

## First Read

# Cielo

## Feedback from company meeting: cautiously optimistic

### Meeting at UBS LatAm Financials Conference in Sao Paulo

Feedback from management was cautiously optimistic. While competition is picking up and volumes could be weaker in 2H16, regulatory pressure is stable and the [launch of Lio](#) provides some support to POS revenues. Moreover, 2017 should provide a better backdrop. We do not view smaller acquirers ([PagSeguro](#), Stone) as a key threat for now, due to small volumes and limited distribution. We tweak our earnings estimates, expect EPS growth of +14/+9% in 2016E/17E and reiterate our Neutral rating on valuation. We expect 3Q16 earnings of R\$1,011mn (+2%qoq).

### 2H16 challenging for top line; possible margin expansion after 2017

Consumer sales remain weak, with ICVA pointing to -6%yoy in August. Cielo guides for card volume growth of 7-9%yoy for 2016, with a weaker 2H16 driven by lower agribusiness. Yield should continue to come down very gradually due to competition (Itau/Rede is better integrated). However, we think the secular decline in operating margins could revert after 2017. Cielo's Ebitda margin has come down from 67% in 2010 to 53% in 2Q16, due to competition and acquisitions (MeS, Cateno). As Cielo completes key projects (system upgrade/BoB, involving ~10% of the workforce), expenses could come down exactly as volumes recover. We expect Ebitda margin of 57% in 2018 and dividend payout rising gradually to 70% in 2018 (30% now).

### Stable regulatory front; prepayment still a key focus

We covered 4 key themes: 1) the end of exclusivity is on track for Elo, Hiper and Amex. Those brands will follow a full-acquiring model by 2017, favouring smaller acquirers. 2) Regulators are not requiring a reduction of the credit settlement period of T+28, and instalments represent 2/3 of credit card volumes, suggesting still strong prepayment. 3) Attending to the Central Bank's concerns over the legal structure of prepayment, Cielo has started to operate prepayment through a FDIC (fund structure). 5) Pinpads could be open to smaller acquirers at a cost, under a discussion that is taking place at ABCEC (Card Association).

### Valuation: Neutral, PT of R\$39.0 (DCF-based)

Cielo trades on 17x 2017E EPS. **Risks:** [pricing compression](#), regulation impacting prepayment, [POS pressure](#).

## Equities

Americas  
Diversified Financial

12-month rating **Neutral**

12m price target **R\$39.00**

Price **R\$33.00**

RIC: CIEL3.SA BBG: CIEL3 BZ

### Trading data and key metrics

52-wk range	R\$37.33-23.42
Market cap.	R\$74.6bn/US\$17.6bn
Shares o/s	2,262m (ORD)
Free float	42%
Avg. daily volume ('000)	4,202
Avg. daily value (m)	R\$144.2
Common s/h equity (12/16E)	R\$9.31bn
P/BV (12/16E)	8.0x
Net debt / EBITDA (12/16E)	1.1x

### EPS (UBS, diluted) (R\$)

	From	To	% ch	Cons.
12/16E	1.77	1.77	NM	1.79
12/17E	1.99	1.94	-2	2.01
12/18E	2.23	2.18	-2	2.26

### Frederic De Mariz

Analyst  
frederic.de-mariz@ubs.com  
+55-11-3513 6511

### Mariana Taddeo

Analyst  
mariana.taddeo@ubs.com  
+55-11-3513 6512

### Philip Finch

Strategist  
philip.finch@ubs.com  
+44-20-7568 3456

Highlights (R\$m)	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
Revenues	7,851	9,373	13,252	14,924	15,318	15,924	16,993	18,399
EBIT (UBS)	4,293	5,059	6,461	6,943	7,452	8,139	8,964	9,926
Net earnings (UBS)	2,674	3,220	3,511	4,015	4,384	4,937	5,608	6,317
EPS (UBS, diluted) (R\$)	1.18	1.42	1.55	1.77	1.94	2.18	2.48	2.79
DPS (R\$)	0.74	0.76	0.34	0.51	0.97	1.53	1.73	1.95
Net (debt) / cash	(2,065)	(3,341)	(12,050)	(8,371)	(5,324)	(3,611)	(2,179)	(368)
Profitability/valuation	12/13	12/14	12/15	12/16E	12/17E	12/18E	12/19E	12/20E
EBIT margin %	54.7	54.0	48.8	46.5	48.6	51.1	52.8	53.9
ROIC (EBIT) %	91.7	77.5	43.3	31.9	35.7	40.0	44.0	48.4
EV/EBITDA (core) x	9.8	11.8	12.0	10.5	9.8	9.1	8.2	7.3
P/E (UBS, diluted) x	16.4	19.1	20.7	18.6	17.0	15.1	13.3	11.8
Equity FCF (UBS) yield %	2.6	2.4	2.3	5.8	6.1	6.0	6.3	7.4
Net dividend yield %	3.8	2.8	1.0	1.5	3.0	4.6	5.3	5.9

Source: Company accounts, Thomson Reuters, UBS estimates. Metrics marked as (UBS) have had analyst adjustments applied. Valuations: based on an average share price that year, (E): based on a share price of R\$33.00 on 19 Sep 2016 18:15 EDT

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### Forecast returns

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Forecast price appreciation	+18.2%
Forecast dividend yield	1.6%
Forecast stock return	+19.8%
Market return assumption	15.6%
Forecast excess return	+4.2%

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### Valuation Method and Risk Statement

Brazilian financials' performance is closely linked to the local economic environment and changes in interest rate and foreign exchange. Brazilian financials may also be affected by changes in the regulatory framework and overall competition. The acquiring industry in Brazil is undergoing structural changes that could further impact the companies' ability to deliver positive results. Furthermore the Brazilian government already expressed concerns over this industry's regulations. We value Cielo using a DCF methodology with a CoE of 14.5%, WACC of 11.8% and long term growth of 6.5%.

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Buy	FSR is > 6% above the MRA.	47%	32%
Neutral	FSR is between -6% and 6% of the MRA.	38%	25%
Sell	FSR is > 6% below the MRA.	15%	21%
Short-Term Rating	Definition	Coverage <sup>3</sup>	IB Services <sup>4</sup>
Buy	Stock price expected to rise within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%
Sell	Stock price expected to fall within three months from the time the rating was assigned because of a specific catalyst or event.	<1%	<1%

Source: UBS. Rating allocations are as of 30 June 2016.

1:Percentage of companies under coverage globally within the 12-month rating category.

2:Percentage of companies within the 12-month rating category for which investment banking (IB) services were provided within the past 12 months.

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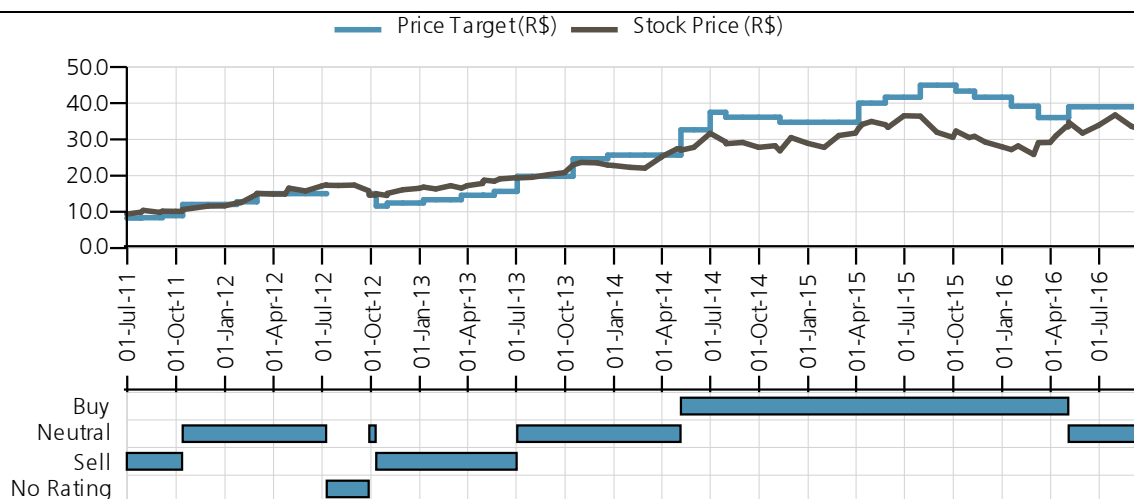
Company Name	Reuters	12-month rating	Short-term rating	Price	Price date
<b>Cielo</b>	CIEL3.SA	Neutral	N/A	R\$32.78	16 Sep 2016

Source: UBS. All prices as of local market close.

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#### Cielo (R\$)



Source: UBS; as of 16 Sep 2016

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