

**Rating Action: Moody's downgrades Cielo to Ba2, stable outlook**

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26 Aug 2021

New York, August 26, 2021 -- Moody's Investors Service ("Moody's") downgraded Cielo S.A. ("Cielo")'s corporate family rating to Ba2 from Ba1. At the same time Cielo's senior unsecured notes and the backed senior unsecured notes issued by Cielo USA Inc. were also downgraded to Ba2 from Ba1. The outlook is stable.

**RATINGS RATIONALE**

The downgrade to Ba2 reflects Cielo's ongoing deterioration in its market share, profitability, and credit metrics. Although the Brazilian cards and electronic payments market presents favorable long-term growth fundamentals, Moody's believes competition will continue to increase not only from other merchant acquirers driving pricing down, but from alternative payment means, technological and regulatory developments all leading to reduced barriers of entry. Cielo's EBITDA has reduced yearly from BRL8.2 billion in 2016 to BRL4.2 billion in 2019 and BRL2.7 billion in 2020 with a negative impact on sales from the COVID crisis. In Moody's base case scenario, Cielo's EBITDA will be an average BRL3 billion per year in the next two years. EBITDA margin has reduced to 22.8% in 2020 from 57.4% in 2016 and will average 25% in the next two years. Cielo maintains a conservative financial policy and liquidity profile and has taken several important steps to improve profitability during the last couple of years that could lead to more stable margins going forward, but still at lower levels than those observed in the past.

Cielo's Ba2 rating reflects its leading position in the Brazilian payment cards industry and widespread footprint in the large Brazilian territory and the favorable long-term growth fundamentals for the payment sector in Brazil. The ratings also incorporate Cielo's strong liquidity profile and conservative financial policies. Moody's also takes into consideration the ownership by Banco do Brasil S.A. (BB, Ba2 stable) and Banco Bradesco S.A. (Bradesco, Ba2 stable), second and third largest Brazilian multiple banks as supportive to the ratings. On the other hand, Cielo operates in a highly competitive industry and has seen its market share deteriorate significantly over the last the last 3 years. Although the company has implemented new strategies to counter the changes and remain profitable, Moody's believes that competition will continue to increase, resulting in further pressure in Cielo's metrics. Cielo has implemented KPIs (key performance indicators) and actions to improve client satisfaction and it has strengthened its commercial team to gain clients, with special focus in small-and-mid sized businesses (SMBs). The company has also been focusing in the anticipation of receivables as a tool to increase profitability as these SMB merchants become more relevant in its portfolio -- in detriment of larger corporate merchants. SMB merchants had a participation of 39% Cielo's total processed values in Q2 2021 up from 34% in Q2 2020.

Cielo's liquidity remains adequate with an estimated BRL6.1 billion in cash (pro-forma to liability management executed in July and August) and no relevant short-term maturities. In November 2022, \$502 million in bonds are due. Cielo has been focusing on increasing the penetration of the anticipation of receivables for SMBs, although profitable, Moody's expects Cielo to increase the use of third-party resources to fund these operations. The preferred funding structure has been via securitization funds (FIDC). Moody's believes the balance of senior third-party shares of such structures will reach BRL7.6 considering FIDC Plus, FIDC Emissor I, FIDC Emissor II, and the full subscription of quotas of FIDC Receba Mais during 2021. At the same time Cielo has fully amortized BRL3 billion in debentures ahead of schedule in July 2021. Moody's adjusted gross leverage, that includes third-party FIDC shares, will reach 4.6x by year-end 2021, and it will remain between 4.6x -- 3.6x, higher than average historical levels of 1.4x between 2016 and 2019, as Cielo maintains appropriate funding for the anticipation of receivables and credit products. Interest coverage (5.4x LTM June 2021) and retained cash flow to net debt (27.4% LTM June 2021) will remain adequate at 4.0x to 4.5x, and around 25% to 30% respectively.

**OUTLOOK**

The stable outlook incorporates that Cielo's metrics will remain stable and outside of downgrade triggers in the next 12 to 18 months. It also incorporates a solid liquidity with net receivables and cash in hand covering its short-term debt.

## FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Negative pressure on Cielo's rating could develop if liquidity deteriorates, or if free cash flow generation were to remain negative. Quantitatively, a downgrade in Cielo's ratings could be triggered if margins continue to reduce (EBITA reaching 18% compared 22% LTM June 2021) and there is a perception of reduction in cash generation capacity (retained cash flow/net debt remains reaching 17% compared to 27.4% LTM June 2021), in combination with a gross leverage, measured by total debt to EBITDA, consistently above 4.5x. A negative action on Brazil's government bond rating could lead to a downgrade for Cielo.

An upgrade would require Cielo to show its ability to maintain solid organic growth, increase operating margins, while it maintains a low gross leverage and strong liquidity profile. It would also require an upgrade of Brazil's government bond rating.

## METHODOLOGY

The principal methodology used in these ratings was Business and Consumer Service Industry published in October 2016 and available at [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_1037985](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1037985). Alternatively, please see the Rating Methodologies page on [www.moodys.com](http://www.moodys.com) for a copy of this methodology.

## ISSUER PROFILE

Headquartered in the city of Barueri, Brazil, Cielo S.A. (Cielo) is the leading corporation in the merchant acquiring and payment processing industry in Brazil, with presence in almost all Brazilian municipalities. With shares listed on B3 S.A. - Brasil, Bolsa, Balcão (B3, Ba1 stable), formerly BM&F Bovespa, Cielo is controlled by BB and Bradesco, which together hold 58.7% of the company's voting stocks and are the second and fourth-largest commercial banks in Brazil, respectively, in terms of total assets. In the last twelve months ended in June 2021, Cielo's revenue was BRL11.6 billion (\$2.2 billion at the average exchange rate) and its Moody's adjusted EBITDA margin was 24.7%.

## REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: [https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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