International Conference Call
BM&FBovespa
3rd Quarter 2013 Earnings Results
November 8th, 2013

Operator: Good morning, ladies and gentlemen, and welcome to the audio conference call about the earnings results of BM&FBOVESPA for the third quarter of 2013. Thank you for standing by.

At this time, all participants are in a listen-only mode. Later we will conduct a question and answer session and instructions to participate will be given at that time. If you should require assistance during the call, please press the star key followed by zero (*0).

As a reminder, this conference is being recorded.

I would now like to turn the conference over to Mr. Eduardo Refinetti Guardia, Chief Product and IR Officer of BM&FBOVESPA.

Mr. Eduardo Refinetti Guardia: Thank you. Hello everyone, thank you for joining us in this call today. I have with me Daniel Sonda, Luis Furtado, Cicero and Claudio.

Before I start we, had a problem this morning in the Portuguese conference call so I will kindly ask you to write down a dial in number because just in case we lose the connection I will ask everyone to join us in this new number. The dial in number is: 55 11 2565-4222. Repeating 55 11 2565-4222. In the ID number is 1122, the passcode is 2013. So repeating the ID number is 1122 and the passcode is 2013. So just in case we lose the connection. I hope it's not going to happen.

So let's start. I will start this call with some highlights of the quarter and then I will hand over to Claudio to walk through the numbers in more details.

Moving on to the presentation we can see on page 3 the main highlights for the quarter. As we discussed in our last conference call in August we were expecting that the challenges related to the internal and external scenario would affect third-quarter volumes, especially when compared to the all-time high volumes observed in the second quarter of 2013 in these volumes in the 3Q were below those of second quarter in both segments; cash equities and futures.

Concerning equities, volumes in the 3Q are practically flat compared to the 3Q 12 and 12.7% below the second quarter 2013. I think from the revenue perspective, we have observed a 2.4% reduction in cash equities revenue. This reduction is explained by a 2.2% decrease in the market capitalization and 0.37 bps reduction in margins.

These negative impacts were partially offset by a higher turnover velocity in the quarter, which has reached 73.7%.

Concerning margins, the reduction from 5.7 to 5.36 bps is mainly explained by the increase in the HFT participation, which has grown to 13.4% of total volumes compared to 9.8% in the 2Q12.

It's important to say that we are also aware of the cash equities volumes in the quarter were negatively affected by investors difficulties to borrow some stocks, particularly OGX, which increased significantly the lending fee rates and limited investors ability to negotiate the index future, therefore the so-called cash and carry transactions were affected resulting in lower volumes in the cash equities market.

It's difficult to estimate the impact of this, but we believe it has had a material impact on volumes in the quarter. On top of that, we know that the concerns related to the performance of the Brazilian economy has resulted in a more conservative approach from several fund managers who have increased their cash position.

Moving on to the derivatives, volumes decreased 7.5% compared to the 3Q 12 and 31.7% compared to the last quarter.

In terms of revenues this reduction in volumes was offset by a significant increase in the revenue per contract, which has grown 10.6% compared to the 3Q 12 and 22% compared to the last quarter, therefore, despite of the decrease in volumes the RPC increase resulted in a 4.3% rise in derivatives revenues compared to 3Q 12.

The best performance in the quarter is related to the other revenue, which has reached R$111 million up 12.5% compared to the 2Q 12. The main reason behind this good performance is related to securities lending and custody. I will give you more details on that later on in the call.

Concerning expenses and Capex, we are on track with our guidance for the year, as Claudio will demonstrate later, the numbers are consistent with the 560 to R$580 million guidance for adjusted expenses and the 260 to R$290 million guidance for Capex, therefore, and we are reasserting our guidance for this year for both Capex and adjusted expenses.

Concerning the guidance for next year, we are still discussing our budget with the Board and we should announce new Capex and Opex guidance before year-end. I would like to take this opportunity to remind you that we have a two-year guidance for Capex and our intention is to maintain this practice.

We will revise the existing 170 to 200 million guidance previously announced for 2014 and announce new Capex guidance for 2014 and 2015. We do not have the final numbers yet, but you should expect an upward revision for the 2014 Capex guidance.

Concerning adjusted expenses it has reached R$150 million in the quarter up 10.4% compared to the second quarter 2012. It is important also to look to the number year to date, as a matter of fact year to date adjusted Opex totaled R$460 million compared to R$389 million in the nine first months of 2012.

In other words, he year to date we are talking about a nominal growth of 4.4% and as we are keeping the guidance for the year even considering the top of the range, in other words, R$580 million for the year, nominal growth in 2013 will be up to 2.8% and therefore below inflation.

I'm not saying that the numbers for the year will be 580; I'm just saying that even if we consider the top of the range for Opex this year, the nominal growth will be limited to 2.8%. So despite the 10% increase in the quarter, we have no doubt that the expenses growth in nominal terms this year will be limited to 2.8% and therefore will have a reduction in real terms.

Last, but not least, as for dividend payment, yesterday our Board approved a payout equivalent to 80% of GAAP net income equivalent to R$0,12 per share or R$225 million. The payment will be made on November 27.

Now I would like to hand over to Claudio.

Mr. Claudio Jacob: Thank you Eduardo. Hello everybody. Let's go to page 4. Here we have some aspects of the Bovespa segment performance.

I would like to highlight some specific points once we actually report monthly all these numbers, at least the majority of these numbers. The big point here is the higher turnover that we had in 3Q 13 when we compared with 3Q 12 so actually a consistent number above 70%, so reaching over than 73%.

We consider the result of a more intense high-frequency trading activity and this kind of investor once they have a price incentive it impacts the average price in bps that we have mainly in the cash market, as we can see in the table below to the left side that moved from 5.3 to 4.9 bps.

And another thing that I think it's important to mention is that these incentives will be extended through all the traders next December.

Now come up moving to page 5, as Eduardo has already mentioned, we had a reduction in volumes in BMF segment, actually this page is for BMF segment, and this comes mainly from interest rate contracts as we can see in the chart below at the right side, but this was offset by a higher rate per contracts what derives from currency devaluation that in this case impacts a relevant contract at the futures for FX and another contract that is the interest rates in US dollars.

We can see here at the chart at the left side below the average rate per contract and the futures of FX contracts moved from around 2.4 to something like 2.7.

Now moving to page 6, all this combination of volumes and prices shows and brings us the following breakdown in terms of revenues, but shows healthy diversification and we have here three aspects that I think it's interesting to mention; the cash market's revenues responding for 6% of the total that is in line with the second quarter and financial derivatives with 37%, so well balanced with the cash market, and within the financial derivatives we have FX contracts that now response for over 14% of total revenues.

Moving to page 7, here we tried to give a message that despite the challenging times we have faced in the last few years mainly for the equity market we were able to keep revenues growing and we see the big responsible for this growth was the derivative portion of the company with around 15% CAGR per year since 2009, and we also had the contribution from other revenues as we see at the bottom of around 10% growth per year with the highlights in securities lending and treasure direct and, more recently, from agriculture credit bills – this is the LCA that we started in 2010.

The other point here in the case of equity market I think it's important to mention that the higher turnover helped to maintain the revenues resilient as we can see since 2010 we have the revenues well balanced, pretty much stable and despite the market cap stable as well or not growing and we consider these revenues as a consequence, actually, the performance of these revenues as a consequence of the higher turnover whereas result of a combination of our efforts to improve the systems (here and when I mentioned the systems is the trading system by the DMA that we implemented since 2008, 2009, collocation our connections that we have improved), the press incentives that we offer to heavy users and as well as an upsurge of the market sophistication mainly from a Brazilian local funds that started to use more strategies here and it helped to increase the turnover.

Now switching to expenses side, in the page 8, we showed that the 3Q keeps our year to date in line with the guidance of 560 to R$580 million in 2013. The 10.4% growth compared with 3Q 12 comes from mainly personnel and data processing specifically regarding the personnel costs it’s a consequence of two situations; one is the union bargain that happens every August and the other is a reduction in the capitalization of man hour that were dedicated to the projects that have been delivered and now are being treated as expenses.

The case of data processing we have a higher costs related to the software and hardware maintenance once we delivered some of our important projects.

It's not shown here, but we did have a growth in the depreciation. You can see in our income statement and this growth is expected, this is something that we've been mentioning to everyone and the reason is the investment cycle starting in 2010 and the delivering of the projects like Puma and the ERP system in 2013, so we start to depreciate part of the investment that we started in 2010.

And the other important point, as Eduardo has already mentioned, just to reinforce, when we compare year to date versus year to date 2012 the growth is around 4.5%, so we are going under the inflation.

Going to page 9, we show the financial situation with the available cash going around R$2 billion and total cash of R$4.5 billion. This total cash increase pretty much comes from increase in cash collateral from market participants as we can see in the chart here, from 1.1 to R$1.6 billion and it is mainly due to our market participants that pledged cash collateral for a spotted fact transaction that actually offset in the following day after the balance sheet, so we returned to the normal levels after that. Normal levels are around R$1 billion.

Another important point here is the return to shareholders, as Eduardo has mentioned, it is illustrated by almost R$160 million buyback performance and R$225 million dividend that is going to be paid in the end of this month.

Regarding Capex we keep on track in terms of the guidance we announced of 260 to 290 million, so until September we performed 202 million so we have the 4Q to complete the budget of the year and, as Eduardo mentioned, the 2013 is under review and as soon as we have the Board approval we will be reporting it for you and it's going to be in the next few weeks.

So now I will return the word to Eduardo. Thank you.

Mr. Guardia: Thank you Claudio. If we turn to page 10 we can see the strong revenue growth of six selected products with an outstanding operational performance. We are talking about real estate funds, securities lending, ETF's, treasury direct, agriculture credit bills and options on single stock would

These products as you can see represent 7.6% of our total revenue and their compound growth rate over the last three years is close to 40%. In other words, the revenue with these products has increased almost 3 times since 2010. I think it's a good example of our continuous effort to maintain top line growth in all market scenarios.

Turning to page 11 I would like to give an update on 4 important initiatives. Firstly the new methodology of the IBOVESPA index announced in September. We are confident that the new methodology represents an important improvement that will provide us with a much better representation of our capital markets and a much better index.

Just to remind you, the main change is the index weighting by market value of the company's free float and, as you know, we will implement the change in two stages; in January we will rebalance the index using an average of the old and the new methodology and in May 14 then we will rebalance the index with the new methodology, so only in May the new methodology will be fully implemented.

Secondly, the clearing house integration process is moving in accordance with our schedule and the new derivatives clearinghouse should be operational in the first quarter of 2014. Cicero and Luis Furtado are here and I am sure they will be glad to give you more detail on that during the Q&A.

Thirdly, concerning the changes to the pricing policy we have made two announcements during the quarter. We have extended the volume discount for all-day-trade transactions on options on single stocks and we have announced our new fixed income policy for corporate bonds, asset backed securities and real estate and agribusiness receivables.

Last, but not least, we have concluded our proposal for developing the access market to small and midsized companies, the so-called BOVESPA Mais. This initiative was conducted with the support of the CVM, BNDES and the Ministry of Finance. We are very confident that the changes will make an important contribution to developing the access market in Brazil and to facilitate SMEs financing through capital markets.

Will also be very glad to give you more details concerning these initiatives during the Q&A. Thank you very much for your attention and now I would like to open up the call for any questions.

Question & Answer Session

Operator: Excuse me, ladies and gentlemen, we will now begin the Question and Answer session. If you have a question, please press the star (*) key, followed by the one (1) key on your touch-tone phone now. If at any time you would like to remove yourself from the questioning queue, press star 2.

Our first question comes from Mr. Alexandre Spada, Itaú BBA.

Mr. Spada: Hi gentlemen, good morning. My question relates to that new initiative to bring additional individuals to the exchange. Could you provide more color on that and what type of expectations does BOVESPA have?

I know in the past BOVESPA tried several times to bring more individuals to the exchange, but the success of those initiatives were not as expected, I mean, what's the rationale behind this new initiative and why do you think it could work better this time? Thank you.

Mr. Guardia: Alexandre, thank you for the question. It's really important. We have announced during the last quarter a program to give incentives for brokerage house that are successfully bringing new investors; I'm talking about retail investors exchange.

So the first important aspect to comment Alexander is that we recognize that we do need the brokerage house to access, to be in contact with the retail investors, so we're not… we would not be able to bring new retail investors without the brokers.

So what we're trying to do is simply to share part of the new (and it's important to emphasize) the new revenue with brokerage house that have a focus on retail investors.

So what we're doing? First the brokerage house has to apply to this program so they have to present their strategy to us, what we're trying to do, what we are planning to do to attract and to bring new retail investors to the exchange and once accepted in the program what we are going to do is to give a fixed amount of money by each new retail investor that this brokerage house is bringing to the system.

This will only apply to new individual investors. Remember that we have the final beneficial owner model, so we know who our clients are, we know each individual that is today trading stocks in our exchange. So these incentives will only give if the brokerage house brings a new individual, so the program will be in place… the brokerage house has up to three years to get this benefit so every new retail investor that they bring to the exchange over the next three years, they will have this fixed amount of money per month during two years. So we are talking about a program that can go up to five years from now.

I think the biggest difference when you compare to all other initiatives we had in the past is, first, we are in a way selecting the brokerage house that will meet all the requirements that they have a clear strategy to attract retail investors. Second, we will only give this money if they bring new investors so if they attract investors from other brokerage house then they don't have access to this money that we will share with the brokerage house.

Third, it's, again, important to emphasize that we are talking about new revenue for be BM&FBovespa, so we are not giving up any revenue that we have today.

What we are willing to do is to share part of the new revenue with the brokerage house and we believe that because of that it is a program that makes sense, we made all the calculations and if we have success in this program of course we will increase BVMF's top line because we may reduce the rate of growth for our revenue during the two initial years because we will have to share with the brokers, but after that we have a new client and we will benefit from that.

But even in this initial two years we will not give any revenue that we have today; we are only talking about new revenues.

Mr. Spada: Okay that's very clear Guardia. And how has been the acceptance of the brokers for this new program?

Mr. Guardia: It's still new. There are some brokerage house that are already applying for the program, so we have some 20 or 30 days to get back to the brokerage house saying whether they were approved or not, if we need any additional information, we have to ask them during this period. So we are still in a moment of receiving the proposal from the brokerage house and approving or not the brokerage house applying for the program.

So as far as I know we do not have anyone approved yet. Claudio, correct me if I am wrong. Yes, that's correct. I think Daniel wants to make a comment.

Mr. Daniel Sonda: Just to add to sentence this year. I think this is not something that we are going to see immediate results; it's a process that takes a bit of time for the brokers to apply and have ourselves review, as Claudio was just mentioning, before preparing themselves to discuss their strategy with us.

But I think that in the long-term we think this works because from now on our way of attracting individual investors is to leverage on the good work done by the best retail brokers who are focused and dedicated on this are rather than trying to do it ourselves.

So I think we have created a mechanism, as Eduardo has stated, that does not take away any of our revenues; it mitigates clients, sort of, one taking the client from the others and if we see net new additional retail clients we will have done a good job and I think we have the proper incentives so with the right people, which are the brokers.

Mr. Spada: Okay, that's very clear. Thank you all.

Mr. Guardia: Thank you Alexandre.

Operator: Our next question comes from Francisco Kops, with Banco Safra.

Mr. Kops: Hello everyone. Eduardo, Claudio, Daniel. Just two quick questions here. The first one is about the depreciation expenses. What can we expect for, I don't know, what you guys can talk about this line for 2014? I know you guys don't give guidance, but, I mean, this has been growing and of course it's part of the investments you guys have been doing since 2010. So my first question is what to expect about depreciation?

And my second one is regarding the BSM, the self-regulation body. You guys always had some kind of contribution on the 4Q. Should we see some of this on this next quarter as well? Thank you.

Mr. Guardia: Okay Francisco. First, on depreciation, yes, it is fair to expect to see this expense continuing to grow because we are continuing to invest a lot, as you know.

And particularly this year we are increasing, we are investing from 260 to R$290 million, which is the guidance we have for the year. So I think you should also expect to see some growth in depreciation in 2014. I think only after that we will start to see depreciation stable and only a few years forward reducing.

But we should still see some growth in depreciation next year.

Concerning BSM, if we have any contribution to BSM and the last quarter of this year it will be within the range that we gave to you. So there is no chance we will exceed the top of the range for 2013. So we have all expenses under control if (I'm not saying that we will, but if) we have any contribution to BSM this year this should be considered within the range announced that we reaffirmed today.

So that's… I don't know if Daniel wants to add anything? Nope. That's it Francisco.

Mr. Kops: Right, thank you. Just one follow-up on the depreciation question. If you guys increase... you guys are going to revise your budget for 2014, if you guys increase the guidance for Capex may we imagine the depreciation increasing not just in 2014, but for further years as well?

Mr. Guardia: Francisco, as I said, we are still discussing with the Board, but I'd rather say we will it just the guidance so you should not expect anything significantly different from what we are announcing.

So remember we have announced the guidance for 2014 in December 2012, we are talking about a very complex project so it's natural to have some adjustment in our forecast after one year and on the top of that I would like to remind you that part of our Capex expenses are in US dollars and we did have the impact on the currency depreciation in our numbers and we have to take this into consideration next year.

So what I'm just saying is that it's more of an adjustment of our Capex than something completely different from what we have been telling you since last year.

Mr. Kops: Thank you Eduardo and the US dollars effect it's really helpful here, I was completely forgetting about this. Thank you.

Operator: Excuse me, if you would like to pose a question, please, press start one.

Mr. Guardia: We have one question from the Internet. Cicero will read the question and answer the question.

Mr. Cicero Vieira: The question is:

"*I know that interest rate derivatives in BM&FBovespa are different of those in other parts of the world. Said this, do you see a way high-frequency traders could begin trading interest rate derivatives BMF*?"

So first point is that the assumption is right; interest rate derivatives, I mean, the G.I. future is different from interest rate, typical interest rate futures seen for example in US and Europe. If you take for instance the Euro Dollar future what's traded is a forward trait, in the case of the G.I. future what is traded would be the equivalent of our zero-coupon bond or the equivalent of a bullet, so it is a spot rate with different maturities and not forward trait.

So that's a difference and the information that high-frequency trader volume in the G.I. future is correct, it's very low, almost a zero.

So what I would like to add here is that we are going to have fixed income ETFs and on top of that those fixed income ETFs are going to be traded in Puma and on top of that we are going to have Brazilian treasury bills and treasury bonds also being traded in Puma and that is going to create a very interesting situation because there will be for the first time the opportunity for arbitrage, interest rate arbitrage across interest rate futures, interest rates or fixed income ETFs as well as different maturities of public bonds, Brazilian treasury bonds.

With that in mind, we expect high-frequency traders to start to arbitrage and to start entering this type of market because, as we know, generally what they have is relative trade, they are long and short in different contracts, which tends to be highly correlated. That's the type of strategy normally developed by HFTs.

Operator: This concludes today's question-and-answer session. I would like to invite Mr. Eduardo Refineti Guardia to proceed with his closing statements. Please go ahead Sir.

Mr. Guardia: Okay, I just want to thank you again for joining us in this call and if you have any further doubts do not hesitate to contact myself or Claudio. Thank you very much.

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