Q2 2012 Earnings Call

Company Participants

- Clovis Poggetti, CFO/IRO
- Roberta Noronha, IR
- Romulo de Mello Dias, CEO
- Unidentified Speaker, Unknown

Other Participants

- Carlos Macedo, Analyst
- Daniel Abut, Analyst
- Eduardo Nitsu, Analyst
- Matthew O'Neill, Analyst
- Paulo Ribeiro, Analyst
- Saul Martinez, Analyst

Presentation

Operator

Good morning, everyone and thank you for waiting. Welcome to Cielo's Second Quarter 2012 Earnings Call. This event is being recorded and all participants will be in a listen-only mode during the conference presentation. After Cielo's remarks, there will be a question and answer session. At that time further instructions will be given. (Operator Instructions)

This event is also being broadcast live via webcast and maybe 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 has 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 is finished.

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

Investors and analysts should understand that conditions related to macroeconomic conditions, industry and other factors could also cause results to differ materially from those expressed in such forward-looking statements. Now I'll turn the conference over to Ms. Roberta Noronha. Ms. Roberta, you may begin your presentation.

Roberta Noronha {BIO 20488075 <GO>}

Hello. Good morning. I would like to thank you all for joining us as we present our results from the Second Quarter of 2012. With me today are Romulo de Mello Dias, our CEO; Clovis Poggetti Junior, CFO and IR Officer; Eduardo Chedid, Executive Vice President of Solutions and Business; Roberto Dumani, Executive Vice President of Organization Development, Dilson Ribeiro, Executive Vice President for Retail Business, also the IR team and the finance team are here present. Now, I'd like to turn it over to Romulo.

Romulo de Mello Dias {BIO 2054119 <GO>}

Good morning. Thank you for joining us for another results conference call. The Q2 of 2012 had a solid operating performance and we once again showed our commitment to our strategy of differentiation by announcing the new Crediario product in the agreement for acquiring Merchant e-Solutions. We can see the highlights of the quarter on slide three.

Net income totaled BRL549 million, up 30% year-on-year with net income margin at 37%. Adjusted EBITDA was BRL914 million, up 27% over the same period of 2011 with margin at 62%. Our financial volume grew 23% according to the two criteria we work with, the market criterion in which all installments are recognized at the time of purchase and the accounting criterion.

In the same period, credit volume was up 25% to BRL59 billion. Debit volume was up 19% to BRL 33 billion. Out net operating revenues plus prepayment of receivables was BRL1.5 billion, up 31% over Q2 of last year. The US rental revenue increased 35% year-on-year reaching BRL356 million. In Q2 we innovate once again launching the Crediario product in a partnership with Banco do Brasil and Bradesco.

We believe that this is a very important product facilitating access to credit and it can grants benefits to Cielo by increasing the financial volume that can be captured by our network. We also announced an agreement for deposition of 100% of the capital stock of a US company called Merchant e-Solutions, a global provider of payment solutions re-enforcing our strategy of differentiation and strengthening our product and service portfolio. On the next slide, they will give you more details on the announcement.

Also during this quarter we won the biggest and best award from Exame magazine for the sixth consecutive year as the best specialized service company. The Company was also chosen for the second consecutive year as one of the best companies to start your career by the Voce S/A magazine and it is also featured for the second consecutive time among the 20 most valuable Brazilian brands according to the ranking by Brand Analytics/Milward Brown released by Istoe magazine.

On slides 4 and 5, we have details of the Crediario product. As previously mentioned, the product is a pre-approval credit line for account holders of partner banks that can be accessed via their bank cards and financing simulations can be done at the POS. The product is currently available for Banco do Brasil and Bradesco (inaudible). But in the future other banks such as HSBC, Caixa Economica Federal and others may offer it as well. Just to highlight how important this product could be, both banks have provided BRL100 billion for this credit line.

On the next slide, number 5, we highlight the benefits for those involved in the Crediario installment. Merchants can offer an additional payment method without having to finance the card holder thus selling more and increase in their average ticket while improving cash flow as payment is received on the following day, just as in a debit transaction.

For the card holder, it is an additional credit line with more attractive interest rates and the possibility of simulations at the POS so that he or she can cash for the best payment term which can reach up to 48 months in the settlement date. And finally for Cielo, we should capture these additional volume with a similar MDR to the credit installment.

On slide six and 7 we've addressed in more detail our second major announcement for the quarter, the agreement we signed with Merchant e-Solutions. We have no Merchant e for about two years. When we start a product we identify the best auction among existing acquiring platforms in the market.

Merchant e stood out due to its unique solution, which was developed from scratch for the acquiring sector by an experienced group of former executives from Bank of America Merchant Services. We will pay their position amount on the agreement date, which should be in Q3 of $670 million. The amount stands for 11 times the project (inaudible) for 2012.

On slide 7, as you can see, Merchant e revenues reached $14 billion with 130 million transactions processed in 2011 and more than 70,000 affiliated merchants. Last 12 months revenues considering May of 2012 was $124 million.

The adaptation of the Merchant e platform to the Brazilian market, we will also be able to offer top notch service and ensures more automation of back office process and flexibility for the development of new products guaranteeing a fast time to market. Merchants will have the option of new solutions and new relationship and service models such as online interaction with almost real time information on financial statements and reconciliation, for example.

On slide 8, we have more details about our Second Quarter performance with the key indicators and their comparisons. As I have mentioned, our volume growth was 23%, it is still resilient mainly over the industries growth. Year-on-year revenues were up 31% and Q-o-Q 5%. In this quarter our total operating expenses increased mainly due to sales and marketing expenses. This increase was 94% year-on-year and 78% Q-o-Q. It's important to register that a significant portion of these expenses occur given the increase in Cielo's financial volume. As we mentioned in our Q1 conference call, part of those expenses were postponed.

We still expect that sales and marketing expenses will represent about 4% of total net revenue in 2012. Total unit expenses, net of subsidiaries with expected (inaudible) for 2012 share with the market increases by 18% to BRL0.44. However, considering the first half of the year, we are the providers of guidance of $0.41 per transaction. Finally, regarding MDR, as you can see, the blended increase of 1.5 basis points year-on-year and decreased 2.7 basis point Q-o-Q.

The reduction is justified strictly to the following reasons among others. First, a higher participation of debit cards volume in this quarter. Second, by the growth of the large account segments within Cielo's portfolio which for having lower MDRs reduced the average. And finally, given the higher participation of the regular credit in the overall credit volume as a result of our accounting method, that results in the Christmas installments being recognized in the First Quarter.

Just to remember, the Agricard products corresponds to credit lines, use it to impact negative business made available at Banco do Brasil to farmers through debit cards. Given the nature of the products in the second and the Third Quarters show higher volumes due to the harvest seasonality. Such product tickets are usually very high but with low MDR resulting a decrease of the average debit MDR.

I would like to take the opportunity to anticipate some movements that should impact our next quarter results. As we have mentioned before by our IR team, we have observed a more aggressive behavior from our main competitor. Though due to this aggressiveness we are aware that we have lost some major accounts and that will have an impact on our next quarter's volume.

Now, I'd like to go to Clovis who will take it from here with more detail.

Clovis Poggetti {BIO 16529642 <GO>}

Thank you, Romulo. Good morning to you all. On the next slide, number 9, on the upper-left we can see the 17% growth in the number of transactions as compared to the same quarter of 2011. On the right, we have the 23% increase in the transaction financial volume for credit and debit transactions captured in the quarter which totaled BRL92 billion.

It is important to mention that due to our accounting method, it's not correct to compare the Second Quarter performance to the first one, given that as we recognize volume and revenue at each installment and being so our Christmas is recognizing in the First Quarter. As such we do not present same retail seasonality and we have more integrated quarters.

And on the left graph of this slide, we have the number of active merchants which are those who have carried out at least one transaction in the last 60 days. And that reached 1.3 million, up 4% quarter-on-quarter and 13% year-on-year.

On slide 10, we have the evolution of our commissions and POS rental revenues. Revenues from commissions grew about 25% or BRL186 million over Second Quarter last year, mainly due to the increase in financial volume. The debit and net MDR decreased 2.3 basis points over the First Quarter this year and as already anticipated by Romulo this reduction is due to the greater participation of the Agricard product that is unique to Cielo and have a differentiated twice.

The credit net MDR decreased 2.6 basis points quarter-on-quarter due to a stronger participation of the larger retailers in our volumes and the variation of the product mix between regular credit and credit installments with a greater share for the regular credit in this Second Quarter. The variation is usual in the period because as mentioned before the Christmas sales installments are recognized in the First Quarter this year. POS rental revenues were up 34% year-on-year which is 17% increase in the installed base and a 14% increase in the average rental price which amounted to BRL75 per month per POS.

On slide 11, we have some information about our pre-payment of receivables operation, which has grown readily with stable levels of return. In the first graph prepayment of receivables generated BRL212 million in revenue, up 54% over the Second Quarter last year. In the second chart the financial volume of prepaid transactions was BRL6.2 billion representing 10.5% of our total credit volume. The average term of these operations grows from 56 to 58 days in the Second Quarter this year.

On slide 12 let's look at our cost performance. The cost of service provided reached BRL408 million in the Second Quarter up 19% over the same quarter of 2011 and up 2% over the First Quarter this year.

We have a cost analysis here where we made impact of our subsidiaries in additional brand fees. Just to remind you, this is key to compare Cielo's performance in cost reduction on an equivalent basis. As a result of this analysis, we can see that the absolute cost is up 11% year-on-year and 3% quarter-on-quarter. Analyzing unit cost by the same method cost would have fallen 5% year-on-year.

And finally, if we exclude depreciation to eliminate the fact of the change in the POS mix, the reduction of the unit cost would have been a significant 9%. Under the same analysis but compared to the First Quarter this year, the unit cost would have increased 2% the same level if we exclude the depreciation.

On slide 13, we have our operating expenses. These reached BRL224 million in the Second Quarter, up 94% and 78% year-on-year and quarter-on-quarter respectively. The decline in both the year-on-year and quarter-on-quarter comparisons is chiefly explained by the sales in marketing lines as with postponing some initiatives and comparing in the First Quarter.

Additionally, we will like to point out that this line is also affected by the incentives paid to partners which are strictly related to volume in revenue generation. For 2012, this year, we still expect that sales in marketing expenses will represent about 4% of total net revenues.

With regards to other expenses, we have three events that impacted this line. First, we had some reverse provisions in our Second Quarter last year base -- second, due to the write off of uncollectible POS rental fees. And finally the increase in provision for legal and civil contingencies, these as a consequence of revaluation of the risk of the claims by our lawyers.

With regards to the write-off of uncollectible POS rental fees, it happened due to a revision of the criterion applied to the calculation impacting this quarter in roughly BRL11 million and this should be considered a non-recurring event. It's also worth to highlight that in this quarter, due to the agreement for acquisition of Merchant e-Solutions, we have some one-off expenditures at about BRL15 million.

Adjusted EBITDA shown on the left of slide 14 totaled BRL940 million in the quarter, up 27% over the same period of 2011. EBITDA margin in the Second Quarter was 62%. Net income totaled BRL549 million in the quarter, up 30% over the Second Quarter last year and down 3.1% over the First Quarter this year. Net income margin was at 37%.

And now I'll go back to Romulo.

Romulo de Mello Dias {BIO 2054119 <GO>}

Very satisfied with our business model we continue to strengthen it with initiatives such as those recently announced with the release of the Crediario products and the acquisition of the Merchant e-Solutions.

We're going to continue to leverage our competitive advantage as a market leader with a large distribution network of an extremely reliable service, not just in availability but also in security. We continue to focus on innovation through products that effectively add value to merchants and with that build a excellent relationship with them, which we're certain will be fundamental in the new market.

Finally, I'd like to stress our commitment to transparency with the quality in everything that you do respecting all our stakeholders and always guided by the best corporate governance practice to add value for our shareholders. We will face challenging quarters ahead regarding the points that you mentioned during the presentation. But it's important to highlight that Cielo will keep focus in profitability and not in market share like we always did and we are confident that we will deliver it.

Thank you for joining us. And now we'll take your questions. Operator, please.

Questions And Answers

Operator

Ladies and gentlemen, we will now begin the question and answer session. (Operator Instructions) Saul Martinez, JP Morgan.

Q - Saul Martinez {BIO 5811266 <GO>}

On the competitive environment, Romulo, you obviously mentioned the loss of some big accounts to your competitor who has been more aggressive in the marketplace. Is there any way you can share with us some order of magnitude in terms of the potential losses of those big accounts in terms of either volume or revenues and how we should be sizing that up when we're looking at 3Q and 4Q and looking forward?

And then secondly on the POS rental rates, pretty impressive evolution. And you mentioned in the release and I think on the call 42% wireless. And my guess is that's going to continue, that shift is going to continue over time.

But how should we be thinking about the different cost currents there? Obviously competitive dynamics at some point is going to matter in terms of rental rates. But you have the ongoing shift to wireless. What should -- how should we be thinking about that or how are you thinking about the evolution on the POS revenues going forward?

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

Hi, Saul, thank you, sir, for your question. About your -- the first one, some big accounts that we lost, as we said there in my presentation, we will continue to focus on profitability. So we are prepared to lose market share because we do think that the main reason of the Company is to provide the best result for the shareholders. It's the reason why we are focused on keeping some accounts and trying not to lose the profitability of the Company as a whole.

So the numbers that I have today, considering the consecutive win and the loss. And it will take time. Also consider the migration because, as you know, it can lose an account because of the commercial agreement. But it takes time considering the let's say back issues that the clients have to address. But it can take one month, two months or three months. It depends. It's case by case. But big numbers. What we have so far is that we lost around the BRL5 billion total sales volume. But as I said, with lower profitability.

Q - Saul Martinez {BIO 5811266 <GO>}

Okay.

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

These numbers, Saul, didn't appear in the number of the Second Quarter.

Q - Saul Martinez {BIO 5811266 <GO>}

Got it.

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

So we expect, let's say, that this BRL5 billion and let's say and wins and loss that you have, that will appear in the coming quarters.

Q - Saul Martinez {BIO 5811266 <GO>}

That BRL5 billion is an annualized figure? Sorry, is that an annual figure?

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

Annual figures. And as I said, some can migrate now in the Fourth Quarter or some can take more time. But I would expect that in the Fourth Quarter we will present a reduction, a big reduction, regarding the BRL5 billion. Talking about the POS rental revenues, the main reason why we are delivering let's say in our opinion good number in this line is due to the mix.

GPRS is growing and becoming more and more important. Let's not forget that GPRS wireless terminal is a very important solution for the clients, for them, for the merchants. They are less expenses as a whole because they don't have the service that they -- usually they hire from telecom companies. And second the main reason why we are having a good performance in POS rental revenues because of the commercial policy in terms of discount that we -- we did with the discounts we provided to the markets.

Going forward, I would expect that these lines, considering the level of differentiation that you have right now in a market, that these lines would be more effected by the penetration, the higher penetration, of the GPRS, the wireless terminal. And as well in the markets it will depend on the behavior now of our main competitors.

And by the way, I'd like to make a clarification here that when you talk about the big accounts that you lost, we lost the big merchant to our main competitor. But when you talk about the small merchants, the competition comes more from Santander GetNet with Conta Integrada in terms of product, okay.

Q - Saul Martinez {BIO 5811266 <GO>}

Got it, that's helpful, thanks a lot.

Operator

Daniel Abut, Citigroup.

Q - Daniel Abut {BIO 1505546 <GO>}

I want to hear a little bit more on the pricing side, on (inaudible) MDR because in the trust, in this conference call, you can think that a normal expectation for MDR declines could be something in the 580 points per year. And we saw three basis points in just one quarter and credit 280 points in variants. And you explain in your remarks that this is related to particularities.

It is not necessarily to competition, the effect of which (inaudible) we'll detail more in the Third Quarter and should affect more volume than pricing. So I wanted to see in this a more individual competitive environment both from your main competitor as well as from Santander mix that you mentioned, the Conta Integrada, changes that brought guidance for declining MDRs in the four to five basis points per year to something more than that. And therefore what we saw in this quarter is not the outlier. But something more relative we'll likely see going forward.

A - Unidentified Speaker

Hi Daniel, thanks for your question. About evolution of the gross MDR, as we tried to explain during our speech, 2.7 basis points was related to -- we have at some reasons and among them Argicard Second Quarter and Third Quarter they are very strong. Just like to give you an idea, Agricard, they blend the net MDR, they blended, it would correspond to more than one basis points just because of Agricard compared to the First Quarter.

Second about big accounts, as you know, big accounts they have, big merchants they have. Let's say that the players considered the volume that they provided to us and the gain that you have in the market share was in both sides. But mainly in the big accounts.

And the third point that I mentioned was related to the credit in 30 days, which you have a lower MDR when compared to the credit installment that is more strong. In the case of sale, remember, it's very important to point out here that when you make comparison about Q1 and Q2 as Clovis stressed during his speech our methodology recognize that our (inaudible) meaning in the First Quarter.

And the credit installments has a higher net MDR when compared to the credit in 30 days. So these few things together -- we had a reduction 2.7 basis points in the bank. Looking forward and considering what we said in the First Quarter when you mentioned that our expectation would be a reduction between five and seven basis points, I would say that compared to the level of recommendation that you have right now in July to the ones that you had in the last quarter, the First Quarter, I would say that now there is more pressure on the MDR and the big accounts.

It's the reason why I had to say during my speech and as well as I explained to Saul that we lost around a BRL5 billion. When I say lost, net, okay? We lost more but we also won other ones. But we lost around BRL5 billion on an annual basis in the total sales volumes.

So what I'm trying to say that I -- looking forward depending on the reaction that our competitors who have -- we -- who -- I will give you more follow up about that. But our understanding today that we are facing more competition in terms of POS MDR compared to the level considering the last two months and the last three months. Regarding the retail sector, regarding the small and medium-size merchant continue to say we are facing the same competition that you are facing and more from the Santander GetNet with Conta Integrada.

Q - Daniel Abut {BIO 1505546 <GO>}

Compared to sales level on that, that means so far, from what you would expect, a part of this effect will go on the volume side than on the pricing side although that could change later on. At least as far as the short term Third Quarter is concerned, as you explained, the effect would be more on the volume side?

A - Unidentified Speaker

I think so.

Q - Daniel Abut {BIO 1505546 <GO>}

Second, quickly, on your merchant prepayment business, which remains quite strong in terms of the contribution, one thing that caught my attention is that in this quarter you've increased quite significantly the percentage of volume prepaid.

But that came at the expense of some lowering in the average monthly spread which has normally not been the case in June. CLO different (inaudible) very gradually the volume prepaid and cannot re-spend it much more than prices. Was that an outlier what happened in this quarter and would you agree with that decline in the monthly spread too?

A - Unidentified Speaker

The evolution of the merchant prepayment, as you said, we increased the penetration from 10.5%. And the reason why net revenues from this line increased was due to two factors, two reasons. The first is related to the higher penetration. And the second, a higher penetration with the small and medium merchants that were not served by Cielo before. So and about the spreads, when you take a look at the whole, the same thing about the net MDR, concept, when I gave more accounts with the big merchants, the gross MDR, of course, is lower.

When I grow on the prepayment, we are growing more with the small and medium merchants, the Cielo is able to keep as a percentage of CDI was trying to increase because we are working with different type of merchants that, of course, does not have the same access that the big merchants have in terms of the -- when trying to raise funds. So I don't know if it's addressed your question. But how it stand today about the prepayment.

Q - Daniel Abut {BIO 1505546 <GO>}

What we are saying is that the biggest part of the increase in volume prepaid in the Second Quarter from larger merchants this time and therefore that mix affected the overall average monthly spread?

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

No, sorry, I was not -- may be it was not clear. When I made the comparison between big merchants and the small merchants, it was much more related to the gross MDR. I just tried to make a balance. Gross MDR is affected in the case of Cielo because we increase with the big accounts. In the case of prepayment, the reason why we are able to deliver it in our understanding a very good result is because we increase more in the small and medium merchants.

It doesn't mean on the other hand that we didn't increase our participation on the bigger merchants. But we increased more in the small and medium merchants. It's the reason why at the end of the day the nominal interest rate was a very good one in percentage wise. In terms of CDI, we increased a little bit.

A - Unidentified Speaker

Daniel. And just to add on Romulo's comments and to give you a glance, for this Second Quarter for the prepayment transactions, jus 86.4% of the transactions below BRL2,000 which means $1,000. So again reinforcing what Romulo just mentioned, the (inaudible) activity on very, very small merchants with very small tickets.

Q - Daniel Abut {BIO 1505546 <GO>}

Then what explains (inaudible) slight decline in the average 100 spreads? That is calculating correctly came down to 176% in the Second Quarter compared to 182% in the first.

A - Unidentified Speaker

It was not a very -- we consider a reduction but --

Q - Daniel Abut {BIO 1505546 <GO>}

No, it's not flat, I agree. (inaudible) things change compared to Third Quarter.

A - Unidentified Speaker

No, no, not really, because the First Quarter, remember, in our case is affected by Christmas. So credit installments appears much more in our First Quarter. So when you talk about the average in terms of days, it's almost the same. We have our difference because now in the Second Quarter, we don't have the effect from the Christmas. So --

Daniel, I think important here is that we no change in our pricing policy regarding prepayment, regarding MDR. We had no change in our pricing policy regarding -- prepayment regarding the small and medium merchants. Of course, considering big merchants, we're targeting above the percentage of CDI. And percentage of CDI considering the reduction (inaudible) it was a factor.

Q - Daniel Abut {BIO 1505546 <GO>}

Understood, thank you.

Operator

Carlos Macedo, Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Just a couple of questions on the quarter. The first on relates again just follow-up on Daniel's question. What do you think is the limit? Is there is a structural limit to how much, what, to a percentage of your credit operations that you can effectively discount? I mean, is there a point at which you are going to penetrate your base to the degree that growth is going to become more difficult and then you are going to have to go to larger merchants when the spreads are smaller and therefore the growth in your receivable discounting will slow down?

And if so, are we near that? I mean, 10.5% is pretty high. And in the past, in the discussions that we had with you and with Redecard typically we talk about 12% as being kind of the place where you'd start going into the larger companies and lowering your spreads. I was wondering just if you think that that 12% is accurate or it's a number that's higher than that and you will be able to continue to expand.

And the second question, Romulo, it's something that you said earlier that you see a lot of competition or strong competition from the Conta Integrada product that comes from Santander. I was wondering if in case Itau is successful in their tender offer for Redecard and they move to a similar kind of offering, which is presumably what they will attempt to do, a similar Conta Integrada offering through Redecard. Do you think that that will make it more difficult for you to sustain your market share gains over the next 18 months given that the Santander product, the Conta Integrada, is what's been difficult to fight against over the last few quarters?

A - Unidentified Speaker

Hi Carlos, thanks for your question. About the first one. And to complement what I said, it's also related to the question that Daniel raised, the penetration. I would prefer not to give you a percentage or if it's 12, if it's 13, if it's 11. What we are confident that we will continue to grow may be not on the same page that we did so far because I think during the last four quarters we learned some issues, we learned some questions and we were able to fine turning in our product.

So the growth, I would say I agree with you, it's going to be difficult because it's not -- when you reach a penetration such as 10.5, that it's more difficult to grow. It doesn't (inaudible) on the other hand that we don't expect to have a high penetration in the coming years. As I said --

Q - Carlos Macedo {BIO 15158925 <GO>}

That is obvious. But if it does, it will be for larger merchants possibly, right. And therefore the spreads can be smaller?

A - Unidentified Speaker

No, no, not really. Both sides, big merchants and small and medium merchants.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay.

A - Unidentified Speaker

Your second question about the strong competition from Santander and the small and medium merchants and as well the big merchants we have our main competitors. I would say it's a fair assumption that may be, I don't know what's going to be their strategy that they are going to follow. But if they decided -- I am talking about Redecard and Itau, if they decided to offer the same product, we will try to see what's going to be the conditions. But I want to stress, as I said in my previous comments, that our focus is profitability. We are not going to fight for market share. We are not going to fight for market share.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay. But --

A - Unidentified Speaker

But we also have a very good distribution and we are also aware about what could happen. We have many different options on our table. Together we've -- only through Cielo and as well with our partner banks that we will try to address appropriately what's going to happen in a different strategy with a different premium because we do believe the service and the corporations steps that you provide (inaudible). This is how we stand and how we try to position Cielo in terms of price.

Q - Carlos Macedo {BIO 15158925 <GO>}

Cielo is clearly the technology leader in this sector. Is that something that you think will be an advantage if Itau does pursue a more service-oriented or fuller package-oriented offering?

A - Unidentified Speaker

We do respect all our competitors, Itau, Redecard, Santander. And they are very smart and they are very competent. But we also have our own strategy. We do think we have a different business model that is more difficult to be replicated because with the kind of penetration together with our own sales force plus the channels plus the (inaudible), it's a very good one.

Having said that, tech issues and product and service, we do think it's important. It's one of the reasons why we decided to buy Merchant e-Solutions because it's an acceleration in terms of platform. By platform I do not want to pass the message that it's related to tech stuff. It's more than tech stuffs. It's about products, service, web-based, it's near-time, something that we do believe it's going to help us in the future.

Of course, this effect cannot be so in the short term because it is going to take some time from up to three years to be ready. But what we have in our hands in terms of tech issues plus the product service, distribution and other things, I think we also consider that Cielo is here to face any different scenario that will appear. Focus, on profitability.

Q - Carlos Macedo {BIO 15158925 <GO>}

Okay, thank you, Clovis, thank you, Romulo.

Operator

Paulo Ribeiro, HSBC.

Q - Paulo Ribeiro {BIO 1929952 <GO>}

You mentioned your strong distribution and in the earlier call you mentioned, you had reached what is all-time high participation of your sales force, about 39% of affiliation. Do you see this -- do you have a strategy in terms of you want to increase your affiliations by your own sales force, it just happens or how do you see that distribution between your partner banks and own sales going forward?

A - Unidentified Speaker

Yes, Paulo, we have the intention to increase our own sales affiliation. It doesn't mean that we don't have the intention to increase the affiliation through the partners. But our own sales distribution, it's one of the targets that we have.

Q - Paulo Ribeiro {BIO 1929952 <GO>}

So in terms of the percentage maybe increased what you are now, you increase from 30 a few quarters ago, a year ago, to 39 and we could see may be that.

A - Unidentified Speaker

It's difficult to say. But I would consider that would be flat. I am sorry.

Q - Paulo Ribeiro {BIO 1929952 <GO>}

I understand that because it could have an impact on your net MDR. You don't disclose like your competitors does the incentive that they pay to banks right there and that it has profit sharing. So I was wondering if you -- this could have an impact, if you were to increase your -- the use of your own distribution, if that could be positive in terms of preserving MDR or --

A - Unidentified Speaker

No, no, don't expect because I would expect the same penetration between 38% to 40%, 35% depending on the quarter. And this wouldn't affect the gross MDR that we are able to charge.

Q - Paulo Ribeiro {BIO 1929952 <GO>}

Okay, perfect. And switch a gear here to the US. How do you see this market? How do you see the US market, how -- what are your plans to grow to invest in EMEAs because heard a lot about what it brings to you in Brazil. But you still bought a business here. So how do you see that and what are your expectation in broad lines, in broad terms to this market here to the growth of the Company here?

A - Unidentified Speaker

It's a challenging market, a very challenging. But the Company is well-positioned to continue its growth. The Company is profitable working with more than 250 banks and more focus e-commerce. So the business, considering this business as a standalone business, our expectation that's going to grow organically with the generation of the cash flow that the Company is able to reach.

Q - Paulo Ribeiro {BIO 1929952 <GO>}

And have you met those partners banks here? I mean, were there any interaction or reaction to the acquisition from partner banks, from at least the main ones by -- do they ask who is Cielo, what are they doing here?

A - Unidentified Speaker

Let me answer this question with two comments. First, I mentioned that there is a partnership with 250 banks. So there is no dependence -- in the Company, there is no really any kind of dependence. There are some banks, Paulo, that are -- they have only six branch, six, seven branch. And don't forget that the total sales volume was $14 billion. So compared to Cielo, Cielo is much, much bigger than Merchant e and 250 banks.

We don't have any concern about that. And by the way, this comes to the second point that I would like to make. I think the announcement were we well-received by the community and as well by the employees and as well by the banks. I didn't meet personally with any bank even though that after the conclusion of the deal that we expect to have during this quarter, we are going to meet some of the banks of course with the team that is going to be there.

Q - Paulo Ribeiro {BIO 1929952 <GO>}

Perfect, thank you. Thank you, very much.

Operator

Matthew O'Neill, CLSA Investment.

Q - Matthew O'Neill

Hi, this is actually Matt O'Neill on the line for Craig. I had two questions. First, given the number of moving parts in the quarter with some of the larger merchants rolling off, would it be possible to give us an idea of the kind of normalized or same-store sales volumes through July? Is it possible just to give an idea of how things are trending sort of excluding some of the volume loss?

And then second, I was just wondering if you could discuss the increase in consulting fees that rolled on in Brazil above what we were expecting just to have an understanding if that's going to continue through the rest of the year? Thanks.

A - Unidentified Speaker

Hi, Matt. I would say to you that the 61 share, 39 -- we don't think it's sustainable as Romulo mentioned already. And so it will be fair to assume from now on for the following quarters that we grow something slightly below the market, okay. And we think -- can you say again your second question please?

Q - Matthew O'Neill

Yes, on the G&A line, the consulting fees I guess were called out as driving the increase there and I'm just wondering if that's something to expect going forward?

A - Unidentified Speaker

Oh, no, okay, we had in this quarter, Second Quarter, a one-off event. We recognize in this quarter something around BRL15 million regarding the merchant fees exempt for consultancy terms. So if we take general expenses from this BRL57 million that we presented this quarter, the BRL15 million is something close to what could be considered from now on.

Q - Matthew O'Neill

Okay. Great. Thank you. So much.

Operator

Eduardo Nitsu, Flopluro [ph].

Q - Eduardo Nitsu

I have two questions. The first is a follow-up on competition. Is any particular industry you see in the competition larger like retailers or airlines, for instance. And is the competition coming from a specific player, your main competitor or new entrants? We know that a few new entrants started few months ago. So just want to double-check if that's the case.

And my second question goes on the Crediario product that you launched. I was just wondering if you can breakdown the fee structure on that and if you have any guidance on how much this can grown and your targets on the sizes it can grow. And where is resistance? I mean, if it's resistance on the credit or debit product? Thank you.

A - Unidentified Speaker

First about competition. With big merchants comes more from Redecard. About small and medium sized merchants, more from Santander. I am talking about price. In terms of our presence in the verticals, you mentioned about airlines, our market share on airlines are very good one because of the offer that being provided, the value added offer, the best value proposition in terms of risk, frauds and other things that we do.

But this competition comes across board. It's not only for -- in the merchants, okay. About the second question, Crediario, I would say to you, don't expect that this product will affect positively big numbers as the result of sale. So the product was just launched. We need to communicate more together with the banks. There is also -- there are financial situations or the market economic situation today. So it's only beginning.

In terms of how you recognize the net MDR it appears as credit installments, okay. We received the net MDR. But it appears -- and I'm sorry, we received the net MDR in terms of credit installments. But the fear is in debit. But it's a small, really small %. It's not going to affect our numbers in the short term, short or medium term.

Q - Eduardo Nitsu

And is fee structure is more like the credit or the debit in terms of net MDR?

A - Unidentified Speaker

Credit, credit installments. The same credit installment for the segments as the start and it applies with Crediario, net MDR for Crediario.

Q - Eduardo Nitsu

But it's booked on their debit, right?

A - Unidentified Speaker

Exactly.

Q - Eduardo Nitsu

Just one more question.

A - Unidentified Speaker

But just to be very clear here, it didn't affect our numbers so far in this quarter. It's going to affect in Third Quarter.

Q - Eduardo Nitsu

It is small.

A - Unidentified Speaker

It didn't -- really too small.

Q - Eduardo Nitsu

Okay. Just one question to clarify. You said that the impact of losing bigger counts will be it like BRL5 billion in financial volume pretty annualized, right? So is that -- if you take that into context, you'll be like 1.5% to 1% impact on volume. Is that -- just to clarify, is that the number? If assumption is correct, this will be like 1% to 1.5% impact on volumes of those accounts?

A - Unidentified Speaker

It depends on the evolution of the market. But if you take the photograph, right now it is I think so.

Q - Eduardo Nitsu

Okay, all right. So in terms of volume scenes, you will be low -- it's a low profitability account that will be -- in terms of revenues, it will less than that, right, the impact?

A - Unidentified Speaker

Exactly. And it's important to point out that when I said that this we decide to focus on profitability, this big merchants that we are not going to work, some of them, they are just one big account who is responsible for 60% or 70% of this total number in terms of BRL5 billion, okay. But I am not concerned at all about this because money, revenue and profitability, nothing, nothing.

Q - Eduardo Nitsu

Okay, thank you very much.

Operator

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

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

I would like to thank you all for your participation and we look forward to seeing you at your Third Quarter conference call. Thank you. And have a nice day.

Operator

That concludes the Cielo's audio conference for today. Thank you, very much for your participation and have a good afternoon.