Q3 2018 Earnings Call

Company Participants

- Clovis Poggetti Junior, Chief Financial Officer & Investor Relations Officer
- Gabriel Mariotto, Business Analytics Director
- Victor Schabbel, Director-Investor Relations

Other Participants

- Alexandre Spada, Analyst
- Carlos G. Macedo, Analyst
- Domingos Falavina, Analyst
- Eduardo Rosman, Analyst
- Felipe Gaspar Salomão, Analyst
- Lucas Lopes, Analyst
- Rafael Frade, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good afternoon, everyone, and thank you for waiting. Welcome to Cielo's third quarter of 2018 results conference call. With us here today, we have Mr. Clovis Poggetti, Victor Schabbel, and Gabriel Mariotto.

This event is being recorded, and all participants will be in a listen-only mode during the company's presentation. After Cielo 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 website at http://ri.cielo.com.br/en/ 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. They will be answered by the IR team after the conference has finished.

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

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

Now I'll turn the conference call over to Mr. Clovis Poggetti. Mr. Clovis, you may begin your presentation.

Clovis Poggetti Junior

Hello and good afternoon, everyone. Thank you all for joining us for another conference call to discuss our results. We also have here with us Gabriel Mariotto, our Head of Business Analytics; and Victor Schabbel, our Head of IR.

Before starting our presentation, I would like to highlight the arrival of our new CEO, Paulo Rogério Caffarelli. Starting Monday, November 5, Paulo will join us and it will be my pleasure to assist him throughout the transition process. By the way, I would like to highlight that this has been a great experience and that we could proceed with our works over the past months without any obstacle or setback.

I reiterate my commitment and the commitment of this entire team to our client-focused strategy. This strategy is based on several pillars and differentials such as ongoing investment in a more modern technology platform and a more agile corporate structure, the most complete portfolio of products, services, and capital brands in the Brazilian industry, the largest and most robust distribution network offering unparalleled capillarity within the sector, enabling our presence in almost all Brazilian municipalities.

This foundation was enforced by recent large investments in marketing actions and a competitive and commercial repositioning given new market dynamics. We continue to work hard, and I reiterate what I have already said, we will pursue a leadership position in the markets where we have enjoyed recent success, and at the same time, maintain our leadership in the markets where we are already leaders.

Now, I'm going to hand the presentation over to Gabriel, who will talk about the Retail industry performance over the last few months. Gabriel, go ahead.

Gabriel Mariotto

Okay. Thank you, Clovis, and good afternoon, everyone. According to the numbers shown by the Cielo Broad Retail Index, ICVA, on slide 3, sales growth in this year's third quarter reflected a similar pace to that of the second quarter, 2.2% in the third quarter versus 2.4% in the second quarter on an inflation discounted year-over-year basis. As mentioned in our monthly ICVA release, both quarters had no recurrent events that directly impacted Retail sales.

In the second quarter, there was the truckers' strike that surprisingly ended up having a positive impact, especially on retail sales in supermarkets due to extra supply buying, and Brazil's first round World Cup matches, which had a negative impact. In the third quarter in turn, we had Brazil's second round World Cup matches in the beginning of July. And on the other hand, (00:05:29), which are both social security programs, withdrawals by a significant portion of consumers, which increased their buying power and boosted sales.

While it's difficult to quantify the exact impact of each of these events, we can say that the net effect was generally neutral. In nominal terms, reflecting what retailers actually see in their sales revenues, the index accelerated again, and as has occurred for the last six quarters. These results reinforced the vision we've been sharing since the beginning of the year that the Brazilian retail sector has demonstrated a trajectory of gradual but consistent recovery, although boosted by inflation that is also accelerating.

It's worth noting the results shown by ICVA during the Father's Day period. The growth rates in that commemorative date was above the average pace of retail sales and numbers (00:06:35). This result emphasizes a trend that has been taking place in here. Brazilian consumers prioritize purchases on commemorative dates. In addition to Father's Day, they also did sell during Mother's Day and Valentine's Day, which also showed growth rates above the average pace of their respective months of celebration when compared with last year's equivalent days.

Last but not least, I'd just like to remind you that the ICVA represents the performance of the retail sector as a whole. It is not a proxy for the cards market, let alone a proxy for Cielo's performance.

Thank you all for your attention. I'll turn it back to Clovis now.

Clovis Poggetti Junior

Thank you, Gabriel. I will now start my presentation on slide 4 in order to discuss a few of our operational highlights. As you can see on the graph on the left, we have our volumes development. To provide a more accurate representation of the company's performance, we have adjusted the way we measure our volumes captured, excluding the volumes processed under the Multivan model. This allows us to present a more accurate picture of our growth.

We see that Cielo's total volume, excluding the Agro product, grew by 1.7% year-over-year, decelerating from the 3.8% growth recorded in the previous quarter. This mainly resulted from the contraction seen in our debit product, which decreased 3% year-over-year, when we exclude the volumes captured under the Multivan model. On the other hand, the credit product grew by 5.1% year-over-year, which contributed to increase our total volumes in the quarter.

However, at this moment, more relevant than volume performance is the growth of our POS base. After falling for 10 consecutive quarters, we have resumed an upward trend with the growth acceleration seen in the second quarter of 2018. I will repeat. After falling for 10 consecutive quarters, we had already reported growth in the second quarter, and now, we are growing again even more. When we consider the POS base of both Cielo and Stelo together, the number of terminals increased by 3.3% in the quarter versus a growth of 0.5% in the previous one. While at Stelo, we continued to gain traction, posting solid increases in the number of sold POS to smaller retailers, at Cielo, we already saw a stabilization over the quarter.

But what I would like to draw your attention is to something that is not very clear to see in a quarterly view, the fact that in a sequential monthly view, more specifically from August to September, the terminal base of Cielo has resumed its growth after the period of three years. In other words, the message I want to convey is that with Cielo alone, we are back to growth, and when we consider Stelo, we have grown even more.

In more detail, Stelo ended the quarter with a POS base of 109,000 terminals, up 111% quarter-over-quarter, compared to the 52,000 active POSs in the second quarter this year. At Cielo, when we add the conventional POS base with the number of LIO terminals, we reach 1.550 million terminals. This figure is in line with the previous quarter which saw more reduction of 5,000 POS.

In third quarter this year, compared to the second quarter, when we look at the sequential POS monthly perspective, as I just mentioned, we can see the first growth of this base in three years. On slide 5, we can see more details of Stelo's performance. Here, it's important to highlight that in only a few months of operation, we were capable of significantly increasing Stelo's POS base from only 4,000 machines in the first quarter of the year to 109,000 in the third quarter.

Most important, however, is the evolution of the operation as a whole. We sold more in the third quarter than in the whole first half of the year, bringing us to our year-to-date total of almost 200,000 POS sold over the first nine months of the year. When we consider the number of machines and active POS points of sale, we recorded 111% and 145% growth, respectively, from June to September this year.

After facing a few issues concerned with POS availability, which affected everyone in the industry, we now have the capacity to sell 100,000 POS per month. Therefore, we expect to accelerate the expansion at Stelo with increasingly more robust and promising results.

These results can already be seen on slide 6. Over recent months, the growth of volume captured by Stelo had been meaningful. In the third quarter alone, Stelo captured BRL 620 million versus BRL 129 million in the second quarter, an increase of almost 400%.

In the first nine months of the year, the company recorded total volumes in the amount of BRL 751 million. It is worth mentioning here that the quality of this volume is very high due to the segment and the fact that most of the clients received cash within two days of credit transactions.

With evolution of volumes recorded over recent quarters, estimates already indicate that Stelo has 0.2% share of the total market. And this, in only with a few months of operations, which attests our strength and transformational capacity. We expect this figure to reach 1% soon, reflecting the high growth and excellent potential of our fastest-growing market segment. It is also worth mentioning that regulatory approval only just occurred in mid-September, so the full consolidation of Stelo operations will not take place until next quarter.

Now, I will hand the call over to Victor who will discuss the quarterly figures. Victor, please go ahead.

Victor Schabbel {BIO 17149929 <GO>}

Thank you, Clovis. Well, thank you, everyone, for joining us today.

On slide 7, I will talk a little bit about the financial highlights. On the chart on the left, we have net revenues expanding by 1% year-over-year. This was mostly a result of the decline seen in our merchant acquiring business at Cielo Brasil where the net revenues came down by almost 10% and were basically offset by a stronger performance of both Cateno and other subsidiaries, right?

As a result, we posted during the quarter an EBITDA figure that was 11% lower year-over-year and basically led our margin to roughly 39% from 44% a year ago. This margin decline, again, was driven by our merchant acquiring business where we keep seeing competitive pressures bringing down the margins and the profitability of the business, and was basically offset by growing top line and growing margins at Cateno, right, which basically helped a little bit of the margin pressure on the merchant acquiring side.

It's worth highlighting here that having Cateno, having other businesses, is part of our strategy of exploring the payment industry in a more diversified way, not to be 100% exposed to a single segment, right? So we are now getting the benefits from that.

Net-net, as a result, we had adjusted net profit, and here we are adjusting for non-recurring items totaling almost BRL 20 million after tax during the quarter, right, as a pecuniary contribution to the antitrust authorities. As a result of this adjustment, the earnings of the company reached BRL 813 million in the quarter, being flat on a sequential basis as we have been basically funneling through the market, right? And this basically means a contraction of roughly 20% on a year-over-year basis with our margins coming down further also compared to the same period of the last year.

With all of that said, I would like to move forward to slide number 8 where we discuss in more detail the revenue yield trends that were the main – I would say, that was the main factor behind the results that we posted last night.

Historically, for the sake of (00:17:14), with the chart on the right, so taking a closer look at the sequential evolution of the revenue yield, we once again can see that rental revenues were again the main drag of our revenue yields, with a 4 basis points negative contribution to the overall figure. This is basically a consequence of, on the positive, the stabilization of our POS base. That, however, has been coming at the expense of greater discounts, right, due to the more competitive environment, right? So this should continue to be the trend going forward. We will continue to work on the recovery of our POS base and also volume growth, and this naturally will be followed by further pricing pressure.

As a result, in the quarter we already had, as the price factor, as the second most relevant in terms - or most relevant for the contraction of our revenue yields contributing alone for 3 basis points of the contraction during the quarter, right? Again this was the result of the more competitive environment that we have been seeing in our merchant acquiring business mainly since May when we saw not only the newcomers being aggressive, but we saw some of the other incumbents large players following a more aggressive strategy.

So, now we have all the players, not only the newcomers, but even the other incumbents being very aggressive, and this is the reason why we are reacting and this is the reason why further pricing pressure should be expected, right?

So with these highlights being said, we - I would only add, the continuous contribution of the Quick

Credit Payment through the yields this quarter again with another 1 basis points contribution. This is something that we will continue to see, but as a result of these two big factors, rental revenues and MDRs, that are under pressure due to this more competitive environment, we saw our revenue yield declining to 1.01% from 1.07% in the second quarter of this year.

So, with all of that said, I hand back the call to Clovis, and thank you all for joining us.

Clovis Poggetti Junior

Thank you, Victor. Before I open to Q&A session, I would like to briefly discuss our guidance.

In the first nine months of the year, adjusted by the Multivan effect, we recorded a 4.5% growth of financial volumes captured by Cielo, slightly lower than the 5% to 7% growth expected for the year. Concerning total cost and expenses, we remain committed to achieving greater operational efficiency. Therefore, the numbers in the quarter up to date are 1.2% growth over the first nine months of the year, slightly below the level of 2% to 4% expected for 2018.

And finally, we must comply with our guidance of CapEx since we already invested nearly BRL 200 million through the end of September, and we expect to be close to our range of BRL 300 million to BRL 400 million for the year.

With all that said, we are now ready to take your questions.

Q&A

Operator

Ladies and gentlemen, at this time we'll begin the question-and-answer session. Our first question today comes from Carlos Macedo from Goldman Sachs. Please go ahead with your question.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Thanks. Hi, Clovis, Victor. Thanks for taking questions. I want to talk first about the competitive environment. Obviously, the IPO of Stone and information that came in (00:21:55) showed us they are growing at a very fast pace in the SME market, which is the meat of the market, and stealing clients from everyone, though I have to assume given you're very large market share that most of the clients that they're taking are from Cielo. It appears that there's been - well, you showed that there's been some stabilization on your merchant base. That's been happening largely because you're adding clients at Stelo, that's a different market. You're still losing clients in the traditional Cielo business. Is there something to do there? Is there a way to recover that? Obviously, when you look at Rede and Getnet, they're also growing at a faster pace than you are, and that goes beyond the Multivan product. And is there something that you can do? Is it a matter of price, that you've lowered it? Is it matter of changing the product? Is it matter of distribution? What can you do there?

Second question, the dynamics in the receivables in the prepayment business, you certainly had a lot of erosion not only on the pricing but also on the volumes - on the relative volumes. Could you talk a little about what you expect will happen in that business going forward? Is that being subject to competition as well, and whether you think that there could be further pressure in the next few quarters? Thanks.

A - Clovis Poggetti Junior

Thank you for your question, Carlos. Regarding your first question, allow me to give one more step back. (00:23:22) company had been investing a lot in the last few years to have, as I mentioned earlier, in a more modern platform from a technology standpoint to have the right products and services that's giving us the privilege of being the player with the most comprehensive portfolio of products, services and brands in Brazil. The company invested a lot to have, let's say, the best capillarity based on, let's say, our distribution network.

More recently, through Stelo having such a different model supplying demands, merchants, individuals demanding, let's say, to buy a POS instead of renting. So, okay, we developed this with prepaid cards, services and solutions and plans. Even more recently, the company had decided to invest more in marketing initiatives. All of that said, just to hang for us, maybe the last piece in this puzzle was to reposition the company from a competitive and commercial standpoint. You are correct. In the bottom of the pyramid, we have been doing very well, getting traction, but we have been losing, let's say, some traction and some share in the mid part of the pyramid. We are quite confident. So, what we can do? I think we are already doing, which gives us the confidence of, let's say, recovering part of what we have been losing in the last couple of quarters in this small and medium merchant segment.

A - Victor Schabbel {BIO 17149929 <GO>}

In regards to the second question, before jumping into it, Macedo, would also take advantage of part of your question as you discussed a little bit what has been going on in regards to our POS base compared to the number of clients or our client base, the different behaviors that you have there. There, clearly, what we are still having is the influence of our stronger performance in the large account segment, right, bigger clients that tend to use more than one device, right? As a result, our POS base at Cielo alone has been stabilizing, following our expectation now in the third quarter.

It's worth highlighting that in the last month, September over August, we already had a recovery, an increase in the number of POS terminals at Cielo alone. But we are still seeing a smaller decline on a sequential basis in the number of clients because there in the medium-sized merchant segment or even the small-sized merchant segment, there is a few more to come in terms mainly, as Clovis said, of a more active, assertive or maybe aggressive if you want, pricing strategy going forward to react to the market circumstances.

With that said, moving to the question, without POSs, you don't get the volumes. Without the volumes, you don't get the prepayment, right? With this basic rationale behind or in mind, it's possible to talk a little bit about the prepayment trends seen recently. We increased the exposure over time to the larger account segments, which reduced the pull for us to do more of the prepayment. This has been a headwind that we have been working on, although in the small-sized and mid-sized merchants, we have been increasing the penetration, right? So we are becoming increasingly exposed to that segment, which is more profitable in the prepayment business. Not to mention the evolution of Stelo where we do have all of the clients getting their money into base, which is another positive for the prepayment exposure.

So, going forward, we should see, or you guys should expect greater efforts from our side to boost the performance there in these products as well, being more competitive as well. So increasing the penetration, offering more to processes as much as we can, under more competitive terms in order to regain the ground against the part of – at least part of the market share loss in the mid-sized merchants in the mid of the pyramid, as you mentioned.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

And just going back, I mean just to understand this, this reposturing in this middle of the pyramid, is that something – you said it was something that happened already in the third quarter? Or is that something that we should expect going into the fourth quarter?

A - Victor Schabbel {BIO 17149929 <GO>}

Something that has already started during the third quarter. Started mid-August, to be precise. So you will see a much more relevant impact probably starting in the fourth quarter.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Okay, and it's mostly as you said, price? But is there - I mean, and advertising? Is that - are those the two channels that you're using?

A - Victor Schabbel {BIO 17149929 <GO>}

Yes. This is the combination. So you should expect lower prices going forward and higher marketing expenses going forward.

Q - Carlos G. Macedo {BIO 15158925 <GO>}

Okay. Thank you, Victor. Thank you, Clovis.

A - Victor Schabbel {BIO 17149929 <GO>}

Thank you, Carlos.

Operator

Our next question comes from Felipe Salomão from Citibank. Please go ahead with your question.

Q - Felipe Gaspar Salomão

Yeah. Sure. Hi, Clovis, Victor. Good afternoon. Thanks for taking my questions. I have two questions. The first one is regarding prepayment revenues. So, Cielo decided to leave SCG and a longer respect banking lock agreements. What does this should mean in the mid- to long-term in terms of prepayment revenues and prepayment volumes? Should we expect an increase in the prepaid volume as a percentage of credit volumes over time? And is the company allowed to negotiate individual contracts with the banks and continue to respect banking locks, but no longer under the SCG rules? This is my first question.

And the second question is regarding Stelo. So the number of active devices reached close to 100,000 devices, mainly thanks to the commercial efforts from the parent banks. For the Stelo device that were distributed by the banks, who has been prepaying those receivables, Cielo or the banks? And whenever Cielo starts to sell Stelo devices to micro merchants with no relationship with Bradesco and Banco do Brasil, who will be prepaying those receivables, Cielo or the banks? These are my questions.

A - Victor Schabbel {BIO 17149929 <GO>}

Well, thanks, Felipe. We had some, let's say, internal problems when getting your question. We will kindly ask you to repeat the second one. I know you talked quite a lot when asking it, but sorry for that. I will start with the first one about the prepayments, and sorry if I missed something, so feel free to follow up. You asked about the SCG and our decision to leave the system of collaterals in Brazil. Here, the decision was clearly made in full alignment with our controlling shareholders because we were basically in a great disadvantage compared to our competitors, mainly those new ones that were not respecting the system. So they were basically prepaying whatever the clients have no matter if the clients had the receivables as collateral for a loan, for example.

So we were respecting – we were limited in terms of doing the prepayment for these types of customers. So that's why we decided in order to fight back these competitive pressures, we decided together with our controlling shareholders to leave the system in order to be able to compete head-to-head with the newcomers.

As a result, although we are not, let's say, guiding the market, we are not talking about the potential for this initiative, as a result of that, we will probably be able to prepay more and over time increase the prepayment penetration to the credit volumes that we have. During the quarter, we have 17% prepayment penetration when both the prepayment and the (00:33:07) Quick Credit Payment product is included. So we had a 17% penetration. (00:33:15) increased further because of the decision of leaving the SCG, the system of collateral. So the trend is positive in that sense. So the pool will increase because of that, and we will be able also to be more competitive compared to the other players.

Now, I would kindly ask you to repeat the second question because, we unfortunately, missed it here.

Q - Felipe Gaspar Salomão

Yeah. Sure, Victor. I hope this time the audio quality is better, and thanks for answering my first question. So my second question is about Stelo. So, there are already more to – close to 100,000 Stelo devices operating, and this was mainly thanks to the commercial efforts led by Bradesco and Banco do Brasil. So my question is, for the Stelo devices that were distributed by the banks, who has been prepaying the receivables, Cielo or the banks that sold those devices? And whenever Cielo starts to sell Stelo devices to micro merchants that are not clients of Bradesco and Banco do Brasil, I just want to confirm that Cielo will be prepaying those receivables and not Bradesco or Banco do Brasil. This is my second question. Thanks.

A - Victor Schabbel {BIO 17149929 <GO>}

Thanks, Felipe. We are the ones prepaying at Stelo, so not the banks. With Cielo Stelo, we are the ones prepaying the receivables (00:34:50).

Q - Felipe Gaspar Salomão

Okay. Thank you, Victor.

Operator

Our next question comes from Lucas Lopes from Credit Suisse. Please go ahead with your question.

Q - Lucas Lopes {BIO 18956724 <GO>}

Thanks for the opportunity. I have two questions as well. Firstly, in October, the gap on the debit interchange became valid. So I'd like to know how the company has been behaving. Has it passed through the whole decline interchange with the gross MDR considering the competitive dynamics you mentioned, or should we expect some margin expansion or some (00:35:30) increase in the merchant acquiring business and the net impact should – Cielo, our consolidated figures should be positive at least in the short-term?

And my second one, the new entrants have been claiming that they have been gaining market share, but only because of lower prices but also because of user experience. So, Stone, for instance, they have disclosed some very good NPS (00:35:53) figures during the IPO. Do you agree with that? Do you believe that you also have to catch up in terms of user experience, or it's – or basically a matter of pricing, and now that you've became more aggressive, is it enough to regain part of the market share lost?

A - Clovis Poggetti Junior

Hi, Lucas. Regarding your first question, the cap of the debit interchange. Let's see, what we said in previous quarters, in Cielo we should see a benefit in the first two to three years. But then having a negative effect in Cateno, okay. And taking both together, should be neutral. Now, with such new competitive dynamics, let's say that the benefit that I mentioned regarding Cielo Brasil may be passed through the merchants faster.

A - Victor Schabbel {BIO 17149929 <GO>}

Lucas, thanks for the question again. In regards to the second question, about the – in theory, superior experience of our competitors' clients, we have to say here that as the leader, as the largest acquirer in the country, operating for a long period of time, we are basically serving everyone everywhere, right? So it's way more challenging to be all around and providing the customers with adequate and good level of services. While for those that are small, that have 100,000, 200,000 clients, to say that they are serving better clients that are more regionally concentrated, which should be seen as a weakness for them because it creates the room for the incumbents, for large players like us to more properly react and go for them, right, so because they are more regionally concentrated than us.

So I would say that the experience, given our track record, given the strength of our brand, and probably the strength of our brand is a good indication of how our services are well seen and respected by our customers. So I wouldn't see this as a big advantage for them over us. I would clearly say that they have been growing, mostly due to very aggressive pricing strategies on both rental and MDRs, taking advantage of the prepayment revenues to make their profits, right?

So, given this approach, they have been growing. Now, given the move seen in the market as well, we are reacting to that as well. So I wouldn't be saying that quality of the service is a big differential. No. It's basically their pricing strategy that worked for a while. And our idea now is to react to that and basically show that there are some limits for this strategy. (00:39:31)...

Q - Lucas Lopes {BIO 18956724 <GO>}

Thanks, Clovis. These are – go ahead (00:39:33).

A - Clovis Poggetti Junior

One last comment. When I asked Carlos a question, I mentioned that maybe we had such a last piece in this puzzle that was repositioning the company from a competitive and commercial standpoint.

Having complete this, I would say to you that we are quite confident, because we have the products, we have the presence, we have the distribution networks, robust ones, capillarity. We have the knowledge (00:40:09) of the business, and also let's say some (00:40:15) spirit.

I really believe we are in a very good shape to operate in these maybe new environments, okay? And as Victor just mentioned, if somehow in certain regions, locations for certain segments, we may have what is being said, on a disadvantage, I have also no problem in, let's say, turning such disadvantage in a advantage, very fast. So my point is, we are okay and confident with what is ahead of us. That's my comment, okay?

Q - Lucas Lopes {BIO 18956724 <GO>}

Thank you, Clovis, Victor, for interesting points.

Operator

Our next question comes from Alex Spada from Itaú BBA. Please go ahead with your question.

Q - Alexandre Spada {BIO 16687974 <GO>}

Hi, gentlemen. Good morning or good afternoon. Thanks for taking my question. Clovis noted in his initial remarks that Cielo intends to maintain its leadership position in the Brazilian market. Also when we look at Cielo Brasil, which separates the pure foreign (00:41:42) business from the subsidiaries, the EBITDA margin, even just considering (00:41:46) the prepayment business, has been recently close to the 50% level. With that in mind, my question is the following. If necessary, how much margin the company is willing to sacrifice to maintain its leadership position? Or alternatively, if you had to make a choice, would Cielo prefer to lose market share to maintain margins or maintain margins and move market share?

A - Clovis Poggetti Junior

Spada, (00:42:20).

Q - Alexandre Spada {BIO 16687974 <GO>}

It's the opposite. I'm sorry. Lose market share maintaining margins, or lose margin to maintain market share, apologies.

A - Clovis Poggetti Junior

Thank you, Spada. I would summarize the answer in the following way. Margins may go down as much as needed in order to the company, let's say, reach its objective that is defending or protecting the leadership where we are already leaders, and taking the leadership position where we are still, let's say, we're not yet.

We may be – we are taking tough decisions, let's say, aiming at the sustainability of the business, let's say, and aiming at being relevant, being a relevant player in a medium to long-term scenery. And if the cost of such a decision is – somehow affect the short term, let's say, okay, that's the way the whole industry is performing and behaving as we speak.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. And one follow-up here. Cielo's leadership in terms of market share is quite wide relative to the second player, (00:44:01). So, it's possible to lose market share and probably remain the leaders. Is that a scenario you have been considering when you think of this leadership, or when you think of leadership, you're actually planning to try to sustain your market share above the 50% level – I'm sorry – above the 40% level, which is where you stand now?

A - Victor Schabbel {BIO 17149929 <GO>}

Thank you, Spada. Looking at the averages can be quite misleading. When we look at Cielo's market share in the whole (00:44:37) industry, we doubtfully are there with our 40-plus percent market share. But the idea is not only to sustain that leadership. The idea is looking on a segment-by-segment basis, so looking at the small merchants, at the mid-sized ones, at the big guys, at the micro-entrepreneurs. The idea is to be the leaders in all of the segments.

And depending on the segments that we look at right now, our leadership position is not as wide, or the gap to the second is not as wide as the overall market share that we have suggest, right? So that's why we are making the tough decisions, as Clovis mentioned, to be extremely competitive, responding to the offense that was first coming from the newcomers, and now it's coming from basically everywhere from the other incumbents as well. So we are basically responding to it, and I think as Clovis said (00:45:44) properly, the key message is that the margins...

[Technical Difficulty] (00:45:50-00:47:55)

Operator

And everyone, I have reconnected the speaker line. Please proceed.

A - Victor Schabbel {BIO 17149929 <GO>}

Sorry, guys. We had some internal problems here with our lines. So we are back, just to finalize the answer here for Spada's question, in summary, following what Clovis basically mentioned, we are going to have our margins coming down as much as needed for us to sustain the leadership position in all segments, right, not only the leadership in the overall market as the average market share basically suggests.

Operator

And ladies and gentlemen, our next question comes from Rafael Frade from Bradesco. Please go ahead with your question.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Hello, everybody. I have two questions. The first one is related to the Stelo. So Clovis mentioned in the initial remarks that there were some problems related to availability now solved, and now you should be stronger on November. I'd like to understand a little better what - if now it's really - it's the new date, because we have (00:49:09) being postponed for a while starting with the - this big campaign after the work curve (00:49:15) and then new date. So if there is any date that we should follow here?

And the second question is related to the Cielo base of POS standalone (00:49:26). I would like to understand if you are start to sell - if you were selling Cielo POS, then how relevant this is in the base if it's something that's relevant or not? Thank you.

A - Victor Schabbel {BIO 17149929 <GO>}

Thank you, Frade. Yes. We have at the beginning of the quarter, between July and August, problems in regards to the availability of terminals to be sold at Stelo. And this was not a problem only faced by Stelo. Other players in that market were facing constraints in terms of the supply of POSs. These constraints, at least in our case, have been addressed by the addition of new suppliers, right? And right now in November, we already have a capacity of 100,000 devices that can be sold on a monthly basis, right?

So we already added to our capacity. This should help us accelerate the growth base there at Stelo, a growth base that during the quarter would have been better if we didn't have to, let's say, slow down the pace due to the restricted availability of terminals and the long lead time for the terminals to be delivered.

In regards to the marketing strategy, we will probably invest more and more going forward. So during the third quarter, we had some product launching. We had this problem with the constraint of the availability of terminals, which impacted the amount of marketing that we could make in an effective way. So probably, going forward, you guys are going to see more and more Cielo, Stelo, whatever in the medium (00:51:26).

This is something that we are not going to disclose. We are not going to disclose and talk anymore about the channels and the way we are going to communicate our strategy, because it has been increasingly strategic for any acquire (00:51:43) to work with marketing space, marketing time (00:51:48), in the TV, so we are not going anymore to talk much about that. But the idea is to keep investing in marketing going forward, and probably investing more in the upcoming quarters mainly when compared to the numbers we had now in the third quarter.

A - Clovis Poggetti Junior

And Frade, can you just repeat your second question, please?

Q - Rafael Frade {BIO 16621076 <GO>}

Sure, Clovis. We heard from some of the banks that they were selling POSs. I understand that's both Cielo and Stelo POS. So I would like to get a sense from your base Cielo standalone, how much of those POSs were sold? It's something already relevant in your base, it's something that we maybe – we will have more a mix of new POSs being more sold than rented, so just to give a sense of what's going on your Cielo standalone base.

A - Clovis Poggetti Junior

Allow me to also take advantage of your question to explain what is our strategy and positioning in terms of the brands. The idea is to have Stelo as a channel, let's say, to address the demands in the base of the pyramid, let's say, clients, individuals, and small merchants that demand the very basic products, okay? When we go to the mid part of the pyramid and segments above that, what we have is Cielo, let's say, offering more complete solutions and also, let's say, better services.

That's the idea. Remember, I mentioned in previous quarters, in previous calls that in the past, Cielo had a kind of one-size-fits-all strategy, and then we also mentioned that in the last two years, company has been investing a lot, let's say, customizing its offers. The idea is to whoever demands a premium, let's say, service to be the best partner of such emersion (00:54:00), to whoever demands a basic one also to be the best partner. What we had been seeing and perceiving is there was also demand, let's say, merchants that wanted to buy devices. Under the Cielo, let's say, brand umbrella, so why not offering the same, okay? Respecting the segmentation that I just mentioned to you, I have no issues with that. And our last comment is that that is not irrelevant (00:54:38) because we stopped selling devices a couple of weeks ago.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Thank you.

Operator

Our next question comes from Guilherme Grespan from JPMorgan. Please go ahead with your question.

Q - Domingos Falavina {BIO 16313407 <GO>}

Hi. Thank you all. It's actually Domingos here on the team. Just first I wanted to thank management and IR for being accessible and open to us even during more difficult times of competitive dynamics. It does mean a lot to us here.

My question is actually in regards to your competition. I don't think it's very clear to us exactly how you sell other than the bank, so if you could comment a little bit on your distribution, meaning like, do you have also distribution office spread around the country, how many of those – how large is your commercial sales force today, just so that we understand a little bit better what kind of tools you have at hand to fence off some of the competitive threats?

And the second question is, it seems pretty clear to us that the tone has changed, continues to change, I guess, and that Cielo may be willing to go lower in terms of POS rental price and even in the hard-to-retain clients. My question is that when we compare some of the estimated average POS rental prices for Cielo versus some peers, there is substantial difference, 30%, 40%, 50%. Are you willing to go that low? Are you willing to cannibalize that much that you expected (00:56:10) to retain the clients? Those are my questions. Thanks.

A - Victor Schabbel {BIO 17149929 <GO>}

Thanks, Guilherme (sic) [Domingos] (00:56:18). Well, if we got everything properly, because it cut off a little bit, first, with your first question, in regards – well, first, thanks for the kind words. And now, in regards to the question, the first one, in terms of structure and channels that we have been using to access the clients, we continued to take advantage of the strong distribution capillarity that the banks have been providing us with recently, and we [ph] can't (00:56:58), let's say, say it's here now, because it is in the process of being, let's say, formalized in a quite advanced stage.

We signed an agreement with Caixa to sell POS terminals through their branch networks as well. So we are strengthening the partnerships that we have with the banks. So this is an important channel. We do have over 1,000 salespeople on the street selling our products, and this has been strengthened also in the last months, and we'll keep moving that direction as well. We are not going to disclose much details about the number of new salespeople that we are adding to our sales force because also, this is strategic, but the idea is that, yes, we are doing it.

And in terms of, let's say, centers where we provide the service, where we have the distribution, we have a few Cielo stores located in key regions for clients to directly go to the stores being served directly by us. They're in a big shopping mall here in São Paulo, Ibirapuera shopping mall. We do have a store there and we have other examples. We have other places, distribution centers, spread out in the country, right, in the 27 states that we have here in Brazil.

So we do have physical infrastructure to distribute our services, and also we rely on digital channels, our website, our call center that have been enhanced from time to time in order to provide the best service possible to our clients. So we don't see a gap here compared to what the others are doing, something that we have already been doing quite a lot. So this is something that is already standard for us.

If I go to your second question properly talking about the POS rental revenues, we have been offering discounts as the whole industry has been doing, offering some, let's say, exemptions for a certain period of time, offering the second or third device for free, things like that in order to attract more clients or retain the clients. So this has been driving the average prices down. This is the reality of our industry, and this is also a consequence of this more competitive environment that we are facing. So feel free to follow up, because, as I said, it cut off a little bit.

Q - Domingos Falavina {BIO 16313407 <GO>}

No, this is super clear. Thank you.

Operator

Our next question comes from Eduardo Rosman from BTG. Please go ahead with your question.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi, guys. I have one question, and it's kind of a – in a way, it's kind of a follow-up on Spada and Domingos' questions. I just want to know if the management compensation is going to change or not. Historically, we know that compensation was really based on profitability, right, EBITDA growth, and bottom line. So I want to know if you believe that compensation and the goals for the top management should change as well given the environment. Thanks.

A - Victor Schabbel {BIO 17149929 <GO>}

Well, this is a topic that is taken care directly by the board. We don't have, let's say, any news in terms of any change in that regard. What we do know is that we will continue to have our compensation linked to long-term value generation, so with variable component linked to to (01:01:06) the share price. So this is something that will continue like that. Given the circumstances, probably the board might revisit some of the short-term goals in order to retain the management team. But there is no change, at least not that we are aware of. Again this is a topic discussed by the board, that there might be a change in the remuneration structure.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay, Victor. Thank you very much.

Operator

And our final question comes from Rafael Frade, as a follow-up, from Bradesco. Please go ahead with your follow-up.

Q - Rafael Frade {BIO 16621076 <GO>}

Hi. Thanks for taking my question. Just a follow-up on Domingos' question. Victor, you mentioned that you reached an agreement with Caixa to sell POS with them. So I'd just like to understand if there were in the past some discussions about to have some kind of exclusivity with Caixa, so if you could elaborate a little more on this. And secondly is a follow-up from my previous question, was not very clear that you mentioned that you start to sell POSs because of – for some clients would make sense, but in the recent weeks, do you stopped to sell POSs on scale (01:02:22)? So just to be clear, reverse selling or not POS? Thank you.

A - Victor Schabbel {BIO 17149929 <GO>}

Yes, Frade. You heard right. We are selling POSs at Caixa. There is no exclusivity agreement, right? So in the industry right now, exclusivity agreement is a bad word. So there is nothing like that. This is only an agreement for us to be able to sell POSs, and that's right, selling, not renting POSs. POSs developed together with Caixa in order to serve them the way they wanted. So they had a demand coming from their clients, right, using their brand, right, in order to fulfill their needs. So their clients were willing to buy, and they were willing to sell POSs with their own brand. So that's the agreement that we arrived at. We see this as a positive. It enhances our network, improves the relationship with a long-lasting and very important partner of ours, so we are very happy about it, and we are moving forward in that direction.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Perfect. Thank you.

Operator

And ladies and gentlemen, at this time, we'll conclude today's question-and-answer session. I'd like to invite Mr. Clovis to proceed with his closing remarks. Sir, please go ahead.

A - Clovis Poggetti Junior

Thank you very much, everyone, for attending our earnings conference call today, and see you all in the next call. Thank you.

Operator

Ladies and gentlemen, that does conclude today's conference call. We do thank you very much for participating. You may now disconnect your lines.