Q2 2015 Earnings Call

Company Participants

- Daniel Sonder
- Luís Otávio Saliba Furtado
- Rogério de Araújo Santana

Other Participants

- Alexandre Spada
- Eduardo Nishio
- Frederic de Mariz
- Gustavo Lôbo
- Marcelo Cintra

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call about the Earning Results of BM&FBOVESPA for the Second Quarter of 2015. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions to participate will be given at that time. As a reminder, this conference is being recorded and broadcast live via webcast. The replay would be available after the event is concluded.

I would now like to turn the conference over to Mr. Daniel Sonder, Chief Financial Officer of BM&FBOVESPA.

Daniel Sonder {BIO 18250247 <GO>}

Good morning, everyone. Thank you for joining the call and taking the time. I'd like to welcome you to our quarterly earnings conference call to discuss the second quarter 2015 results. I'm here with the IR and the finance team, which I would like to take the minute to thank for all the work in putting together the materials that you see in front of you.

We open our earnings presentation in slide three with an overview of what has happened in our operations, our financial results, and our strategic projects during second quarter. Then we'll go into the details in the following slides.

On the left side of the stage, you see the positive numbers in all of our main business lines, and I would like to highlight the double-digit growth in the derivative market and in other business lines not tied to volumes with a strong performance of both the securities lending business and the Tesouro Direto platform.

In the middle of the page, you see that the solid operating performance resulted in almost 20% top line growth year-over-year mainly driven by revenues from the BM&F segment and from other business lines.

As has happened in previous years, our adjusted expenses grew below inflation compared to the same period last year. As a result, the company's operating income increased 24.3% year-over-year, underscoring once again the company's operational leverage. Our adjusted net income grew by 17.2% while our adjusted earnings per share increased 19.8%, reflecting the execution of our share buyback program.

On the right side of this page, we show the consistency of our payout practice, which reflects management's commitments to returning capital to our shareholders. We maintained the payout ratio of 80% combined with our share buyback program that reached 26.2 million shares from January to July 2015, or roughly 1.5% of the free float of the company.

Here, I would like to call your attention to the fact that the company opted for distributing its payout using interest on capital rather than dividends. This practice will generate tax losses that can be offset in future periods against taxable earnings, which will be particularly valuable after 2018 for our company.

This should allow us from now on to better achieve our goals through a different combination of interest on capital, dividends and share repurchases. Rogério and I will be happy to go into more details on this during our Q&A session.

Regarding our strategic initiatives, we had some important developments in the quarter. We remain on schedule with the equity space of our clearinghouses integration projects. We also moved forward in our iBalcão OTC initiatives by migrating some OTC derivative contracts to a new sophisticated and more customer-friendly platform.

Additionally, a number of enhancements in our price and incentive policies are already implemented and we can see that impact in our results.

Lastly, it is noteworthy that we announced in the second quarter a program aimed at recognizing state-owned companies listed in our market that implement enhancements to their corporate governance practices.

Now, Rogério will give you some more details on our operational performance.

Rogério de Araújo Santana

Thank you, Daniel. Good morning, everyone. I would like to ask you to move to slide four where we highlight the resilience of BM&FBOVESPA's business model. Revenue diversification across markets and currencies, coupled with initiatives to drive non-volume related revenues underscore this aspect of our business.

We see on the left side that the greatest contribution to revenue growth in this quarter came from the financial and commodity derivatives markets within the BM&F segments, where we have a long exposure to U.S. dollar as well as exposure to volatility around interest rates and FX rates. Another relevant contribution came from other business lines not related to volumes, which were impacted by the solid performance of some products coupled with some enhancements to our pricing and incentive policies which was implemented recently.

On the right side, the pie chart shows that the derivatives markets are the main sources of revenues for BM&FBOVESPA. If we sum up financial and commodity derivatives that represented 41.1%, and derivatives on single stock and interest, for another 3.5%, we reached 44.6% of total revenues versus 34% of cash equities.

Moving to slide five, you will find details (5:49) on the performance of the financial and commodity derivatives markets. As mentioned before, the revenue growth in this segment was driven by a combination of a 28.2% increase in the ADV with 2.2% growth of the average revenue per contract, what we call RPC.

In the bar chart on the left side, you'll see the relevance of both contract spreads in U.S. dollar and contracts exposed to interest rates, and we are seeing high volatility related to these two underlying factors, which have impacted the trading activities (6:29) in a positive way.

We see that the main contribution to the revenue growth in this market has come from contract spreads in U.S. dollar, mainly in FX contracts, interest rates in U.S. dollar and commodity contracts from which the combined revenue grew 46% year-over-year. In the 2Q 2015, contract spreads in U.S. dollars generated around 52% of total revenues in the financial and commodity derivatives market. Revenue generated by interest rates in reais contracts also grew by 20% in the period.

On the slide six, we have the performance of the equities markets. As we can see in the bar graph on the left, the cash equities markets drove revenues up mainly reflecting higher market activity, measured by the turnover velocity that reached 70.5% in the 2Q 2015 versus 66.6% in the first quarter of 2014. The average market capitalization was flat over the same period. Trading and post-trading margins were flat, the year-over-year comparison reaching 5.3 basis points in 2Q 2015.

Moving to slide seven, we highlight the importance of the source of revenues that are not directly related to (7:53). One of the drivers of the company's strategy is to increase the revenues coming from this group of product and revenues. We pursue this goal mainly by actively marketing these products and services as well as altering prices and incentives applied to them when we see opportunities.

At the bottom of this slide, we highlight three products and services that are showing significant growth. The depository line grew more than 20% year-over-year, reflecting the solid growth of Tesouro Direto platform for which we have a very effective incentive program. We also had growth in the registration of agribusiness credit bills, and finally, price adjustments which were implemented in April 2015.

The security lending business, that is in the center of the slide, grew 27.9% versus the same quarter the year earlier, reflecting larger open interest and removal of rebates effective from January 2015. It's also worth to highlight that one of our main priorities is to develop this business by attracting more lenders to the platform, specifically foreigners and local pension funds.

Finally, on the right, on the bottom, we call attention to the market data business that grew more than 10% in the period, mainly reflecting the Brazilian real depreciation versus the U.S. dollar, since roughly 6% of the revenues of this business are priced in foreign currency. Also, a new pricing model was implemented for this market in July 2015 and will start to impact our revenues from 2Q 2015 on.

Now, I will pass the word back to Daniel, who will drive you through our expenses and other highlights.

Daniel Sonder {BIO 18250247 <GO>}

Thank you. So, moving to slide eight, we show the expense breakdown for the quarter. Our adjusted expenses grew 5.3% year-over-year versus average inflation of 8.9% in the period. Our adjusted personnel expenses, which exclude long-term incentive plans and personnel expenses capitalized towards projects, increased 4.1% and were impacted by the wage adjustment of around 7% under the annual collective bargaining agreement of August 2014. The lower increase in personnel expenses compared to the wage adjustment is explained by the efforts made by us in managing the company's head count.

Our IT data processing expenses grew 11.6%, reflecting higher maintenance expenses connected to the deployment of the first phase of the BM&FBOVESPA clearinghouse, which happened in August 2014. We have seen this in previous quarters as well and we should continue to see this line increase as new systems come online over the next 18 months.

Third-party service expenses increased 8.3% due to certain consulting services and legal fees. Other expenses, although a small number, showed a 58.5% increase impacted by higher energy costs and provisions. It is worth mentioning that official energy average inflation grew 58.4% in the last 12 months to June 2015. Communication and marketing expenses fell year-over-year.

Finally, we are reaffirming our 2015 adjusted expenses guidance between R$590 million and R$615 million. This comes as a result of significant efforts by the company since not only did we add new systems but also we have had to absorb unexpectedly high inflation in wages, contracts and energy since the fourth quarter of 2014 when we prepared and released our budget and OpEx guidance.

Moving to page nine, we always like to highlight our financial robustness. On the left, we show the cash position, which is an important part of the business of being a credible counterparty in the financial system. Total cash was R$4 billion at the end of the quarter. Total cash is composed by cash held as collateral on behalf of third parties, and BVMF's own cash.

On the left and blue side of the graph, we can see the third-party cash, which amounted to R$1.8 billion. On the right side, represented by the green bars, is BVMF's cash composed of restricted and available cash amounting to R$2.3 billion. Continuing with the company's practice of consistently returning capital to shareholders, our board yesterday again approved an 80% payout ratio, representing R$254 million. As mentioned in the first slide, for this quarter, we opted to pay interest on capital in order to expand our capacity to return capital to our shareholders in the long run by using tax laws carry-forward later on. We also repurchased 26.2 million shares from January to July 2015, which represents almost R$290 million invested in the share buyback program.

Moving to the financial results, the 20.4% increase in this item reflects the positive combination of higher average interest rates and higher cash balance in the second quarter of 2015 versus the second quarter of 2014. CapEx executed for the quarter reached R$76.6 million. For the year, we expect to invest between R$200 million and R$230 million in CapEx, and then in 2016, between R$165 million and R$195 million.

Moving to the next page, in slide 10, I want to emphasize that we have maintained our focus on building a world-class IT and operations infrastructure and, at the same time, seeking to add revenues through the continued development of products and markets. We are working on the development of the second phase of our new integrated clearinghouse and all the effort and investments in terms of equipment, and human knowhow that we have put in the PUMA Trading System are bearing fruits since we have witnessed the uninterrupted operation of this system for 760 days.

Regarding product and market developments, we are concentrating our efforts in increasing liquidity for listed products. With this goal, we recently announced the expansion of our market maker program in the derivatives market, and we are working to attract new participants to our securities lending platform, mainly local pension funds and foreign investors.

We are working on our inflation-linked future contracts which were relaunched in June in a way that more adequately meets the needs of market participants. The company has also been making an effort to drive revenue growth by implementing adjustments to our pricing and incentive policies. These have been gradually and consistently announced and put in place over the last few months.

Another important announcement made in this quarter was a corporate governance program for state-owned companies, which aims to ultimately strengthen investors' confidence in those companies. Although this is a long-term effort which may take some time to yield results and recognizing, of course, that corporate governance is not the only aspect in market valuation and investors' perception, it is relevant to note that an increase in the value of these companies and more listings of state-owned companies in our exchange could have a noticeable impact on equity market revenues for us since these companies represent 16.6% of average market cap in our market in the last 12 months to July 2015.

Finally, in page 11, we have the recent performance and initiatives to develop selective products. Products and services highlighted in this slide are good examples of the deliberate efforts to drive revenue growth and diversification. For example, we launched new financial contracts in the BM&F segment and expanded our ETFs portfolio and market makers program in the Bovespa segment. In the case of Tesouro Direto, important gains have been achieved by partnering closely with the brokers and adopting incentive programs to boost the number of investors and the amount of assets under custody.

I would like now to conclude this part of the presentation and open for the Q&A section. Thank you very much.

Q&A

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Alexandre Spada with Itaú BBA

Q - Alexandre Spada {BIO 16687974 <GO>}

Hi, gentlemen. Good morning. My first question relates to the new payout policy. Just to see if I understand it right. Is it reasonable to say that the net-net implication from a cash flow generation perspective will, in the end of the day, be limited to the tax credits generated into (17:20) 2017 while you will still have goodwill to amortize? I'm asking that because from 2018 onwards, I believe the market already assumes that you will be taking the most of IOC payments anyways and the tax shield given by IOC. So, question is, can we assume from a cash flow standpoint the benefit will only be concentrated in maybe 2018 and 2019?

A - Daniel Sonder {BIO 18250247 <GO>}

Spada, thank you very much for your question. And the short answer is, you're absolutely right. And the longer answer, maybe I'll take everyone to page 14 of the presentation, which is an appendix that we put together exactly to try to cover this point in more details expecting that it would come up. So, what you described is exactly the case. We already have a near zero cash tax at this point, which should continue until the end of the amortization of our goodwill for tax purposes.

However, from 2018 onwards, we do expect to be paying cash taxes. And that is when we will begin to benefit from the fact that over the next three years, we plan to use the current interest on capital formula to deliver our payouts, our proceeds and, therefore, accumulate during this period tax loss carryforwards that we can use later on.

So, from using slide 14, just to cover what's on that page and perhaps address other people's questions on the line, you can see on the bottom of this graph that from a cash flow point of view, there is no change in 2015, 2016, 2017, and there is a benefit from 2018 onwards because of the realization of the tax loss carryforward accumulated. And then it also describes the impact on the income tax line and the net income line, which you see in our accounting books.

Q - Alexandre Spada {BIO 16687974 <GO>}

Thank you. Just one quick follow-up. But you said, from 2018 onwards, but again, that's limited to the amount of tax credits that you accumulate until 2017?

A - Daniel Sonder {BIO 18250247 <GO>}

Absolutely.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay.

A - Daniel Sonder {BIO 18250247 <GO>}

Correct. Correct. Yeah.

Q - Alexandre Spada {BIO 16687974 <GO>}

That's very clear. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you, Spada.

Q - Alexandre Spada {BIO 16687974 <GO>}

I have another follow-up here, quick one. How comfortable are you that those tax credits will not be challenged by the IRS in the future?

A - Daniel Sonder {BIO 18250247 <GO>}

Very comfortable.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. Very clear. Thanks.

Operator

Our next question comes from Fred Mariz with UBS.

Q - Frederic de Mariz {BIO 15383052 <GO>}

Thank you. Good morning, everyone. Just a follow-up on Spada's question. Can you try to put a number on these effective tax rates for 2018 and 2019? If the law doesn't change, if we don't have any of those changes on the IOC, what do you think would be the tax benefit for 2018 and 2019? In other words, if the statutory tax rate is 34%, where do you think you could be? In the mid-20%s? Around 30%? I don't know if you can try to give us a sense of this. That's the first question.

And the second question is more of a general on the international strategy. Can you share with us your latest thoughts on your ventures, your relationship with CME in terms of products, in terms of equity stake, but also at how you're looking at the other Latin American countries or, generally speaking, if you're looking at any other opportunities outside of Brazil? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Frederic, thank you. Thank you for the question. We do not have a guidance for our effective tax rate afterwards, and I will explain why. The use of the tax loss carryforward that will accumulate over the next three years, the rate of use of that will depend on our earnings before taxes for the future because the rule in Brazil is that you can only use a certain percentage of your established balance of tax losses to compensate a certain percentage of your EBT going forward. So, we don't know how that's going to work out, but it is, of course, a benefit vis-à-vis the effective tax rate using interest on capital only. So it's using interest on capital plus this benefit that we will carry from previous periods, okay?

Regarding the investment strategy in the region, there hasn't been any major changes to the statements we have publicly made before. We continue to see that the region is a natural area for our expansion and that those markets offer some opportunities. But as you have probably realized, we are being quite diligent and selective in looking at the opportunities. We don't have any wish to rush or to make investments that we don't believe would, over the long-term, add value to our company. So, we have made up to this point, the investment in Bolsa de Comercio de Santiago, but we are having conversations with other players that have not yet materialized into any concrete transaction.

And finally, regarding the relationship and the stake in CME, we continue to benefit from that relationship, as you know. It has been so for many years and we truly believe that it will continue to be so. And we do feel that the benefits from that relationship are indeed tied to a cross ownership of one company into the other. So we expect to continue with that cross ownership of one company to the other. However, it is something that we observe, the size that this investment has arrived at or achieved in our total market cap, and therefore, this is something that we have and continue to discuss periodically at our board level.

Q - Frederic de Mariz {BIO 15383052 <GO>}

That's good, Sonder. Thank you. That's very clear. Just on CME, just to get a bit more granularity, not too concerned about the stake itself, but can you give us a few examples of what other products or what other technology transfer you could benefit on going forward?

A - Daniel Sonder {BIO 18250247 <GO>}

Yes. I have actually Luís Furtado here with me that perhaps can help me a little bit with this. But of course, they are one of the leading technology developers and companies in our space, and we do have our – one of our core engines here based on something that they developed in the past. So, I'll stop here so that I don't get in trouble and I'll leave it with Furtado to continue.

A - Luís Otávio Saliba Furtado

Yes, good morning. So, we do have the technology agreement in place with CME and that means that we can explore whatever new technologies they are working on. And some of the exciting technologies they are working on right now include, for instance, the use of FPGA, which is a technology where you exploit the hardware of a certain server in order to extract better performance from that hardware. You don't have the need to have an operational system to use that particular hardware. So, they have some research in that in order to speed up the gateways of a trading platform. So, this is just one of the examples where they have – they invest heavily in R&D, and we can benefit from that because of the technology agreement we have in place with them.

Q - Frederic de Mariz {BIO 15383052 <GO>}

Okay, that's very clear. Thank you for your time.

A - Luís Otávio Saliba Furtado

Thank you.

Operator

Our next question comes from Marcelo Cintra with Goldman Sachs.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Hi. Good morning, gentlemen. Thank you for taking my question. So, I have two questions. The first one is related to your expenses. We noted that during the first half of the year, total expenses they're running slightly – at least under my calculations, slightly below the lower end of your guidance, even considering a stronger second half for this line. So, I just would like to hear from you guys if you remain comfortable or if there was any one-offs during this quarter which reduced a little bit your expenses. And also related to the head count management, if you can provide us more or less how much – if there was head count reductions and the number of employees. And then I will follow-up with my second question. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you, Cintra. Regarding sort of the running rate, we typically have, in the second half of the year, a slightly higher expense than we have in the first half. That has been the case for several years, and it has particularly to do with the fact that our collective bargaining kicks in starting in August. So, that's already an impact. And this year of course, as you are probably following, we have a pretty high inflation number coming our way. So, we reiterate the guidance that we have provided, and I really don't want to give you any indication that we are going to be significantly below that, okay.

Regarding personnel management, of course, we are – as you can see, both from a financial and sort of cash generation point of view, we are doing quite well. And also on the execution of our projects, we are continuing to drive the timetables of the execution of the key projects without any, any changes. What we are trying to do is really on a regular basis make sure that the teams are sized properly and that perhaps activities that in the past, during years where the market was more ebullient, we would engage in, we sort of try to adjust to the current environment. So, I don't – there's no huge change in staffing levels at this point. What we are doing is really trimming on a day-to-day basis as any diligent management team would do.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay, that's perfect. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Right.

Q - Marcelo Cintra {BIO 16463628 <GO>}

And my second question, I just like to hear from you a little bit about the iBalcão platform mainly in terms of the new product and development. And the reason I'm asking that is in order to have a better understanding of the market share evolution, because in the end when we look at the numbers, the market share remains, let's say, at least a little bit lower than maybe initially expected by us, the market share gains. So, how should we see the evolution of these products going forward and maybe how long should it take until it ramps up and it starts to grow a little bit faster? Thanks.

A - Daniel Sonder {BIO 18250247 <GO>}

Right. Right, good. So, I think an important qualification is due here, because when we speak about iBalcão OTC in general, there are two families of products, right. So, one of them is what you refer to, which is securities registration, right, so registration of bank CDs and bank bonds, and all the other typically financial institution-related funding instruments, right. On that front, you recall that we got ready with the full family of products late last year, beginning of this year, and this is when we really turned on the heat on the commercial effort. This is something that is not a off-the-shelf product that you immediately sell, because it's a long duration persuasion process and sale process in the large financial organizations in Brazil, which are few and very relevant.

So, it goes through several layers of decision-makers and business areas, operations and IT. And we have dedicated teams under the leadership of my colleague Guardia that are following up on these financial institutions to try to persuade them to try our services. And of course, we're talking about a infrastructure service that has been provided by a single player in the market for several decades. So, we remain absolutely confident that our strategy is a winning strategy. We have the time and the focus to eventually collect the results from our investments in that, and we have the team in place with the proper incentives to really push hard to get those clients on board. But I'm not in a position here to promise you any timeline or any hard market share aims or goals that we have established, although we do have those internally.

On the second front, in OTC, I think it's important to mention is the derivatives, right. It's not securities registration, but rather OTC derivatives. And that's where we are also making significant strides and we have put a lot of new products into a more sophisticated platform. This is where we have a distinct competitive advantage in OTC, because we have the CCP and where cross-margining is possible and where all the operational and capital efficiencies of our company come into play of a sort of one-stop-shop. So, this is something that is very relevant for us. We are making not only technology and customer service improvements, but also adjusting prices whenever possible to really have the rewards that we believe our technology and operations and services merit.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. That's perfect, Sonder. Thank you for the clarifications.

Operator

Our next question comes from Gustavo Lôbo with BTG Pactual.

Q - Gustavo Lôbo

Hi, everyone. I have a couple of questions as well. Starting with your budget, you published a budget for operating expenses and CapEx in the beginning of December last year. And at that time, the dollar was R$2.5 and the consensus for inflation in 2015 was at roughly 6%. Now, we have consensus inflation of 9%, dollar at R$3.5, and your guidance for 2015 CapEx and OpEx and 2016 just CapEx is still maintained. Is this due to conservativeness of yourselves as you have – as everyone has limited visibility on everything that is going on or are you just cutting costs and cutting projects so that the total amount spend is roughly at the same level that you were forecasting in the end of last year? Just wondering is this efficiency – better efficiency that you are delivering now or is there something else going on for maintaining both ranges? Thanks.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you. I think that's a fair question. It's basically – our best view at this point, it is due to considerate effort on our part. On the OpEx side, I'll just mention a few things. One is that we use cash flow hedge accounting for our very small but yet existent dollar expenses. So, what we do is that we actually "mark some dollars" at the beginning of the period that we are going to use to pay for those expenses later on. And therefore, from a reporting standpoint, we are hedged on the dollar movement for most of our OpEx during the year.

On the other – on the inflation front, what we have essentially done is to really work internally on efficiencies and trying to use our discretionary expenses of budget in a very conservative way, making tough choices, of course, but to try to counter the additional inflation that came our way. So, it's a combination of things.

On the CapEx front, we also moved most of our CapEx hardware purchases, which were dollar-denominated, to the first part of the year. And we did that deliberately through a sort of task force at the beginning of the year with purchasing, IT and other people to try to get over that risk of dollar depreciation during the year. And we were rather successful there. So we continue – and most of our other CapEx, which is not equipment related, has to do with human capital, programmers and software developers and so on, which are reals based. So again, these two things have led us to reaffirm the current guidance.

Q - Gustavo Lôbo

Great, thanks. And my second question is regarding your tax litigation on the goodwill amortization. If you could just give us a recap on how are the processes evolving and what should be the next steps and when should we hear more things about this.

A - Daniel Sonder {BIO 18250247 <GO>}

Yeah. There is really no update on this. So I would just restate what I have said previously. So, the first litigation linked to the 2008 and 2009 period, we are taking it to the second level of the Boards of Appeal of the CARF at the Admin level. We were unfortunately unsuccessful at the first level. So now, we are taking it to the second level. We don't have an update for when that will be heard. And the second tax litigation regarding the same subject, the goodwill amortization, which refers to the 2010 and 2011 period, we were assessed early this year and we challenged it at the Regional Tax Authority level, what's called the (38:55), and we haven't heard back from them yet. So this is the status of those two, which is the same as previously mentioned to you.

Q - Gustavo Lôbo

Okay, thanks a lot.

Operator

Our next question comes from Eduardo Nishio with Banco Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Hi, good morning. Thank you for taking my question. I have two questions. The first relates to the IOC. I'm reaching R$86 million for next quarter on tax benefits. So I just want to confirm that number. And if you can assume that quarter as an illustration, I think we can assume a total tax benefit of R$806 million in 2017, yeah (39:45). That's a number that we can work with and just to confirm if it's in addition to the IOC tax thereafter from 2018? That's the first question. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. I think that the best way of thinking about this – and I don't know how you arrived at your numbers, but I'll assume that the calculations are similar. But I think that the best way to think of that is to look at the actual amount of interest on capital that we distributed, that we will distribute now in September related to the second quarter and take a tax benefit of 34% of that, okay, so that is the reduction in – that you will see in the third quarter. And then from then on, this process will repeat itself. So depending on earnings the next quarter, we will make decisions regarding the distribution in the next quarter. And if we were to choose again to use interest on capital, which is a reasonable assumption, then it would be 34% of that in the following quarter, so.

A - Rogério de Araújo Santana

And this is Rogério. I'm going to add some words on what Daniel said. Always you need to take into consideration the limits that the law sets for all single companies in Brazil regarding the tax benefit that you can take every time you approve interest on capital. Basically, you are talking about shareholders' equity times long-term interest rates in Brazil that we call TJLP or 50% of the EBT after the payment of social contribution. That is in our case considering that social contribution is 9% is the same thing of saying that our limit would be 45.5% of our EBT. These are the two limits that we need to respect and we need to take the lower one. And this should be the strategy going forward and as a consequence we will take the amount of interest on capital we should pay going forward and the benefits that we will accumulate, it's going to be 34% of this number.

Q - Eduardo Nishio {BIO 15333200 <GO>}

All right, thank you. My second question relates to the integration of clearing, if you can give us an update on where you are and if you are on schedule. And also, you're doing a very good job on cutting costs, right, in managing costs. Just wondering if after the integration, you still have a space to optimize your cost structure. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Sure. I think that's a continuous effort by the company. I think this is our job to be vigilant on that. We will always invest in the things that we think makes sense, including adding people if we find that that's a proper allocation of investors' money. But at this point and for the past few years, we have indeed been able to adjust some of our expenses without at all hurting our business, which is the merit of the entire organization here. When we complete this major project of the integration of the clearinghouses, I think it's reasonable to expect that we would look at our staffing levels and continue to pursue opportunities for improvements in our teams.

We are simplifying certain processes, but we are also going to be doing much more, right. The clearinghouse has a number of new features and capabilities that the previous systems did not. So, if in one hand, we are sort of getting rid of multiple legacy systems that have been in parallel, we are also, when we do something new, adding a number of functionalities and responsibilities to that. So, it's a very long way to answer your question. But I guess my point is expense management is something that is extremely dear to us, extremely ingrained in our organization and in the thinking process of every decision that we make. And it's, I think, incumbent upon us to really look at 2017 and beyond period and really not leave any opportunities on the table.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Thank you. And on schedule, as you reported, you expect to finish the system building up this – end of this year?

A - Luís Otávio Saliba Furtado

Yes. This is Luís, Eduardo. Yes, we're on schedule. We are targeting the end of developments for the end of this year and then we will start the testing process with the participants. First, it's what we call a certification phase and then we go into production parallel. Also, in order to go live, in parallel with testing, we need to get the approval from the regulator. So, if everything goes according to plan during the test phase and the regulated approval, we should be going live at the end of next year.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Perfect. Thank you so much.

A - Luís Otávio Saliba Furtado

Thank you.

Operator

Our next question was sent through the Internet from our webcast and it was sent from Lynn Clays with Old Mutual (46:13). What will the effective tax rate be once you take advantage of tax saving on interest on capital? Second question, will the changing pricing of products increase or decrease revenue from pricing?

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. So, thank you for the question, Lynn (46:32). I think the first question regarding the effective tax rate, I think we addressed before. And I think that just to make it clear, by just using interest on capital 2018 and beyond, we would probably be looking at a tax rate of around 25%-ish. And by adding to that for a few years, as properly highlighted in the first question of the Q&A period, by adding to that in the first few years, the additional tax credit that we carry forward, that would reduce it a few points further, okay (47:15), depending on how much EBT we have over those periods. So I don't want to give any clear number here.

And the second question regarding pricing changes, we are implementing a number of pricing changes since about second half of last year, and most of them are in the direction of adding to our revenues immediately by changing prices upwards in products that we feel are relatively insensitive to prices. There are, in fact, also some price changes in the other direction. They are of course more rare, and we will only do that if we feel that there is price sensitivity on volumes. That's what I meant to say, so whenever we feel that there is an opportunity for the market to increase trading volumes in a product that is perhaps that is mispriced compared to alternatives or to international competitors.

Operator

This concludes today's question-and-answer session. I would like to invite Mr. Daniel Sonder to proceed with his closing statements. Please go ahead, sir.

A - Daniel Sonder {BIO 18250247 <GO>}

Okay. Just before we close, I just wanted to take a minute. If you look at page 13 of the presentation, because there were so many questions on effective tax rate and so on, which obviously is relevant, there is one more thing that you should take note of as you look at our numbers and your models which of course you will diligently do, which is the fact that now, under the new accounting treatment for our investment in CME, we are now subject to the fact that CME pays dividends on an irregular schedule and amounts during the year. And now, the dividends that we receive and the taxes on those dividends impact directly our tax line. It used to be the case before that it impacted our expense line, as you might recall, which made everybody's life pretty difficult.

But now, it impacts our tax line. And therefore, if we receive – and we hope we do – large dividends from CME, that will, on a quarterly basis, now impact our effective tax line as reported. So, I just wanted to call your attention for that, because perhaps not in the next quarter which is the third, but more likely than not in the fourth quarter, you will see a much higher effective tax rate reported by us, which is just a result of something that has happened in the last few years, which is an extraordinary dividend by CME but now under a new reporting methodology. So with that, I would like to again thank you for the time. Thank you for all your very good questions, and please do call us if you have further clarifications. We want to make ourselves available to answer any questions that you might have afterwards. Thank you very much.

Operator

That does conclude the BM&FBOVESPA audio conference for today. Thank you very much for your participation. Have a good afternoon and thank you for using Chorus Call.