Q2 2016 Earnings Call

Company Participants

- Daniel Sonder
- Rogério de Araújo Santana

Other Participants

- Carlos Gomez-Lopez
- Frederic de Mariz
- Gabriel Gusan
- Gustavo Lôbo
- Gustavo Schroden
- Marcelo Cintra

MANAGEMENT DISCUSSION SECTION

Operator

Good morning, ladies and gentlemen, and welcome to the audio conference call about the earnings results of BM&FBOVESPA for the second quarter of 2016. At this time, all participants are in a listen only mode. Later, we will conduct the question-and-answer session, and instructions to participate will be given at that time. As a reminder, this conference is being recorded and broadcasted live by a webcast. The replay will be available after the event is concluded.

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

Daniel Sonder {BIO 18250247 <GO>}

Good morning, everybody. Thank you for joining the call. I'd like to welcome you to our quarterly earnings conference call to discuss the results of the second quarter of 2016. As always, thank you for your interest and for spending time looking at our results and listening to this discussion. I am here with the team from the Investor Relations as well as the finance team, which I would always – as always like to thank so much for putting together the materials that we're going to use during this conference.

I'm also here with my colleague at the Executive Board, Rodrigo Nardoni. Nardoni is joining the Executive Board as a new CIO in the company. As you might have read, our colleague Luís Furtado has announced his personal decision to leave the company at the first quarter of next year, and Nardoni will be his replacement. Nardoni has been a professional with the BM&F IT team for 14 years and is obviously a very seasoned professional which has participated in the technology overhaul which we have gone through over the past few years.

I'd like to now turn to the presentation. If you move to slide three, there is an overview of what happened in our operating and in our financial results during the second quarter of the year, as well as some updates on our strategic initiatives. We'll go into more details in the following slides. On the left side of this page, we see the operating highlights in both BM&F and Bovespa segments.

Average daily volume in BM&F segments showed an increase of 4%, while revenue per contract declined 1.3%. Both were influenced by the growth in Mini contract volumes. In the Bovespa segment, we see stability in both volumes and fees in this quarter.

As we'll see in slide eight, the increase in turnover velocity, offset the lower average market cap, resulting in flat volumes. Margins were 10 bps lower, affected by higher participation of day trade in the average daily traded volume, and higher volumes tied to the exploration of options on indices.

Additionally, the other business lines showed a very solid performance, especially in our market data and Tesouro Direto businesses.

In the middle of the page, we see how our revenues performed year-over-year. In addition to the operating highlights I just mentioned, volume-related revenues also benefited from the fact that in the second quarter of 2016, we had two trading days more than in the second quarter of 2015. We maintained the diligent expense control during the quarter, with adjusted expenses growing 3.5% compared to the same period of last year, well below average inflation, which was 8.8%.

During the second quarter of 2016, we had several extraordinary items that impacted our bottom-line. They were mainly related to the sale of our remaining 4% equity stake in CME Group in April and to the transaction with Cetip, which is still pending regulatory approvals. These extraordinary items impacted our IFRS numbers, and explained why we saw a net loss in our accounting net income.

Excluding these extraordinary items, our net income would have reached almost BRL 500 million as you see in the slide. I'll go through these extraordinary items in a moment.

Our board approved the payment of BRL 215 million in interest of capital this quarter. This consideration represents 50% of the net income excluding impacts from the divestments from CME Group shares. The 50% payout ratio is lower than what we had been practicing over the past few years of at least 80%. As you know the company is retaining cash in order to pay for the cash portion of the Cetip transaction once all approvals are obtained.

On the far right side of slide three, we present updates on some long-term strategic initiatives that aim at offering growth opportunities and value creation to our company. The main achievement of this quarter was the approval of the proposed business combination with Cetip by the vast majority of both BM&FBOVESPA and Cetip shareholders.

We are thankful to our shareholders and humble by their support in the Extraordinary Shareholders Meeting, while we achieved a record column (05:42) of 72%. In the end of June, another milestone was achieved with the filing at CADE the Brazilian Antitrust Authority of the transaction.

After all regulatory approvals are obtained, we are committed to work hard to jointly and jointly to preserve and improve upon the operational excellence, the client relationship and the innovation skills for which both companies are recognized. To fund part of the transaction, we sold in April the remaining equity stake we held in CME Group. The total gross proceeds from the 5% ownership sale including also the sale executed in September 2015, amounted to BRL 5.5 billion before tax. And we will retain this large cash balance until the financial settlement of the transaction with Cetip.

The second phase of the new integrated BM&FBOVESPA Clearinghouse is moving forward as all of our other projects continue to move forward. In the second quarter of 2016, we moved to the parallel production phase, the deployments planned for the end of this year. This is a key project for BM&FBOVESPA and for the market as a whole.

Lastly, during the quarter, we increased our participation in Bolsa de Comercio de Santiago to 10.4%, and also acquired stakes in Colombia and Mexico, 9.9% in Bolsa de Valores de Colombia and 4.1% in Bolsa Mexicana de Valores.

We now move to slide four. I want to give you some more details about extraordinary items that impacted 2016 in the name of full transparency as we like to do to make sure that people can: one, understand exactly the numbers of the quarter; and two, be able to model properly and project adequately what goes on from now on.

In terms of the extraordinary items, we summarized in this table the items that impacted our results in the quarter, aiming to help analysts and investors in their analysis. For that reason, we show the income statement lines impact and also the amount before and after taxes. First, we have extraordinary stock grant expenses related to severance due to changes in the management that we already announced. Second and most relevant, reflecting the divestment from CME group shares, we saw several extraordinary accounting impacts in this quarter, most of them with no cash impact.

First, BRL 572 million before tax that comprise the recognition of an accounting loss related to the difference of CME share price and U.S dollar FX rates between September and April 2016 which amounts to BRL 460 million with no cash impact, and the payment of PIS and Cofins taxes levied on the capital gain generated in the transaction amounted to BRL 112 million, this is a cash expense.

Also related to the divestment from CME Group share, we paid IOF tax of BRL 16 million on the proceeds from the sale when we transformed them from dollars into real. And last, we booked in the quarter some expenses, related to the proposed business combination with Cetip which amounted to BRL 47.8 million in the quarter, this expense is composed by transaction cost and expenses with the planning of the business combination.

We move now to slide five, and I wanted to emphasize that we maintained our strict focus with respect to product and market development. We have concentrated our efforts in increasing liquidity for listed products by adding new market maker programs. We have now 35 asset programs versus 19 at the end of the second quarter last year.

We maintained our efforts to promote our securities lending platform to foreign investors. We see the development of the securities lending market is very important to having an increasingly sophisticated equity market in Brazil. With regards to new products, we saw a significant increase in average daily volume and open interest for the inflation-linked future contracts, and we do believe that this performance is directly related to the introduction of market makers for this contract in May.

We also expanded the number of non-sponsored BDRs listed in our markets. In July, we admitted 16 new programs increasing the portfolio to 122 BDRs.

Just recently, the regulatory and tax frameworks for the fixed income EPS has been completed. We have held discussions with market participants and are optimistic about the launching of these new products soon.

Now, Rogério will give more details about our operational performance.

Rogério de Araújo Santana

Thank you, Daniel, and hello, everyone. I would like to ask you to move to slide six of the presentation. The chart on the left side of this slide shows that as we've seen in the previous quarter, the greatest contribution to revenue growth came from financial and commodity derivatives market. We've seen BM&F segment, where we have a long exposure to U.S. dollar as well as exposure to volatility around interest rate and FX rate.

Also, the business line is not related to ones, showed solid results (11:30) in the quarter and contributed to revenue growth mainly reflecting the performance of Tesouro Direto platform and market data revenues.

On the right side, the pie chart shows that the derivatives market continues to be the main sources of revenues for BM&FBOVESPA. If we sum up financial and commodity derivatives that represented 41.8% and the derivatives on single stocks and infos (11:57) for another 3.8%, we reached 45.6% of total revenues.

Additionally, 25% of the company's top line were (12:08) U.S. dollar-linked in the second quarter 2016 showing the merits of our revenues diversification.

Moving to slide seven, you will find the data (12:20) on the performance of the financial and commodity derivatives market. The 5.5% revenue growth in the BM&F segment was driven by a 4% growth in the total ADV, coupled with the increase in the number of trading day to 63 days in the second quarter 2016 versus 61 days in the second quarter 2015.

This quarter, the main contribution to advanced growth in this market came from Mini contracts, which grew 86.7%. It is important to note that since these contracts have an RPC that is significantly lower than average, a higher participation of them in the total volumes has a negative impact on the average RPC. This is the main reason for the 1.3% reduction in the average RPC year-over-year as you can see on the bottom of this slide.

In the bar charts on the left side, you see that contracts priced in the U.S. dollar, and contracts exposed to interest rates are the most relevant in this segment. Finally in the derivatives market, more than 50% of the revenue is linked to contracts priced in U.S. dollar showing our revenue diversification.

In slide eight, we have the performance of the equity market. Revenues in the equity business from Bovespa segment was stable in the second quarter 2016. Although, the turnover velocity showed a significant increase in the periods, reaching 79.4% versus 70.5% in the second quarter 2015. This growth in the market cap was only enough to offset the 10% reduction in the average market capitalization during the same period.

Trading and post-trading margins, reached 5.208 basis points in the second quarter 2016, versus 5.309 basis points in the second quarter 2015. This 1.9% or 0.1 basis point reduction in margins is explained by the combination of two factors, higher participation of the traders in the overall volume since these fees are lower than average. And higher volumes connected to the expiration of options on equity-based indices to which trade and post-trading fees do not apply in most of these parts.

Moving to slide nine, we highlight other sources of revenues that are not related to volumes. You may know that one of the drivers of the company's strategy is to increase the revenue coming from this group of products and services. We pursue this goal mainly by actively marketing these products and services, as well as revisiting commercial policies that apply to them.

This growth of business line, as you can see in the grey piece of the pie chart, represented 21.4% of total revenues in the second quarter 2016, in aggregate, grew 8.1% year-over-year. This growth results from solid operating performance of some products as I mentioned before, notably market data in Tesouro Direto which is under the depository line, combined with change to the commercial policies of some products and services.

Now, I will pass the word back to Daniel, who will detail our expenses and other financial highlights.

Daniel Sonder {BIO 18250247 <GO>}

Thank you, Rogério. In the next slide, page 10, we show the expense breakdown for the quarter. Our adjusted expenses increased 3.5% year-over-year, mainly driven by higher adjusted personnel and data processing expenses. Our adjusted personnel expenses, which exclude long-term incentive plans was 4.5% higher compared to the second quarter of 2016, due primarily to the annual salary adjustment of approximately 9% applied in August 2015. The growth in data processing, our second largest expense line, is explained by the exchange rate, and inflation adjustments to some IT maintenance contracts.

IFRS expenses in 2016 second quarter grew 36% year-over-year, as you see in the bottom of the page, impacted by extraordinary expenses connected to; one, the proposed business combination with Cetip amounting to BRL 47.8 million, and higher stock grant expenses which were impacted by the increase in the amount of provisions for payroll taxes reflecting higher BM&FBOVESPA's stock price, and by extraordinary severance costs.

The expenses with the transaction with Cetip, and the impact from severance on the stock grant expenses are non-recurring as explained before.

Moving now to page 11, we see the financial highlights. We always like to underscore our financial robustness with a solid cash position, which is an important part of the business of being a credible counterparty in the financial market.

Total cash amounted to BRL 10.5 billion at the end of the quarter, composed by BM&FBOVESPA's own cash, and third party cash, mainly related to collateral pledged by clients.

On the left side, and blue part of the graph, we can see the third party cash, which amounted to $2.2 billion, mainly composed by market participants' cash collateral of $1.6 billion. It's important to highlight that the company earns interest on most of this cash balance.

On the right side represented by the green bar, you find BM&FBOVESPA'S own cash, composed of restricted and unrestricted cash, which totaled BRL 8.2 billion in the second quarter of 2016. BM&FBOVESPA's own cash includes the necessary cash to run the day by day activities of the company that totals between BRL 2 billion and BRL 2.5 billion. This amount includes approximately BRL 1.1 billion in Clearinghouses' required safeguards. The remaining balance supports our activity as a central counter-party and general corporate needs. Excluding this cash position, that it is necessary to run the business, we have somewhat under BRL 6 billion in available cash including the proceeds from the divestment from CME Group shares. As mentioned before, we are retaining the significant additional cash position to fund the proposed transaction with Cetip.

We move now to slide 12, and I'll ask Rogério to go into some more details on what happened to our financial results. In this slide, we highlight the extraordinary items that impacted the financial results, as we see in the green box in this slide on the left side.

This extraordinary items from the selling of 4% of CME shares includes BRL 406.5 million related to change to the CME stock price and to the exchange rate of Brazilian reals versus U.S. dollar with no cash impact. Also, it includes the payment of PIS/Cofins on capital gain of BRL 112.3 million. And finally, it includes IOF on capital gains of BRL 16.4 million. Excluding these extraordinary impacts, we reached a recurring financial results of BRL 107.9 million in the quarter.

This amount includes the financial revenue from interests and proceeds coming from the divestment from CME Group shares, considering, we intend to retain these proceeds into the settlement date of the proposed business combination (20:18) with Cetip. It will positively impact financial results in the quarters to come.

On the other hand, the financial expense is now impacted by the cost of the hedge of the principal amount of its 2020 Notes, which totaled BRL 58.5 million in the quarter. The cost of this hedge is 79.1% of CDI on approximately BRL 2.2 billion.

The coupon on the 2020 Note also affects the financial expense. As being – as has had been the case since we issued these notes in 2010, I call your attention to the fact that the coupon is not hedged at this point. The interest owned which is approximately BRL 14 million per year from 6.5% effective interest rate on the amount of $612 million notional fair value of the bonds is still exposure to (21:23) change in the BRL versus U.S. dollar exchange rates.

I would like to conclude the presentation on page 13, where I just wanted to highlight the strong cash flow generation of the company in the quarter, before paying interest on capital or dividends or repurchase, we generated almost BRL 445 million in cash, which is stable year-over-year. And even considering the cash tax payment of BRL 128 million in the quarter, the company maintained its capacity to generate cash, one of the main strength of our business model.

I would like to conclude the presentation now and open for Q&A.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session for investors and analysts. Our first question comes from Marcelo Cintra with Goldman Sachs.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Hi, good morning, everyone. Thank you for taking my question. Now, I had two questions actually. The first one is related to the one-off expenses related to this M&A with Cetip. I just want to hear from you, if we should expect any more cost and expenses on this front given that we are still waiting for the regulatory approvals and you are still waiting for CADE approvals? And then a follow-up, in how much would be these additional expenses? And then I will follow-up with my second question.

A - Daniel Sonder {BIO 18250247 <GO>}

Good. Thank you, Cintra. We – we've to expect to see some additional expenses. We broke down in the – in a footnote, the fact that some of these expenses we saw in this quarter related to what we call the transaction execution itself, so essentially, same for advisors and lawyers and so forth. And another part is – another part is related to some consulting work that has to do with the integration that we need to plan for.

So, in the first category, we do not expect to see any significant number, although there are some fees that are still pending payment through the closing of the transaction, but they are not very significant. With respect to the – to the expenses linked to work that is actually in the planning of the integration that's where we're going to see some – some additional pieces because we've just started doing that. We're not guiding specifically for those expenses, they are reasonable consulting fees, according to – to – to market prices and we are very comfortable that they're not going to significantly impact our results in any materially different extent than what you have perhaps seen in this quarter.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. And just a quick follow you will provide – you will breakdown these – the expenses in the following quarters and also show them as non-recurring? Right?

A - Daniel Sonder {BIO 18250247 <GO>}

Absolutely, yes. What we – what we want to do is to continue to have the consistency of measuring our ongoing business related or sort of expenses related to running the company on a comparable basis, and this is obviously good for how we communicate to the market but also good for our own internal management processes. So, we will separate those up.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. Perfect, thank you. And my – my second question is mere related to the buyback program. Given that, you are still increasing your cash position in order to fund the – the acquisition of Cetip. Is it fair to assume that we should not – we should not expect any buybacks until this goes enough the transaction? And I just would like to also understand if you're forbidden by relaters (26:02) are not to buy back shares before the closing?

A - Daniel Sonder {BIO 18250247 <GO>}

Yeah. So, the answer is, we do not plan to have any buybacks until we conclude the transaction. As you know, the buyback program has been for several years away to add to our distributions over and above dividends and IoC, because the company generated more cash earnings than accounting earnings. In this situation now, we are actually distributing below what we could potentially do in order to return some cash. So, the answer is we don't intend to buy back.

And with regards to the second question, the company has always and that is irrespective of whether there is a transaction or there is no transaction. If the company is in possession of material nonpublic information, we would be obviously restricted from buybacks, but it doesn't really apply because we are not going to do it for financial reasons.

Q - Marcelo Cintra {BIO 16463628 <GO>}

Okay. That's perfect, and thank you.

Operator

The next question comes from Gustavo Schroden with Bank of America Merrill Lynch.

Q - Gustavo Schroden {BIO 18713982 <GO>}

Hi, good morning, everybody. Thanks for the opportunity. My question is related to CARF ruling because the last week was published in the official diary that CARF is expected to rule on the Brazilian tax authorities at tax assessment of BVMF by August 17. And if I'm not wrong, these specific rules should be related to 2008 and 2009 years and according to our designates (27:57), this could reach in a BRL 1.4 billion of fines, right. So my question is that, could you confirm this news that saying that if you are expecting this rule for the next week, and also provide us an update in terms of figures that you have been asked by the tax authorities including all the assessments that you already have been noticed, and how the company could blame in case of a negative decision from the ruling? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Good. Thank you, Gustavo. Give me an opportunity to say once again what our position on this is, but it really has not changed. So, number one, yes, there is a scheduled hearing on August 17 on this matter. As in previous situation, we cannot predict whether there will be a decision on that date or not. These hearings have several technical nuances that I'm not going to engage in, but which could and have in the past presented a definitive decision to be made in any one particular meeting. So, the schedule of the meeting and the cases that will be heard are public in the CARF website. So, you will be able to continue to follow this, and we will communicate with the market through the proper channels only if there is a final decision.

Second, with respect to the amount, the amount is stated in our financial statements under Note 14. And as of June 30, it totals BRL 1.137 billion, which includes all fines and interest up to that date that's regarding the first case, that is the one that is more advanced in terms of the stages of the appeal process in the CARF and therefore, will be heard on the August 17th date which I just mentioned.

With respect to accounting treatment, this is considered as a unlikely loss. And therefore, we do not have any provisions for this, and according to our legal advisors and our discussions with our accounting - sorry, audit committee, even if there is a negative decision at the cost level at some point and we - we do not feel that we would need to change the provisioning policy on this.

Our conviction is very, very strong and backed up by our legal and tax advisors as well as independent tax advisors that have to review this periodically that our case is a very good case, and that eventually, we will prevail even if we have to go to the judiciary.

And because of that, there is no provision required. Obviously, I'll make the caveat as I always do, that obviously, if there is a change in some precedent, in some other type of news that comes from outside of our case that is material and significant and that affects our lawyers views on the success of our appeal, we could potentially change our mind, but that is not the base case scenario at this point.

And finally, with regards to strategy, here, again, we do feel that we have a very strong case for the appeal for the revenue services, charges against us are weak. And therefore, we hope to be successful at this higher level of the CARF. However, if we are not - if we fail to obtain the suspension of the tax assessment, the cancellation of the tax assessment, we will go to court and that would start obviously after this CARF procedure at the higher court.

Finally, if we are successful in our appeal at the CARF, the government meaning, the revenue service cannot take us to court. We can take them to court, but they can't take us to court. Is that clear?

Q - Gustavo Schroden {BIO 18713982 <GO>}

Yes, perfect. Very clear, Daniel. Thanks for an answer.

Operator

The next question comes from Gabriel Gusan with Bradesco.

Q - Gabriel Gusan {BIO 16184494 <GO>}

Hi, good morning, everyone. You showed a BRL 41 million charge (33:24) in the stock rent line this quarter, and it will breakdown a BRL 19 million of BRL 20 million (33:32) of labor charges regardless, and mentioned that both BM&F stock price increase, and contract terminations. What are the reasons for that increase are still (33:44) increasing from 25 level in your previous quarter (33:48)? My questions are is it possible to break it down, the effect of each of those two points that you mentioned charges (33:58) and the stock price increase? And my second question is the new stock price level changes your expectation for recurring expense going forward, what would that level be, BRL 20 million, BRL 25 million, BRL 30 million for project taking all of the (34:16) variables constant? Thank you.

A - Rogério de Araújo Santana

Hi, Gabriel this is Rogério. I'll start with the first question regarding the impact on the personal loan. Personal expense loan comes from stock grant expense. As we mentioned and as we have (34:32) put into in the documents, we had an extraordinary item related to severance that totaled BRL 17.6 million including the principal amount and also the payroll tax on that. If we break down this BRL 17.6 million, we have BRL 6.9 million in principal and BRL 10.6 million in the payroll.

So, addressing your question the BRL 22.5 million in payroll tax provision, out of these number, BRL 10.6 million is related to extraordinary items. So, it would be roughly BRL 11.9 million in our recurring base, and yes, it is directly impacted by BM&FBOVESPA stock performance in the quarter. And remember that we needed to submit provisions on this expected payroll taxes we're going to pay as amount we transferred the shares to the beneficiary. And every time the share price moves, we need to mark-to-market these provisions, that's why this number in the second quarter, the recurring number is much higher than the number we saw in the first quarter, because you have this share price movement between March 31 and June. And also, we need to update the number that was booked in the first quarter and it also impacted the second quarter. Is that clear?

Q - Gabriel Gusan {BIO 16184494 <GO>}

Yes. So, then just to understand, if you don't have a change in level from the closing of the second quarter to the closing of the third quarter then you should expect that level to drop, so because you don't have to mark up the inventories, is that it?

A - Rogério de Araújo Santana

Yes. It makes sense, exactly.

Q - Gabriel Gusan {BIO 16184494 <GO>}

Okay. I got it. Thank you.

A - Rogério de Araújo Santana

Then, you're going to provision it only the third quarter number.

Q - Gabriel Gusan {BIO 16184494 <GO>}

Okay, perfect. Thank you very much.

A - Rogério de Araújo Santana

And the other way around if the share part (36:50) goes down, we write-off – kind of write-off the provisions that we made before.

Q - Gabriel Gusan {BIO 16184494 <GO>}

Perfect, thanks.

Operator

Next question from Gustavo Lôbo, JPMorgan.

Q - Gustavo Lôbo

Hi. Good morning, everyone. I have two questions as well. First is a follow-up on the deal, just do you have any expectation of signing for the conclusion of the deal, could you remind us that each of the next (37:24) deal which concluded in the order of it, and what should be the recurring level of payout ratio going forward once the deal is concluded? And then, I have a second quick question afterwards. Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Great. Gustavo, thanks for your question. So in terms of timeline, we filed our official papers with the CADE on June 28. According to their statutes, they have eight months to make a decision with the possible extension for another three months, so that would be either February or May. We are obviously working to have a decision by February at the latest, but it's obviously, not our – not under our discussion. There are no clear intermediate sort of goal post (38:25) clear steps in the transactions that I can detail. I think that CADE is a very transparent agency. And if you take the time to go into the website, you will see that they have already started collecting feedback from market participants and putting together the materials that they would need to thoroughly review our case.

With respect to the two other regulators, we're already working with them, they don't have such a clear out time table, but we do not expect that they will be taking longer than the CADE neither Central Bank nor CVM. So I think that, it's reasonable to assume under the information that we have now that the last – sort of the last date that I mentioned when I spoke about CADE. So, that is on the transaction.

Pardon me, what was your second question?

Q - Gustavo Lôbo

Yeah. Just...

A - Daniel Sonder {BIO 18250247 <GO>}

Oh, payout, payout. My bad.

Q - Gustavo Lôbo

Got you.

A - Daniel Sonder {BIO 18250247 <GO>}

My bad, my bad. Payout. So, in terms of payout, this year we are again being conservative here, and accumulating a little bit, retaining a little bit of cash for the possibility of the approval perhaps happening this year, although we don't think that's the most likely scenario given the time table that I just gave.

So, we have announced 50% payout. Although, we have been reviewing this every time at the board levels, and we have to take into consideration obviously the tax consequences of paying more or less interest on cap 2 (40:35) as we approach the end of the year, and how this works for most company.

For the following years, our estimates show that we think we can amortize the debt that we'll be adding on to our books related to the CPO (40:57). And in the time table that we think is reasonable, we have given this sort of macro guidance of trying to reach one-time EBITDA by the end of 2019, three years into the deal, and we think we can do that by using our cash to amortize debt, and yet pay something around 80% of accounting net income as dividend.

Again, we do not consider this as a formal dividend policy or dividend guidance. This is taken as a decision point to the board every single quarter, but that's roughly where we think that under reasonable circumstances could be (41:50), but obviously the nature of how the business is performing or other circumstance may alter that.

Q - Gustavo Lôbo

Thank you, that's very clear. A quick question if I may, regarding your regional integration, what exactly your strategy there? Should we see more acquisition of space in the near future? What do you intent to get from this relationship with the other players? If you could comment a little bit about that?

A - Daniel Sonder {BIO 18250247 <GO>}

Absolutely, absolutely. I'll talk about that and don't take me wrong, but I don't like to use the regional integration expression for two reasons. One we're not seeking to integrate those companies or by control of them, that's not part of the strategy, and second is the strategy is different for each country. So there is no macro strategy that we can apply to every single market and we're approaching it in a very, let's say, customized way in the discussions with each one of the exchanges.

Having said that, the general view of our company is that, there is an opportunity for us to play a role in developing these markets, each one individually, helping the companies, the local exchanges to perhaps improve their ability together with the stakeholders in each market of attracting more listing and more trading as well as perhaps in some cases develop derivative markets.

And in parallel, maybe increase some of the links between one or more of these markets and our own market, both for investors as well as for issuers. So we think that, again this is something that is a long-term view of our opportunity that is knocked here immediately. But what we think, we can work. Again, it's a direct approach, a different approach to each one of these companies. We are acquiring these investments. We seek to have board seats in the next opportunities that board seats open up in each case.

And then, we will develop with them plans for each one of these markets. Some things will work in place and we'll not work in another and some things we'll work in another market and we will take it one-by-one. And, I think this is a – these are sound well-run companies that performed their role to generate cash and payout dividend. So from my financial exposure position, we do not consider that this is an enormous risk for our companies and it does present the upside that I've just mentioned. We are taking it very, I think cautiously and pragmatically.

Q - Gustavo Lôbo

Great, thank you very much.

Operator

The next question comes from Carlos Gomez with HSBC.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Hello. Good morning. Two questions, and the first one, can you give us an update as to the expected accounting and fiscal treatment of the goodwill generated in the transaction when it closes? And second, will you expect that the new combined entity would launch a new stock grant program for the coming years? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Yes. So thank you, Carlos, for your question. So regarding the accounting treatment of goodwill generated in the transaction, we are still generating – we are still working on the details of how that would be precisely done. So, I will be able further down the line, when we are nearing the consolidation itself to give you a lot more information for something that is obviously a critical item.

But let me give you the general guidelines, the general guidelines is that, obviously goodwill is calculated as the difference between the price paid and the book value of the company. There are some items which are not available for tax deduction and the net of this difference minus the items that are not tax deductible become tax-deductible items.

However, they are divided into two lines in our accounting books; one is called the line of adjustment to existing asset values. And therefore, this will increase the book value of certain assets of the company, and we'll be seeing in future years as an increase in amortization, right?

So you'll see the full amount of that increase in amortization in our income statement and that will create as a non-cash expense obviously, and that will create a tax benefit of the statutory tax paid for 34% over that number. There is another portion, which will go straight into the tax line, which is the goodwill portion, and that will again be treated as we have treated the Bovespa goodwill, which is you basically calculate the tax benefit in the tax book. And then, you bring it back into your income statement as a reduction to your cash taxes, and then you book a deffered tax liability. And that's also 34%, so that's – again, the tax benefit for the company, it's 34% of the tax deductible portion of the total amount, but it shows up in two different lines.

The second question with regards to stock grant, I think the answer is, yes. We will continue to have stock grant as a relevant part of our compensation package for the key people in the combined company.

I think this is something that has worked quite well here as a mechanism of attracting and motivating and retaining talent, and the same way in Cetip. So, I do expect that we will have this instrument going forward, we'll obviously have to merge these programs as we move forward so that as many other things will have one program for the entire front.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

And the current program upon completion of the transaction, all the grants would base (49:47) at the same time or it will be extended in the surviving entity?

A - Daniel Sonder {BIO 18250247 <GO>}

No, not, no, not. Well, for – not for BM&F investment.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Okay, for the other one? And also on the account – on the goodwill, can you give us a rough idea about the proportion, how much will be goodwill, and how much will be amortizable or you don't know yet?

A - Daniel Sonder {BIO 18250247 <GO>}

Look, it's hard to know for sure, we did a initial study, which is part of the documents of the transaction with all the caveats that are due where KPMG in – again, in an initial study allocated about 60% to intangibles, which then get amortized and about 40% to goodwill.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

And does that change with the stock price?

A - Daniel Sonder {BIO 18250247 <GO>}

If it changes with the stock price, well, I mentioned a proportion so...

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Right

A - Daniel Sonder {BIO 18250247 <GO>}

...so, if the value paid is greater, you might see a change there in the number.

Q - Carlos Gomez-Lopez {BIO 18107094 <GO>}

Yeah. Thank you very much.

Operation: Our next question comes from Frederic de Mariz with UBS.

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

Good morning, everyone. Thank you for the opportunity. I just have a quick follow-up on the question on the CARF, the tax administrative course. You mentioned, you were not planning to provide for the case, you haven't made any provision so far. Could it be possible that in the case of a negative decision by CARF, by the tax court, you may have to do a judicial deposit or get a guarantee maybe from the bank, could there be some kind of cash impact or some kind of P&L impact? Thank you.

A - Daniel Sonder {BIO 18250247 <GO>}

Thank you for the question, Frederic. You're correct, I should have mentioned that. Although, we don't plan to do any accounting provisions even in the case that we were to be unsuccessful at the CARF. The fact that we take this to court might require a judicial deposit, which is basically posting a bond to continue the discussion in the judiciary. And we would likely do so using a letter of credit or some equivalent instrument, so without using the cash reserves of the company, and this might hit our financial expense line to the cost of that.

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

And typically from your experience, would that be for the full amount, the BRL 1.137 billion or typically they would require a deposit maybe just for a portion of this?

A - Daniel Sonder {BIO 18250247 <GO>}

It would be the full amount, plus some ...

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

Got you. Thank you so much.

A - Daniel Sonder {BIO 18250247 <GO>}

... plus some so might be upwards or down.

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

Okay. Sounds good. And do you have a guidance or an estimate for what that would represent, or is it too early to say, we should wait for next Wednesday?

A - Daniel Sonder {BIO 18250247 <GO>}

It's too early to say, we will give proper disclosure when, if that would be the case. And again it might not be next Thursday.

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

Sure. Sure. That's sounds good. Thank you Sonder.

A - Daniel Sonder {BIO 18250247 <GO>}

All right. Thank you.

Operator

This concludes today's question and answer session. I would like to invite Mr. Daniel Sonder to proceed with his closing statements.

A - Daniel Sonder {BIO 18250247 <GO>}

Well, once again everybody, thank you so much for joining. We really appreciate your time. And our team is here available with additional information, should you have any follow-ups on what we discussed here. So thanks so much. Bye-bye.

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.