

Q4 2014 Earnings Call

Company Participants

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

Other Participants

- Alexandre Spada, Analyst
- Aníbal Valdés, Analyst
- Carlos Macedo, Analyst
- Craig Jared Maurer, Analyst
- Eduardo Nishio, Analyst
- Eduardo Rosman, Analyst
- Gerardus Vos, Analyst
- Rafael Frade, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, everyone, and thank you for waiting. Welcome to Cielo's Fourth Quarter 2014 Results Conference Call. This event is being recorded, and all participants will be in a listen-only mode during the company's presentation. After Cielo's remarks, there will be a question-and-answer session. At that time, further instructions will be given.

This event is also being broadcast live via webcast, and may be accessed through Cielo's website at www.cielo.com.br/ir where the presentation is also available. Participants may view the slides in any order they wish. The replay will be available shortly after the event is concluded. Those following the presentation via the webcast may post their questions on our website.

Before proceeding, let me mention, that forward-looking statements are based on the beliefs and assumptions of Cielo's management and on 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 over to Mr. Rômulo de Mello Dias. Mr. Romulo, you may begin your presentation.

Rômulo de Mello Dias

Good morning. I'd like to thank you all for joining us as we present our results for the fourth quarter and the year of 2014. With me today are Clovis Poggetti, CFO and Investor Relations Officer; members of the management team, finance and IR teams.

Let's start on page 3 by presenting the evolution of our transaction financial volume with credit and debit cards. When comparing to the fourth quarter of the previous year, the financial captured volume present 9.3% growth reaching R\$144 billion. In the same period, the credit volume growth was 6.8% and debit volume growth was 13.2%.

Regarding the immediately previous quarter, the total volume was 11.8% higher with the credit volume growing 8.1% reaching R\$85 billion, while debit was up 7.5% to R\$59 billion. The volume growth in the quarter came below our expectation due to our more aggressive competition and the deceleration of the economic activity that's impacted the electronic payment industry.

In our view, the market is expected to grow around 13% in the quarter, which entails market share loss to Cielo as previously reported. In the year 2014, the industry is expected to grow close to 15.5% in line with our stock guidance between 15% and 18%.

On page 4, regarding the financial volume, we present the graphics with the evolution of the annual growth rate per quarter for the years 2012, 2013 and 2014. Each growth pointing out that when comparing the growth rates from 2014 and 2013, they were very similar with the latter above (03:53) 15% although the curve presents an opposite (03:56) behavior.

For the year 2015, we expect a similar curve with the year 2013, but certainly at a lower level. To share our view, we expect the industry to grow between 11% and 13% in financial volume and we expect that Cielo will grow below the industry level. Breaking down the products, we expect debit card volumes to grow between 13% and 15%, and credit card volumes between 9% and 11%.

On page 5, we present the number of transactions captured. There is a growth of 11.8% in Q4 compared to the same period of 2013, representing an amount of R\$1.6 billion transactions; Q-on-Q, the number of transactions increased by 11%. In the year 2014, the number of transactions captured grew 15.5% reaching R\$5.7 billion.

On page 6, we have our operating indicators. We present a number of active points of sales, which has recorded one transaction in the last 30 days and the number of installed POS. We can see in the graphs that all indicators show growth in the period. In comparison with the fourth quarter of 2013, the basis of installed POS grew 10.5%, and in comparison with the previous quarter increased by 4.6%. Wireless terminals reached 62.7% in Q4. The increase of the active points of sales reached 13.5% compared to the same period last year. In comparison with Q3, there was a growth of 5.1%.

Now, I'd like you to hand the call to Clovis Poggetti, who will continue our presentation.

Clovis Poggetti {BIO 16529642 <GO>}

Thank you, Rômulo, and good morning, everyone. On page 7, we have our net operating revenue, which totaled R\$2.1 billion, growing 14.9% over fourth quarter 2013. The increase in net revenue is strictly related to the ongoing business expansion and an increase in revenue generated by the subsidiary Merchant e-Solutions, also impacted by dollar appreciation. Compared with the third quarter of 2014, net operating revenue presented a growth of 9.8%. In 2014, the amount was R\$7.7 billion, 14.7% up year-on-year.

On the next page, page 8, we have our cost and expenses evolution. Total expenses reached R\$1.3 billion in the fourth quarter of 2014, up 26.7% over the same quarter of 2013 and up 21.2% over the third quarter last year. In 2014, total expenses was R\$4.3 billion, growing 21.5% year-on-year. The cost of service provided was R\$905.8 million in the quarter, growing 24.6% and 15.9% year-on-year and quarter-on-quarter, respectively. For the year, the cost was R\$3.1 billion, up 19.6% year-on-year.

Detailing the items that most impacted costs comparing to the same period of 2013, we have mainly increased cost related to the subsidiary, Merchant e-Solutions; due to the appreciation

of dollar; M4U and also costs related to transactions such as capturing and processing, cost center, fees paid to the brands and telecom, given the increase in the transaction volume.

Quarter-on- quarter, the rise is strictly due to the costs related to transactions such as capturing and processing, cost centers, fees paid to the brands and telecom, given the increase in the transaction volume and also due to higher spending with projects.

Our operating expenses represented R\$412.4 million in the fourth quarter last year, up 31.5% compared to the fourth quarter 2013 and 34.5% compared to the third quarter last year. In 2014, the expenses represented R\$1.3 billion, an increase of 26.3% when compared to 2013. The increase in expenses over the same period last year is mainly related to the other operating expenses line that in the fourth quarter last year was impacted R\$37 million, due to expenses related to the JV with Banco do Brasil. The other line that despite the increase, in general and administrative expenses, which in the quarter was impacted by the ongoing projects.

In the quarter-on-quarter comparison, the increase was strictly the expenses related to the JV and the result of the increase in general and administrative expenses, as our result of ongoing projects as expected.

On the same slide, we can see total cost plus expense per transaction at R\$0.84, up 13.3% year-on-year and 9.2% higher quarter-on-quarter.

For 2014, total cost was expensed with transactions reached R\$0.76, 5.2% higher than 2013. Excluding the non-recurring expenses related to the JV, the total cost and expense per transaction reaches R\$0.82 in the quarter and R\$0.755 in the year. Recalling that the

soft guidance share with the market was between R\$0.75 and R\$0.78 per transaction, it means in line with what was reported.

Regarding 2015, to share a soft guidance on cost and expenses per transaction, we improved the way of presenting this information. From this year on, we will present the expectation of Cielo Brazil, which means the core business, and our subsidiaries separately. Our expectation is that in 2015, the Cielo Brazil total cost and expenses per transaction will be in the range of R\$0.49 and R\$0.51 per transaction. In 2014, the same metric was R\$0.54 per transaction, which means Cielo Brazil will present a reduction.

Important to mention that the assumption assumed in this soft guidance consider our proven business structure, which means it does not take into consideration any change with economics of the current brand business model that we have partnerships and also, does not include the JV with Banco do Brasil. For the Cielo subsidiaries that are consolidated, the total cost and expenses will grow in line with or slightly below their revenues.

On page 9, we have indicators and results of the prepayment of receivables operation. In that table, we can see that the volume prepaid presented an increase of 9.4% compared to the fourth quarter 2013 and 8.2% when compared to the third quarter last year.

The amount in the quarter totaled R\$15 billion or 17.7% over the total credit volume with credits installments accounting for 68.5% and regular credit for 31.5%. For 2014, the total prepayment volume was R\$56 billion, a 26.6% increase. The result of prepayment of receivables in the fourth quarter last year was R\$423.1 million, 46.8% higher than the results in the fourth quarter 2013, and 4.5% higher quarter-on-quarter.

In the year, the result was R\$1.5 billion, 68.3% higher than 2013. As usual, let's also present the result of the managerial analysis net of funding costs. Increased analysis shown in the table, we assume that 100% of the volume prepaid in the quarter is applied the 104% of CDI interest rate. According to this analysis, net revenue was R\$269.3 million for the quarter, an increase of 44.2% and 12.3% compared to the fourth quarter of 2013 and third quarter last year respectively. And for 2014, the net revenue was R\$918.4 million, 55% higher than in 2013.

On slide 10, we have our financial performance with EBITDA in both absolute amount and margin. EBITDA totaled R\$924.6 million in the fourth quarter last year, 1.3% year-on-year. EBITDA margin was at a 43.4% in the fourth quarter. EBITDA margin was down by 5.8 percentage points over the fourth quarter 2013. Compared to the third quarter last year, EBITDA decreased by 3.4% and margin decreased by 6% percentage points on March. In 2014, EBITDA reached R\$3.8 billion, 7.4% less than 2013 and EBITDA margin of 49.7%.

On the next slide, number 11, we show that our net income totaled R\$803 million, up 11.4% year-on-year, with a net income margin of 37.7%. Finally, when compared to the third quarter of last year, net income present a decrease of 1.8%, while margins dropped at 4.5 percentage points. In order to analyze the recurrent net income, we have to discount from the fourth quarter last year all expenses related to the JV with Banco do Brasil, which

totaled R\$37 million pre-tax. After having done that, the net income would be R\$827.6 million, slightly higher than the third quarter last year.

Now, we'll go back to home loan. On slide 12, I'd like to comment the most recent announcement regarding the JV with Banco do Brasil. This is, with no doubt, the Cielo's greatest strategic highlight for allowing revenue diversification in business related to electronic payment.

Just to recall the JV's call, it will be responsible for the management of the payment accounts of parts of the Ourocard arrangement, that is all credit and debit cards issued by Banco do Brasil labeled Visa, Mastercard, AmEx, Elo, among others, excluding the cards related to the prepaid business, payment solutions provided to government entities, and the private label cards.

The JV's revenue will be linked to fee of transaction according to this call I just mentioned. The costs and expenses will be related to the activities performed of which the fees paid to brands being (17:20). Just to stress, the activity the JV will perform does not expose Cielo to credit risks.

The JV was evaluated at R\$11.6 billion. Cielo will be responsible for investment R\$8.1 billion in the operation. As informed in the moment the announcement was made, the pro forma net income of the JV in the last 12 months was R\$578 million, that is, from October 1, 2013 to September 30, 2014.

Here we hold 70% of the shareholders' equity and we'll therefore indicate that CEO and we have majority in the Board of Directors. The JV has already received the regulatory approvals and has now owned some precedent conditions to be finalized. And finally, in the last slide number 13, we present the remuneration approved by the Board of Directors to be proposed in our Annual Shareholders' Meeting. For the second half of 2014, it will be distributed equivalent R\$0.45 per share and R\$0.04 on interest-owned equity, result considering the fact which represents a payout of 50% in the second half of 2014.

In relation to the yearend of 2014, the company will pay a certain amount of R\$1.8 billion in dividend and interest on equity, or 60% payout. The payout reduction to 50% is related to the expectation of the closing of the deal with Banco do Brasil to set up the JV, which will mean a higher leverage than the current one. It's important noting that, as already mentioned, after the closing of the deal and (19:17) shareholders' meeting will be called to reduce the minimum payout from 50% to 30% in our by-laws. I started it to be approved to the next General Shareholders' Meeting to take place in March 27. We will also have a new increase of R\$500 million in shareholders' equity by means of a 20% stock bonus, which would result in the new number of R\$1.8 billion shares to Cielo.

To summarize, I finished my presentation recalling that (19:52) we delivered all the soft guidance share with the market. The industry growth was in the range of 15% and 18% as shared previously. Costs plus expenses plus transactions reached 76% of payout, in line with the range of 75% to 78%. And finally, CapEx for POS terminals above our expectation

reaching R\$500 million. When compared to the range of R\$300 million and R\$400 million. This increase is mainly due to the increase in the active merchant point of sale and also, for the offering the most modern equipments to our client. That was what I want to share with you and thank you for your attention.

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

Operator

Ladies and gentlemen, we will now begin the question-and-answer session. Our first question comes from Eduardo Rosman with BTG Pactual.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Hi, Rômulo and Clovis. I have two questions. The first one is related with the JV with Banco do Brasil, so I want to know if other banks look for Cielo in order to do a partnership in the credit card segment similar to the one done with Banco do Brasil. So I wanted to understand if this is a possibility in the future or not. And the second question is related with the JV with Linx. Rômulo, you said during the Portuguese conference call that Cielo has been growing like a new, smaller client and as a result, it's helping the penetration of the markets increase, right? And with that in mind, I wanted to understand a bit more about the JV between selling Linx and how this could help Cielo to have a stronger competitive advantage with smaller merchants, right. Besides, of course the strong distribution of Banco do Brasil and Bradesco. So, if you can - if you could please give us an update and your expectations about the JV? So that's it. Thanks.

A - Rômulo de Mello Dias

Hi, Eduardo. Thanks for the question. Regarding the first one, if you are open to consider audit first submitted (22:12), so audit deals that we both, it means of course, we are open to consider. Right now, what we have in our hands is the lease agreement with Banco do Brasil. About Linx, you're sure that we are very excited about the opportunity to work with Linx, one of the best companies in IT related to retail segment. And the idea, as you know, is to provide IPOS or Integrated Point of Sale, which means software plus hardware plus electronic payments to merchants with up to 5 stores. And we think that, with this partnership with Linx, at the end of the day, we will be able to create margin stickiness with our customers and for - to increase our penetration in SMEs.

About the JV and the state that you are today, I would say the following. It's not possible to give an assertive estimate of the conclusion of the business. We are still negotiating some precedent conditions which unfortunately, cannot be disclosed, since they are confidential. Such conditions do not change the business valuation. As soon as you close the deal, you'll present a summarized version of the income statements. So, that's a Google review of the revenues and expenses we delivered. We'll also present more information about the potential tax benefits that might be incorporated for instance, to intangible assets amortization. Regarding the operations standards, it is too early to talk about - such assessment will be done by a specific committee comprised of Banco do Brasil nominees and and as well, Cielo to be constituted after the close of the deal.

Q - Eduardo Rosman {BIO 16314825 <GO>}

Okay. Thanks a lot, Rômulo.

Operator

Our next question comes from Gerardus Vos with Barclays.

Q - Gerardus Vos {BIO 3301062 <GO>}

Hi, good morning it's Gerardus from Barclays, thanks for taking my questions. Just a couple if I may, you've given the kind of outline for the kind of volume growth for 2015, and I was wondering if you could help us a bit on the MDR, which you would expect for 2015 as well. And then, on the cost side for 2015, I'm just struggling a little bit with the new guidance, where you break down for Brazil and the subsidiaries. Also on that, how would you expect the kind of seasonality to work, because I guess in the first half, it's still relatively high, but then it should rapidly come down in the second half when the projects are coming to an end. And then finally, on the end of the exclusivity of the international card schemes, what kind of headwind do you pencil in in 2015 and perhaps even 2016, as well? Thank you.

A - Rômulo de Mello Dias

Hi, Gerardus. Thanks for your question. About first one, 2015, and what you expect for MDR, we are not saying many things about MDR, but we are expecting the MDR will not be as it is today. In other words, we expect reduction in the MDR, considering the level of competition that you're facing right now. And the newcomers and considering also the new policy that incumbents are following at this stage. Having said that, I will pass the second question to Clovis, and I will talk about at the end of exclusivity.

A - Clovis Poggetti {BIO 16529642 <GO>}

Hi, Gerardus I will take advantage of your questions to clarify the following. First, why we are latest (25:56) giving a new way to analyze cost and expenses - our cost and expenses. That's because, we understand the indicator that we're using so far is not the best way to evaluate the company's performance with regard to cost and expense, okay? And why? Let me give you a few examples. One, as you all know, the company start to grow let's say through some acquisitions, okay? Two, these controlled companies, they contribute when we consolidate, they contribute with in terms of sales, in terms of costs, in terms of expenses, in terms of the bottom-line, and et cetera.

But as you also know, we do not consolidate financial volume and we do not consolidate number of transactions, okay? And three, there is one specific controlled company, Merchant e-Solutions, a U.S.-based company that, let's say suffers not only in terms of costs from let's say, its growth, but also suffers the impact of the dollar evaluation, okay? And this is not under our control, okay?

Rômulo is just recalling me to say it. When I say we suffer from the dollar rate evaluation, that's because we are talking about costs only. Don't forget that the dollar also helps in - affect the revenues, which means the bottom-line is somehow preserved and also, don't

forget that with regard to Merchant E the whole acquisition, we have a perfect patch in terms of we have the investment that is based on U.S. dollars, but we issue the bonds, end of 2012, also in dollars, okay? But going back to...

A - Rômulo de Mello Dias

The points are, if you allow me Clovis, in other words, there is no impact in on our net earnings because of appreciation or depreciation of real related to dollar, we have a perfect patch.

A - Clovis Poggetti {BIO 16529642 <GO>}

So my point is, we have this controlling companies that we consolidate expenses, expenses that with regard to Merchant E, had impact of the dollar and we take all of these in the previous, let's say indicator and divide by Cielo's number of transaction. So in this way we understand that, let's say clearly the information between Cielo, what we are calling Cielo Brazil and other controlled company, we allow a better analysis of this metric, okay? And in this sense, I reinforce that, when we look at Cielo Brazil, we'll deliver a number strongly better, okay? From R\$0.54 to something around R\$0.50. And not only because, let's say some projects will be, let's say delivered as we explained an increase in comp cost, but also, because we will continue our efforts in terms of seeking more efficiently in these - in all the lines and costs and expenses, going from process analysis, we are going to do, let's say summing up more with less, okay? And also very important, something that I called the attention of everybody in the Portuguese call, and all of these with the responsibility and sustainability.

A - Rômulo de Mello Dias

Gerardus, regarding the third question that you made. If I understood correctly, I'll make a first comment and if it's necessary, can I add more color on my answer? Having said that, about the end of the exclusivity, the grounds opened up for us to start in December last year. When we started test phase, we have a limit number of merchants. In order to be adopted, it is still not defined because negotiations that are still going - ongoing, in the industry and with some Brazilian Central Bank. So I don't know if you want to have more color and more clarification than that and I'm open to provide more info if you need.

Q - Gerardus Vos {BIO 3301062 <GO>}

That's fine. Thank you very much.

Operator

Our next question comes from Carlos Macedo with Goldman Sachs.

Q - Carlos Macedo {BIO 15158925 <GO>}

Good afternoon, Rômulo and Clovis. Thanks for taking my questions. I have a couple of questions on, one, if you can give us more color on the rental business and POS, so we did see a few things first, you start - you continued to see the number of POS's rented rise, continued to see the percentage of wireless POS's rise. Could you talk a bit about

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the contribution margin for the wireless versus the wireline? Talk about the expense side of the business, it could be, if it's a headwind for your – that the goal of lowering the cost for transaction on the Brazil business to R\$0.51. Talk about what you expect, it could be the impact. If you remember in the past, there was a lot of talk about the new entrants coming in and basically giving out the POS for free. If you think that could be a headwind for what you charge merchants, just to get an idea of how that business is going, given that we have less visibility now than we did maybe a couple of years ago?

Second, if you can talk about the debit side of the business a bit. We did see volumes being a little bit – they decelerated largely because of the Agro card, but they're more resilient than the credit side. I am assuming here that that's been driven by LO. If you could talk a little bit about how LO – the percentage of the LO is of your debit business and how that has evolved over time, so that we can get an idea of what to expect once the exclusivity ends over the next six months? Thank you.

A - Rômulo de Mello Dias

Thank you Carlos for your question. About the rental business, we are not splitting line-by-line. But we can tell you that rental business is helping a lot in terms of the growth of the revenues, because if you consider the total sales volume growth in the Q4, it was 9.3%. And if you exclude Merchant E from the revenues, you're going to have something around 13%, 14% in terms of revenues. What's happening here? Because you think, with Merchant E, the growth of revenues goes to, if I'm not mistaken, 15%, something like that. So what's helping the growth of the revenues to be more – to be higher than the total sales volume?

Rental business, the penetration of our GPRS that reached 62%, and as well some other business that you have in other companies. About the debit, what – I'll less comment about the first question. Let's not forget that in terms of cost that Clovis can mention later, even though that's good in terms of – to help the growth in terms of the revenues, at the end of the day, the cost of the wireless is much higher when compared to the cost of the wire. And why? Because it's something that goes to the floor frequently and it breaks much more than the others.

In terms of margin, the wireless terminal margin percentage-wise is lower. The margin of this GPRS when compared to the wire. But in terms of nominal money, the money that comes from wireless is much better than the money that comes when compared to the wire. And last comment about this, is that, let's not forget the cost of the wireless is also higher because of the depreciation and also because of the logistics and how many times you have to go there in order to fix the terminal.

About the question related to debit, you're right when you say that it decelerated more than we're expecting. The deceleration of the industry, or – sorry, the deceleration of Cielo in Q4 was related to deceleration of the economy and as well there's some, let's say more aggressive behavior from our main competitor as well and the other players that are or are participate in the market. The penetration that Cielo has today, sorry, debit in terms of – corresponds to something around 85% to 90% of the debit in the case of

Cielo if understood your question about the penetration of Cielo and the share that Cielo and the share that debit has in Cielo.

Q - Carlos Macedo {BIO 15158925 <GO>}

Yes, but also the opposite, how much of Cielo does, how much of your overall volume that you're able to give does Cielo represent in terms of debit?

A - Clovis Poggetti {BIO 16529642 <GO>}

In terms of volume? The debit?

Q - Carlos Macedo {BIO 15158925 <GO>}

Yes.

A - Clovis Poggetti {BIO 16529642 <GO>}

It's around 20%.

Q - Carlos Macedo {BIO 15158925 <GO>}

20%, okay. Thank you. Debit. Just going back to the...

A - Clovis Poggetti {BIO 16529642 <GO>}

Debit. At the end of the day, if I consider the whole thing, if we include the credit, it's less than 10%.

Q - Carlos Macedo {BIO 15158925 <GO>}

Understood. Just going back to the first question, a few years back, there was some concern that the new entrants would basically not charge anything and would give out machines for free, be it for a year or six months or whatever term. Is that something that you're prepared to face again through the end of the year if competition intensifies once these final exclusivities are over? Is there a plan to face this? Are you going to maintain your current pricing scheme? What are you looking for going forward?

A - Rômulo de Mello Dias

Don't get me wrong because we do respect the new entrants and as well the incumbents. Having said that, we are the leaders of this market and we have our own policy and of course we try to let's say to provide the best service for the customers, to the merchants, and also to try to chart for the service that we are offering to them. Having said that, at the end of the day, that question about also how the market is evaluating, how the market is - how is the behavior of the new entrants? How is the new conditions that their merchants are receiving? So we need to adapt our policy, even though that our policy, considering the fact that we are leader, as you said, don't get me wrong. We do - let's say have a perception with the merchants that they like to work with us so - but we've also are always looking trying to understand, how is the reaction from the market,

what the new entrants are offerings, so on and so forth. I don't know if I answered your questions.

Q - Carlos Macedo {BIO 15158925 <GO>}

You did, Rômulo. Thank you so much. Thank you for your answers.

Operator

Our next question comes from Craig Maurer with Autonomous.

Q - Craig Jared Maurer {BIO 4162139 <GO>}

Yes. Hi. Just a question on the JV, what are the opportunities going forward considering your own existing internal capabilities for synergies in the JV as the year moves? Thank you.

A - Rômulo de Mello Dias

Craig, thank you for your question. About the synergies, it's too early to say something because a committee will be formed after we close the deal. This committee, as I mentioned before will be comprised by some members from Cielo and some members from Banco do Brasil.

I would say that something that's more clear for us, that after the new resolution that came from Central Bank related to the process that Banco do Brasil have, would have with this transaction, that the intangible assets could be recognized. If the intangible assets could be recognized in Banco do Brasil, of course you also could do the same thing in the JV. So this is something new that will also help the results of the JV.

But about the synergies, as I said, it's too early to say because we are just finalizing some precedent conditions and when you have all the P&L with revenues, cost, and expenses, I can - we can provide you more color and more information about the JV.

Q - Craig Jared Maurer {BIO 4162139 <GO>}

Okay. Thank you very much.

Operator

Our next question comes from Alexandre Spada with Itaú BBA.

Q - Alexandre Spada {BIO 16687974 <GO>}

Hi. Good afternoon. Thanks for taking my questions. I have two questions actually. The first one is, there was a reduction in the average price charge in the prepayment segment. According to our calculations, the monthly price shrank to 1.72% per month in the 4Q, from 1.77% in the previous quarter, even with an increase in the SELIC rate.

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Bloomberg Transcript

Given that the penetration was roughly flat Q-on-Q, what triggered the press contraction, and what can we expect going forward, and then I will come back with my second question?

A - Rômulo de Mello Dias

Alexandre, thank you for your question, but if you allow me to say, there was no reduction in the price that we charge from the merchants. How you charge the merchants? Big merchants as you know, as a percentage of CDI. If SELIC goes up, CDI goes up, so it's exactly the same.

There is no change in terms of percentage that you charge, of course depends on deal by deal, the size of the client, so on and so forth. When you talk about the small merchants, we also take into consideration the SELIC when it goes up or goes down. So there is no reduction, what happened because, we raised more money to fund the product and its (41:06) the product receivables.

A - Clovis Poggetti {BIO 16529642 <GO>}

Yes. Alexandre, we - I don't really know how you get this figures but, what Rômulo is saying is when we analyze the price we sell our prepayment, considering the corporate area in SME and compare the average that we had into the fourth quarter with the one that we present in the third quarter, they were somehow flattish and even slightly - there was a slight improvement, okay? What happened is that, every end of March and every end of September, we pay dividends. So, we use our cash to pay dividends. But we still have demand for prepayment, okay? Which means that we prepay more our receivables with the issuing banks during the third quarter, during the second quarter, and the fourth quarter of every year.

A - Rômulo de Mello Dias

We raise more money after when we pay divided is so what...

A - Clovis Poggetti {BIO 16529642 <GO>}

So, maybe when you consider the financial expenses that we have consequent of these funding that, I'm guessing here may be a reason why you got the conclusion about the slight decrease.

Q - Alexandre Spada {BIO 16687974 <GO>}

Can I put the question in another way?

A - Clovis Poggetti {BIO 16529642 <GO>}

Okay.

Q - Alexandre Spada {BIO 16687974 <GO>}

If we take a look at the slide number 9, we can see that the volume on a quarter-over-quarter basis expanded about 8%, right?

A - Clovis Poggetti {BIO 16529642 <GO>}

Okay.

Q - Alexandre Spada {BIO 16687974 <GO>}

And the gross revenue with the prepayment expanded by 11%. The average term was pretty much flat quarter-on-quarter. And the SELIC rate was up more than the 3%, which is the difference between the 11% and the 8%. So, that's why my conclusion was the price strength...

A - Clovis Poggetti {BIO 16529642 <GO>}

Agreed. But don't forget, for sure you're taking into consideration the analysis, let's say the present value adjustment, and this is something that account and take into consideration, let's say only. Because, for sure, we had a change in the characteristic of the merchant that prepaid with us - end of the fourth quarter, if compared to the kind of the merchant that prepaid with us end of the third quarter. Give a look that, the adjustment grew 400% in the same period and this number affects what we consider here, the accounting result of the prepayment business. But, reinforcing what Rômulo just mentioned, taking the product only. Let's say taking what our sales guys are selling the price and et cetera. We had an improvement and not let's say, any kind of decrease or discount.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay, that's fair enough. Thank you. And my second question, if you allow me, what do you believe would be the implication for Cielo in the case where it goes through an electricity rationing scenario and if the largest and most important cities in the southeast region of the country adopt a severe water rationing measures?

A - Rômulo de Mello Dias

Good question, Spada. I'm assuming that, all the governments, the Federal and also the state, and municipalities, they will take measures to avoid this situation. But of course, if you suffer some kind of reduction in terms of the offer in terms of the energy, at the end of day will affect our business of course, and as well, and the others. But I'm assuming that they would take measures - and I heard by the way, yesterday, some governors saying that they'll begin to rationalize the offer of water and so on and so forth. So I'm assuming that this is not going to happen because it's something completely unacceptable.

Q - Alexandre Spada {BIO 16687974 <GO>}

Okay. Thank you.

Operator

Our next question comes from Rafael Frade with Bradesco.

Q - Rafael Frade {BIO 16621076 <GO>}

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Hi. Just a follow up on the Portuguese conference call. So talking about you already mentioned, we discussed a lot about the cost per transaction, but I will like to hear your view on the revenues per transaction. When we are seeing volumes, we are seeing some negative, something that should be putting a downward pressure on the revenues per transaction that are higher growth from debit, and also some pressure in MDR coming from competition. On the other side, we have inflation that probably would be positive for revenues per transaction. I would like to get your view on the - all those factors, should we should expect revenues per transaction flat or some increase or some decrease for 2015? And how do you see this?

A - Rômulo de Mello Dias

Rafael, thank you for your question. I think it's - if it were more - and we have more small merchants to our - let's say our clients. At the end of the day, this is not going to help in this metric, revenue per transaction. And why? Because you're talking about smaller merchants. Also, when the debit grows more than the credit, is also the ticket is lowered when compared to credit. So to be honest, if you allow me to say, I'm not concerned in this regard about this. And why? Because it's a question about the - the stage that Brazil is. Brazil today has a penetration of around 28% in terms of the sea. And this penetration of course can continue to grow, but how can you grow? To go - we should grow, trying to pursue other segments, we should borrow, trying to pursue other kind of merchants that today are not including, and are not participating in this business, are not participating using credit card as a means of payments.

And also, debit is to break down the percentage that debit has, let's not forget that usually, on the Q4 is much higher when compared to the other quarters because you have the 13th salary that Brazilian employees receive. So, there are many explanations about that. And of course, I would prefer to have that revenue per transaction higher, but it's a mix of answers, it's a mix of explanations, that at the end of the day, explain why the revenue per transaction is not growing at the same pace that used to have until some months ago. But we don't consider this as a - let's say as a bad thing.

Q - Rafael Frade {BIO 16621076 <GO>}

Okay. Perfect. Thank you, Rômulo.

A - Rômulo de Mello Dias

Thank you.

Operator

Our next question comes from Aníbal Valdés with Barclays.

Q - Aníbal Valdés

Hi. Good morning guys, thank you for the call. I have two questions regarding the state of the company. Just wanted to know if there is still like a guidance or internal by-laws in terms of leverage ratios for the company. And also the second question has to do with

the promissory notes that you guys issued ahead of the JV with Banco do Brasil. I wanted to understand what the game plan in order to refinance that promissory note? Thank you.

A - Rômulo de Mello Dias

Hi Anibal. Can you repeat your first question please?

Q - Aníbal Valdés

Yes, sorry. So the first question has to do with if there is any internal by-laws in terms of leverage for the company, because your third quarter earnings, I mean it's still very low, it's one-time net debt to EBITDA, but I just wanted to know if you guys were looking forward to leverage the company more or if this is the level where you feel comfortable with the company?

A - Rômulo de Mello Dias

Aníbal, sorry. Thank you for your question. This is Rômulo speaking. No, we don't have internal bylaw or written bylaw of the company or internal policy which is written. What you have that - we should consider that our controlling shareholders are more conservative than the others. So having said that, the company usually does not like to be very leveraged when compared to other companies in the same industry. But with the new association, with the new JV with Banco do Brasil, our net debt EBITDA will go to 1.6 times and we expect that there's going to be an accretion considering the reduction of a payout ratio from 50 to 30 (51:11), and the accretion will occur at one year after the conclusion of the deal. So, as I said, we are more conservative than the others. We do think that we have a capacity. And having said that and after paying the debt, we could increase again this business.

Q - Aníbal Valdés

Okay.

A - Clovis Poggetti {BIO 16529642 <GO>}

And with regards to your second question, so issued is R\$4.6 billion promissory notes end of December, okay. 100% related to the JV with Banco do Brasil. You might consider this as a kind of - it's a bit lower in the short term (51:55), as I just mentioned, 180 days. We will have a takeout in a, let's say, much longer than 180 days credit facility but with regards to this specific point, unfortunately we are in a - I cannot give you further details. But I can give you, let's say, not details but some kind of things that we - the reason why we reduce the dividend from 50 to 30 (52:30), we are going to reduce when the deal closes is because we have the intention to pay very, let's say in a certain period of time, very fast. Okay.

Q - Aníbal Valdés

All right. Thank you. Understood. Thank you very much.

A - Operator

Our next question comes from Eduardo Nishio with Banco Plural.

Q - Eduardo Nishio {BIO 15333200 <GO>}

All right. Thank you for taking my questions. I have a couple of questions. First, if you can give us a little bit more detail. You talked about the Merchant e-Solutions integration. When you plan to rollout, is it going to be rolled out in phases in way these are as was initially announced at the end of 2016 or there's any chance for rolling out before that in stages? The second question is regarding the JV. I know you still need to close the deal, but if you can talk about a little bit why it's taking a bit longer to close the deal, what to expect in terms of - if there's any changes in valuation tangibles and taxes that was initially talked about with the deal being closed? Thank you.

A - Rômulo de Mello Dias

Thank you, Nishio, for your questions regarding to the first one, Merchant e-Solutions, and the focalization of the new platform that we are developing. We are going to deliver in phase, as you said. The first phase is going to happen this year, the second phase, next year and the third phase 2017. Okay.

Q - Eduardo Nishio {BIO 15333200 <GO>}

And what to expect in terms of cost? Do you think that after this first phase and second phase, you're already going to have a decrease in costs and expenses? And in terms of revenues, what do you expect in terms of additional revenues that this rollout can bring? Thank you.

A - Rômulo de Mello Dias

For sure, the cost after 2017 will be lowered when compared to the one that Clovis shared with you. We said there in the speech that, Brazil Cielo, I don't know if you had the opportunity to listen to the speech. But we said that the Brazil Cielo had in year 2014 at a cost of \$0.54 and we expect for this year, it's going to be some - the range is going to be between \$0.49 and \$0.51. For 2017, considering the fact that we right now and until 2017 you're going to have two platforms and the cost of the two platforms, we will - we don't have a lot of expectation until 2017, 2016 because the two platforms needs to run in parallel. After that, when we turn off the old platform in year 2017, I think we are going to be able to provide and to deliver better cost than \$0.49 and \$0.51 for Brazil Cielo.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay.

A - Rômulo de Mello Dias

In terms of revenues, we do expect that if you have a better platform, that's going to help us to create more stickiness with the customers and to have more customers. I prefer not to provide a number because it's too early to say. But at the end of the day, if you have a platform that's a near-time platform and you can have access, you don't need to wait for the audit date to know how much you sell, not only one day. It takes more than one day to provide some kind of information that the merchants ask.

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And by the way, it's necessary also to explain that's not only in the case of Brazil, but also outside Brazil. So this new platform that took us, as you know, more than two years trying to understand what would be the best platform the next-generation for Cielo in order to provide a better service for our customers. This was the main reason why we bought Merchant e-Solutions, will help us with no doubt to create more stickiness and to have more clients because the clients and the merchants they would have - not only the merchants, but as well our banks that are partners of Cielo. They will have access almost instantaneous with 10 seconds delay by credit, by debit, by merchants so on and so forth. So, many formation is going to help us in this regard.

The second question about the JV, why it's taking longer, because I would say that with more weeks we expect to close the transaction. As I said, we have some precedent conditions that when we signed the deal with Banco do Brasil, that need to be reached before we close the transaction, but we are confident that we are almost there.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Special changes in the numbers announced that...

A - Rômulo de Mello Dias

No. No way.

Q - Eduardo Nishio {BIO 15333200 <GO>}

Okay.

A - Rômulo de Mello Dias

The net earnings, R\$578 million from October 1, 2014 and until September 30, 2014 is exactly the same. So, there's no change in terms of the earnings that the JV will have.

Q - Eduardo Nishio {BIO 15333200 <GO>}

As well as valuations, right?

A - Rômulo de Mello Dias

Yeah, we are talking about valuations. That's right.

Q - Eduardo Nishio {BIO 15333200 <GO>}

All right. Okay. Thank you.

Operator

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

A - Rômulo de Mello Dias

Thank you all guys for participating in our conference call. And as usual, we are open to consider further questions that you may have. And have a nice day. Thank you.

Operator

This concludes Cielo's audio conference for today. Thank you very much for your participation. Have a good day and thank you for using Chorus Call.

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