- is competition emergence among small and mid-size merchants, do you expect the POS rental rate pressure to accelerate going forward?

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

I would say that we expect a decrease in terms of the rent even though that we are trying to be very, let's say, cautious about that. When we talk to them its not our first -- when they ask for a reduction, we have, as you may know, we have a lot of steps, often services, often products, talking, giving attention, addressing SLAs, providing a better service, providing everything. It's the reason why you see that the reduction in POS rent is not so aggressive as some people were expecting. But going forward I would say that POS will continue to suffer rent, POS rent will continue to suffer but we expect to control this line of revenue.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay, but do you this quarter is a good proxy for the kind of pressure we should see going forward on rental rates?

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

No it's too early to Saul. It's too early to say.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay.

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

It's too early to say.

Q - Saul Martinez {BIO 5811266 <GO>}

Alright, fair enough. Thanks a lot and congratulations again.

Operator

Our next question comes from Craig Maurer from CLSA. Please go ahead.

Q - Craig Maurer {BIO 4162139 <GO>}

Yes. Good morning and thanks for taking my question. First I wanted to commend you on sticking to something Clovis said at my conference 15 months ago that you weren't necessarily going to chase major price declines for the sake of market share. And I commend you for that. But on that point I was wondering how you see the evolution of market share now. Clearly your competitor has taken some share of large merchants. You see that in their growth rate of volume. It's come at the expense of their MDR to an extent, and I was wondering how you see the evolution of market share to this point. Thanks.

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

Craig, about the evolution of market share, we continue to expect that we are going to lose some market share due to the fact that our focus is to provide profitability. We -- I think, as everybody knows, Visa transactions now is available and Visa has a larger number in terms of total sales volume. So it's the reason why we continue to expect to have, let's say, a lower market share going forward. And we will not fight, Craig, we will not fight for market share. We will not fight for market share.

Q - Craig Maurer {BIO 4162139 <GO>}

Okay. I'm glad that continues to be your message. Thank you.

Operator

(Operator Instructions) Our next question comes from Alexander Spada from Itau BBA. Please go ahead.

Q - Alexander Spada

Hi gentlemen. good afternoon. I have a question on your cash position. How do you guys see Cielo's cash position a few years from now? Do you think the company will shift from your current net cash to a net debt position somewhere in the next one or two years as the prepayment business evolves even further? Then I have a follow up question. Thank you.

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

I think we already answered your question. Our next cash will -- it's a strong one due to the fact you have a strong generation. And we hope and we continue to pursue a better position, a better percentage in the prepayment business. If we are able to reach this goal that we have internally, of course in the future maybe we should change and switch from net cash to a net debt.

Q - Alexander Spada

Okay. Thank you. And as a follow up, changing your payout policy is not under discussion because of this eventual net debt position in the future.

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

Today, we have -- the minimum is 50%, 50%. We are paying 90%. If we don't have to do -- if the money were available in the Company and you --- what you have to do is if I have money after the prepayment is already funded by our cash flow, I have to pay dividends for the shareholders. So to change the policy it will depend, if it's the case, if it's necessary, if its appropriate, it's going to be -- this decision should be taken when it's necessary, when I need to fund our, let's say, activities. (I'm no doubt) unclear. Go ahead.

Q - Alexander Spada

Yes. But that's not in your radar right now. I mean the 90% is a good number to think of going forward at least for now.

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

At least for now is a good number considering the level of everything that you have in our Company.

Q - Alexander Spada

Okay that's very helpful. Thank you.

Operator

Our next question is a follow up from Daniel Abut from Citi. Please go ahead.

Q - Daniel Abut {BIO 1505546 <GO>}

Romulo, Clovis, just a follow up on the prepayment business. If I look at the evolution of this business in recent times you have been growing steadily the percentage of credit card value transactions that you get to prepay, still a single digit number but a high single digit number. But you have really focused on this business also on profitability much more than on share and volumes as you have defended the spreads that you get to collect here much, much more than your main competitor, to the extent that now with a much lower percentage prepaid on them, you are deriving on a revenue contribution from this line which is not that much lower than what they do. You made about BRL120 million in revenues from prepayment this quarter versus BRL145 million for them.

So how should I think about the sustainability of your spreads, which again is significantly higher than what they are getting, I assume because of mix of the merchants that you go after is much more geared towards smaller merchants in your case than them? Do you think the current spreads that we saw in the last quarter is what we should expect you to continue making or at some point that spread will have to start to give?

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

Daniel, about the trends for prepayment, we'll continue to focus on this line of revenues because it's of course very important for us. If I take into consideration the small and medium sized companies, I do not see a reason why we should expect a lower percentage of (CDI). Because they -- the main thing that you need to provide to them is the service and the availability of the funds, so they are not very sensitive to price.

About the big merchants, as you know, they are more sensitive to price. And if you grow on a percentage base total credit card transactions from 6.7% to 7% and trying to continue to grow this percentage, of course, if I do the breakdown between the big merchants and the small to medium sized companies that you have, the big merchants, let's say, the next level of the additional percentages that we expect to reach the coming years will come mainly for the big merchants. And these big merchants they have lower spreads.

So -- but the small and medium sized companies, I repeat myself, I do not see a reason why we should change on a percentage base of CDI because if CDI goes down of course we also go down, that the spread should be lower.

Q - Daniel Abut {BIO 1505546 <GO>}

And you are not intending to change the mix of your repayment business or start to be more aggressive in trying to get business form the larger merchants that could affect therefore your blended spread?

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

No, not really. We are intending to increase in the big merchants because, as you know -- but on the other hand, as you know, there are some lock-in with the banks and right now these negotiations are taking place within the whole system. So the big merchants is important for us. It's something that we'll try to pursue, but I wouldn't expect in the short to medium term that the mix or even the percentage of the prepayment business would change very much the coming quarters.

Q - Daniel Abut {BIO 1505546 <GO>}

Thank you, Romulo.

Operator

(Operator Instructions) Our next question comes from Efraini Chavez from Artha Capital. Please go ahead.

Q - Efraini Chavez

Yes, hi. Just two quick questions. I was wondering if you could just provide us a little bit of an update of, one, the competitive landscape outside of your main competitor. What have you seen? I know we've -- there have been numerous accounts of different entities getting into the business and I was curious if you could give us an update on what you're seeing more recently.

And lastly if you could just remind us in terms of the regulatory environment, is there any reports or ongoing dialogue that we should know about in terms of how the recommendations that they have made have been implemented and when those things are reviewed and when they could be potentially changed. Thank you.

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

Hi Efraini. About the competitive landscape we have right now four other companies that make the announcement about to begin to -- the business from the scratch. And as a matter of fact Santander plus GetNet deal had begun and they reach 1.3% according to our numbers in the First Quarter. Global Payment Networks, Elavon, First Data, I think they are a very important companies. I think they are going to have their fair share. As far as I know they are not ready to begin to offer service to the clients, but I would say that they would have a fair share in the coming quarters and the coming years.

So we -- but the competitive landscape in terms of how they are going to be aggressive or not, I do not have information because they didn't begin the operation.

Regarding your second -- go ahead.

Q - Efraini Chavez

Please, when you say 'their fair share', is that, for Santander GetNet is that 10% given the distribution of their branches? And what does that mean for Global Payments when you say 'fair share'? What does that entail?

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

It depends on what you are saying. We have our own expectation. Santander, they said that they would have reached 10% or 12% until 2012. Elavon said that they would reach 15%. GPN didn't say anything, at least I don't know. And First Data as well I don't see -- I didn't see one information about that. So if I get Santander plus Elavon plus others maybe, maybe I'm wrong but maybe they have some kind of optimism because, in our opinion, the two incumbents have some kind of an advantage compared to the ones that we will begin the business from the scratch.

So fair share for us means that we do recognize that the market is too big, the market, the pie, and the trend of the market will grow after we begin the operations. But on the other hand I would say the two incumbents will continue to have, let's say, a huge percentage of the whole market.

Q - Efraini Chavez

Okay.

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

Second question about regulatory environment, we do not have I think any kind of information or that should be shared with you. It seems to me that after the new scenario that we will face in July 1, we -- the merchants have their options about macroeconomic prudentials. You --- I have mentioned we do not expect to have something happening at least directly for our business.

And how we stand today, I would say that we are, the industry is in good, is in a good path even though that we haven't -- unfortunately we do not know what is their minds. But I would say that more competition is the other side of the coin about regulatory environment. More competition to some extent reduce the pressure for regulatory environment because, at the end of the day, now the market is completely open to everybody that wants to come to Brazil.

Q - Efraini Chavez

Thank you very much.

Operator

Our next question comes from Henrique Navarro from Santander. Please go ahead.

Q - Henrique Navarro {BIO 16188960 <GO>}

Hi gentlemen. Just to know that in the past the Company used to give guidance on the main numbers and now you expect that after the Second Quarter we might have some visibility on the long term for the company. Does Cielo -- is thinking about come back and start publishing, giving guidance again for 2011 or 2012?

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

Henrique, I understand what your saying and we decided not to give guidance about the total sales volume and other things because we had some kind of lack of visibility. Now we are having a better visibility and I hope that after the Second Quarter or even after the Third Quarter we would be able to provide more guidance.

On the other hand we are giving you a guidance about the net MDR. That was one of the most important questions that usually the investors and the sellside analysts want to know. And for the Second Quarter, as I said, one single digit decline, consider the information that you have now in our range right now. About the costs and expenses also is another a guidance that we are providing that we -- should help you in terms of the cash flow analysis. We --- that, as Clovis mentioned.

And I think what you can say, when you have this year, this year when you have more visibility, when you are more comfortable about the information that we have in our hands the investors and the sellside analysts will be the ones to know and to receive because it's good for everybody.

Q - Henrique Navarro {BIO 16188960 <GO>}

Okay. Thank you.

Operator

Our next question is a follow up from Alexander Spada from Itau BBA. Please go ahead.

Q - Alexander Spada

Hi just a quick follow up on Santander. Have you guys -- are you seeing Santander attacking larger merchants or on your perception they are mostly focusing on those very small merchants?

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

Alexander, Santander, they were more focused on the small and medium sized companies because they were not ready for (cash), for (ECS) -- ECR. But they are ready for ECR or not?

A - Paulo Guzzo Neto {BIO 16447955 <GO>}

Almost.

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

Yes. Almost ready. I am asking here my IT guy. They are almost ready according to the information that we have and also from the information we have from the market. Probably in the short term they'll begin to offer their offer to the larger merchants. But it's important to mention that we see rational behavior from Santander in the small and medium sized companies. They are increasing and providing a good service for their clients. But we are not seeing at this stage irrational behavior in terms of price policy in terms of net MDR and so on so forth.

Q - Alexander Spada

Okay. Thank you.

Operator

Our next question comes from (Everett Gong) from PioneerPath Capital. Please go ahead.

Q - Everett Gong {BIO 16906152 <GO>}

Yes, I just wanted to clarify your comments earlier. You said a single digit decrease in MDR going forward. You're talking about single digit percentage decrease from 1Q'11 rate to 2Q'11. Is that basically what your saying?

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

No. We are talking about basis points. We -- right now net MDR in terms of credit is 1.22.

Q - Everett Gong {BIO 16906152 <GO>}

Right.

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

And I say that one single digit is -- sorry, when we say one single digit we are talking about less than 10 basis points.

Q - Everett Gong {BIO 16906152 <GO>}

Got it, got it. Okay. Thank you very much.

Operator

Thank you. This concludes the question and answer session. At this time, I would like to turn the floor back to Mr. Dias for any closing remarks.

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

I'd like to thank you all for your participation and reiterate what I said earlier that we are going to continue to focus on profitability to leverage our competitive advantages as a market leader with the largest distribution network to offer an extremely reliable service not just in availability but also security. We continue to focus on innovation for products that definitively add value to merchants and with that build excellent relationships with them, which are certain will be fundamental in the new markets.

Finally, I'd like to stress our commitment to transparency with the quality in everything that we do, respecting all our stakeholders and always guided by best corporate governance practice to add value for our shareholders. Thank you for joining us and have a nice day.

Operator

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