Stone Co 3Q23 Earnings Conference Call

November 10, 2023

Operator:

Good evening, everyone. Thank you for standing by. Welcome to the StoneCo third quarter 2023 earnings conference call. By now everyone should have access to our earnings release. The Company also posted a presentation to go along with its call. All material can be found online at investors.stone.co.

Throughout this conference call the Company will be presenting non-IFRS financial information including adjusted net income and adjusted net cash. These are important financial measures for the Company but are not financial measures as defined by IFRS. Reconciliations of the Company's non-IFRS financial information to the IFRS financial information appear in today's press release.

Finally, before we begin our formal remarks, I would like to remind everyone that today's discussion may include forward-looking statements. These forward-looking statements are not guarantees of future performance and therefore you should not put undue reliance on them. These statements are subject to numerous risks and uncertainties that could cause actual results to differ materially from the Company's expectations. Please refer to the forward-looking statements disclosure in the Company's earnings press release.

In addition, many of the risks regarding the business are disclosed in the Company's Form 20-F filed with the Securities and Exchange Commission, which is available at www.SEC.gov. I would now like to turn the conference over to your host, Roberta Noronha, Head of Investor Relations at StoneCo. Please proceed.

Roberta Noronha – Head of Investor Relations

Thank you, operator, and good evening, everyone. Joining me today on the call is our CEO, Pedro Zinner, our Chief Financial and Investor Relations Officer, Mateus Scherer and our Chief Strategy & Marketing Officer, Lia Matos.

Today, we will present our third quarter 2023 results, discuss some recent trends and provide an updated outlook for our business.

I will now pass it over to Pedro so he can share some highlights of our performance. Pedro?

Pedro Zinner – Chief Executive Officer

Thank you, Roberta and good evening, everyone.

Overall, I was very pleased with the results delivered and the improvements we have made within the organization. As I did in the previous quarters, I want to begin by making a brief evaluation of our performance related to the priorities set for the quarter.

1. In our first priority, to **"Grow with efficiency",** we once again had very positive results. Total revenue increased 25% year over year, to reach R$3.1 billion, exceeding our guidance by 2%. Combined with top line improvement, **Adjusted EBT increased 3.3x year over year**, reaching **R$545 million** and surpassing our guidance by 16%. As a result, **Adjusted Net Income grew 4.0x** year over year **to reach R$435 million, the highest bottom-line figure in our history.**

2. Our second priority was to **"Generate Cash".** Adjusted Net Cash increased by R$1.8 billion year over year and R$530 million quarter over quarter, reaching R$4.9 billion. Part of this excess cash was allocated in the repurchase program, as approved by the Board in September 2023, and totaled R$300 million.

3. In our third priority, to **"Expand Financial Services Business",** MSMB TPV continued to grow consistently at a strong pace, increasing 20% year over year and more than twice the industry rate. Combined with this, we have also presented a healthy client base increase and an improvement in monetization.
    - Our MSMB client base increased 42% year over year, with a client net addition of 317 thousand quarter over quarter, reaching almost 3.3 million merchants using our payment solutions, and
    - At the same time, our MSMB Take Rate increased 28 bps year over year to reach 2.49%.

   We have also evolved in our banking and credit solutions:

    - Banking active clients increased to 1.9 million, with R$4.5 billion in deposits, demonstrating the successful strategy on the development of our platform and client engagement with our solutions.
    - And lastly, we have expanded our credit portfolio, reaching R$113 million in this quarter, and concluded the main features testing, in-line with our expectations.

4. In our fourth priority, to **"Evolve our Software Business",** we continued to improve our results, focusing on increasing efficiency – as we promised. Software revenues reached R$388 million, with Adjusted EBITDA increasing significantly to R$79 million, reaching a margin of 20.5%. This bottom-line evolution is a result of our continuous focus on improving operational leverage and integration plans with StoneCo.

5. Lastly, **we have recently taken important steps towards building our "fit for purpose" organization**. In October, we announced our new management structure to better align the Company around specific go-to-market strategies per client segment and to accelerate the integration of our software and financial solutions. We will further detail our strategic priorities in our investor day on November 15th, providing a better understanding on how the new organizational design will support us in executing our strategy.

Before passing it over to Lia, I would like to say that I am looking forward to meeting investors in our Investor Day in a few days from now. I believe it will be a great opportunity for us to share our views on the business and our long-term plans.

Now I would like to pass it over to Lia to discuss our third quarter 2023 performance and strategic updates. Lia?

Lia Matos – Chief Strategy & Marketing Officer

Thank you, Pedro and good evening, everyone.

As Pedro mentioned, we had an important evolution over the last year in terms of balancing growth and profitability, which you can see on slide 5. We increased consolidated revenues by 25% while improving our adjusted net margin by around 10 percentage points in a one-year period. As Mateus will detail further, this amazing margin improvement was a result of operational leverage across all main P&L lines.

Moving to the highlights of our Financial Services segment on page 6.

In 3Q23, revenue in the segment increased **to R$2.7 billion, a 29% year over year growth**, mainly driven by our consistent strong performance in the MSMB segment, with above industry MSMB TPV growth and higher take rates. This, coupled with operational leverage in costs and expenses, **led to a**

3.6x increase in the segment's Adjusted EBT, **to reach R$485 million**, with a 17.7% EBT margin, an increase of 2.1 percentage points sequentially.

Moving to slide 7, we will deep dive on our MSMB performance.

MSMB payments client base **increased 42% year over year**, to reach **3.3 million active clients**. Sequentially, this represented a net addition of **317 thousand clients**, driven by our continued investments in performance marketing, combined with better levels of churn. Also, through the strategic optimization of our Ton and Stone offerings across our sales channels, we continued to see positive trends in our client base across all tiers within the MSMB segment. We believe this approach is unique and has led us to profitable TPV growth, as I will show on the next page.

On slide 8, we show that MSMB TPV increased **20% year over year, a growth twice above the industry**, demonstrating our continuous ability to win new clients due to our competitive advantages around distribution, services, and our combined financial services offerings. This TPV performance was above our guidance of between R$87 and R$88 billion. Also, we were able to produce that growth while increasing our take rate by **28 basis points year over year and 1 base point sequentially, to 2.49%.** The yearly take rate improvement was a result of our continued financial services offering expansion, strong pricing execution and client mix.

Now, I will briefly update you on our Key Accounts' performance.

Key Accounts' TPV decreased 22.8% year over year and was stable sequentially, to R$14.4 billion, as we have continued to deprioritize and offboard low margin clients. Year over year, Key Accounts' take rate increased 18 basis points, as a result of the adjustments in our commercial policy and a mix shift within the segment.

Now, let's shift to our Banking performance on slide 10.

Banking active client base **increased 3.4x year over year, to 1.9 million active clients**. This evolution was a result of the launch of "Super Conta Ton" in 1Q23 and the continued activation of banking combined with acquiring solutions for Stone clients. The growth in Banking active clients, combined with an increase in engagement, led deposits to reach **R$4.5 billion in the quarter, a 51% year over year growth, which outpaced our MSMB TPV growth by 30 percentage points.** Since TPV is the main source of cash-in volume to our banking solution, this relative performance is a strong illustration of our continued ability to improve engagement as we launch new features and offerings. In our upcoming investor day, we will give more color on how we are evolving our value proposition around our combined solutions for MSMBs.

On slide 11, let me give a brief update on our **credit offering.**

Until September, we reached a portfolio of **R$113 million, a 6.1x quarter over quarter increase**. The performance of our vintages is above our expectations, **with NPL 15-90 days of 0.40% and NPL over 90 days of virtually zero**. I would like to note this is a recently launched portfolio, so the ratio of past-due loans should increase as our portfolio matures. We will gradually accelerate disbursement, by extending the credit offering to a larger number of clients, without changing our diligence towards risk assessment and, close monitoring of market conditions. Lastly, this quarter we have concluded the main improvements in our product features, as we have finalized rebuilding our renegotiation process.

Now, on slide 12 we will discuss our **Software** segment.

Software revenue increased **6% year over year to R$388 million**, driven by the continued organic active store expansion in our Core POS and ERP business, especially in the SMB segment. Software revenue growth decelerated compared to the previous quarters because of weaker performance of our transactional revenues within our digital business, combined with lower average inflation, which affects price adjustments specially in enterprise accounts contracts.

Software segment adjusted EBITDA increased **50% year over year, to reach R$79.4 million**, with a margin of **20.5%, an increase of 3.1 percentage points compared to 2Q23**. This strong figure was a result of higher revenue in the period and lower administrative expenses, especially as a result of more normalized levels of personnel expenses after a reduction in headcount in 2Q23.

On the strategic front, we have prioritized four verticals as focus to drive financial services and software bundles. During our Investor Day, we intend to share additional details about how we see this opportunity.

Now, I want to pass it over to Mateus for him to discuss some of our key financial metrics. Mateus?

Mateus Scherer – Chief Financial and Investor Relations Officer

Thank you, Lia, and good evening, everyone. I would like to begin on slide 13, where we discuss the quarter over quarter evolution of our costs and expenses on an adjusted basis.

- **Cost of Services** reached R$773 million, increasing 15.2% year over year and decreasing 220 basis points as percentage of revenues due to operating leverage gains. Quarter over quarter, cost of services increased 12.9% and 140 basis points as a percentage of revenues. The sequential increase in cost of services is explained by higher provisions for losses and increased investments in technology and logistics, as we continue to expand our business and client base.
- **Administrative expenses decreased** 3.3% year on year and 9.5% sequentially, leading to a 130-basis points reduction as a percentage of revenue when compared to 2Q23. This improvement can be attributed to more normalized levels of personnel expenses in our Software segment, following a reduction in headcount in 2Q23, combined with higher than usual provision for variable compensation last quarter. I am very happy that we are starting to see the benefits of initiatives we implemented more than a year ago around zero budgeting and integration of back-office functions in our software segment. Increasing efficiency in administrative expenses will continue to be a priority going forward, and we will give additional details around that in the Investor Day.
- **Selling expenses** increased **7.4% quarter over quarter and 20 basis points as percentage of revenues**, due to higher investments in our distribution channels, mainly with partner commissions, combined with increased investments in performance marketing.
- **Financial expenses decreased 1.4% quarter on quarter, with a reduction of 260 basis points as percentage of revenues, reaching 33.3%.** This evolution was driven by lower interest rate in the period, coupled with our decision to reinvest our cash generation towards funding our operation, and was slightly offset by quarterly TPV growth.
- Lastly, **other expenses** increased 11.8% sequentially and **20 basis points** as a percentage of revenue, as a result of normalized levels of share-based compensation expenses, as in 2Q23 we incurred in a non-recurring positive net effect of R$19.6 million.

Moving to slide 14, our **Adjusted net Cash** increased by **R$1.8 billion** year on year and **R$530 million** in the quarter, reaching R$4.9 billion. This strong sequential increase is a result of our strong cash flow from operations, as well as a sequential decrease in capex, as expected.

As Pedro mentioned, given our strong cash flow generation and our long-term perspectives for the business, in September our Board approved a share repurchase program of R$300 million, which was already fully executed.

With that said, operator, can you please open the call up to questions?