Stone Co 1Q23 Earnings Conference Call

May 17, 2023

Operator:

Good evening, ladies and gentlemen. Thank you for standing by. Welcome to the StoneCo first 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, Rafael Martins, VP of Finance and Investor Relations Officer at StoneCo. Please proceed.

Rafael Martins – VP of Finance and Investor Relations Officer

Thank you, operator, and good evening, everyone. Joining us today on the call we have our CEO, Pedro Zinner and our Chief Strategy Officer, Lia Matos.

Today, we will present our first 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 – CEO

Thank you, Rafa and good evening, everyone. First, I would like to say that I am honored and excited to join the Stone team, and would like to thank Thiago for all that he has done for the Company and to ease my transition into the CEO role. I am confident that Thiago will continue to contribute to our success in his new role as a Board Member.

I am also pleased to report that Stone has continued to build on its solid performance from 2022 and delivered stronger than expected top-line and bottom-line results in the first quarter of 2023. Let me provide some quick comments on the strong quarterly results and share some initial impressions on the company so far.

In our last earnings call, the team outlined our priorities for 2023. I am quite happy with the results achieved so far, which you can follow on slide 5.

1. **Our first priority was to grow with efficiency.** I am pleased to report that we have exceeded our expectations on both fronts. We grew our revenues 31% year over year, and delivered strong profitability, with adjusted EBT of R$324 million in the quarter, 22% above our

guidance. As a result, we were able to deliver Adjusted Net Income of R$237 million, which was our best Q1 performance in our company's history.

2. **Our second priority was to Generate Cash.** In Q1, we had strong cash flows from operations and we were able to increase our Adjusted Net Cash by approximately R$500 million to reach R$4 billion.

3. **Our third priority was to keep expanding our financial services business.** As you can see, we have delivered a very strong performance in our MSMB segment. We grew MSMB TPV two times above the industry, accelerated net addition of clients in both payments and banking, and are in line with our plans to resume our credit business. We have taken significant steps on the credit side, having disbursed to a small number of clients, but most importantly, we have improved many aspects of the product and operation that will enable us to grow our portfolio in a sustainable manner. I want to take a conservative approach towards the expansion of this solution and grow the portfolio depending on market conditions and the completion of the tests we are doing. Finally, we were able to achieve this growth and evolution with a significant increase in monetization, with take rates reaching 2.39%, an 18-basis points improvement over the last quarter.

4. **The fourth priority was to evolve our software business.** On this front, results were below my expectations. The team is working hard to build the foundations that will enable us to deliver a unified experience to our clients, integrating software and financial services and becoming the one stop shop solution for Small and Medium Brazilian Retailers. We are making progress integrating and building of those capabilities but we are not there yet. In our software sales, our revenue growth was hurt mainly by a reduction in Ads spending by some of our enterprise accounts and our EBITDA margin was also impacted by an increase in selling expenses. Throughout the rest of this year, I want to put a strong focus on our team integration, cost discipline, and streamlining of our software portfolio.

5. **And finally, our fifth goal is to build a "fit for purpose" organization, that will enable us to deliver on our long-term priorities.** We have to make sure our organization is properly equipped to withstand the additional pressures that come with a high-speed growth. I don't think this guarantees success, but I believe not having the right resources in place is a leading indicator of failure. As part of this process, I want to welcome Luiz André Barroso as a new Board Member. His experience as a Google Fellow and seasoned professional in the tech industry, will help us on our path to differentiate ourselves and lead through innovation.

Now I want to share some additional thoughts on the company and my experience in the role so far.

The first thing I would to highlight is the inspiring and fantastic people I have met over the last couple of months. Whether I have been spending time with teams in our hubs, at our distribution centers or within our offices, the great ideas, positivity, and enthusiasm for the work we do is inspiring. I believe the superior talent in this company will continue to be a great driver for our long-term success.

The second is that we have significantly improved the company's governance structure and management systems over the past year. I see the company doing a better job of setting more clearly defined goals, cascading this to different layers within the organization more effectively and linking compensation more closely to our performance. This is improving decision-making, and I see that we now have a better understanding of the key value drivers affecting our business. This is certainly a continuous process, but I believe we now have better structure to maximize value and returns over the long-term.

The third, is the strong foundation of our client centric culture. I think a key driver of Stone's success during its journey has been its ability to identify and ease the points of friction that MSMB clients have with traditional financial institutions. This, combined with the last-mile and distribution capabilities that Stone has built over the past few years, has become a significant competitive advantage that has enabled Stone to disrupt the market. I think these same attributes can also extend our value-proposition into banking and credit. And, longer term, extend our competitive advantage in our software business by solving the vertical specific complexities of our clients and creating a more cohesive ecosystem of integrated software, hardware and financial services.

For the short term, I believe that by focusing and exceling on the basics, we will emerge stronger and more resilient. For example, our cost management initiatives are already improving our operating leverage and our pricing discipline is impacting our profit margins.

Longer term, I am working with our team to design our strategy through 2030, setting clear goals and the execution path ahead. We will provide you with more details on this new, long-term plan at an upcoming Investor Day that we are working towards and we will share more details of the event a little later this year.

And now I am going to pass it over to Lia, who will discuss our first quarter 2023 performance and strategic updates. Lia?

Lia Matos – Chief Strategy Officer

Thank you, Pedro and good evening, everyone.

I would like to begin by briefly going over our consolidated results in slide 6.

As Pedro mentioned, this was a strong quarter with growth and profitability above our expectations.

Total Revenue reached R$2.7 billion, growing 31% year over year, and our Adjusted EBT increased to R$324 million, above guidance of R$265 million. As a result, our Adjusted net Income increased almost 6x year over year, to reach R$237 million, with a margin of 8.7%.

Now, from slides 7 to 12, I will "double-click" on the performance of our Financial Services segment, which continues to produce strong growth with consistent profitability improvements.

Revenue in the segment increased 36% y/y and was flat sequentially, despite the typical weaker seasonality in the first quarter. This was driven by good performance in our MSMB client base, which demonstrated strong TPV and client base growth, produced higher take rates and generated more revenue from our banking solution and PIX. In addition to this top line improvement, incremental cost efficiency gains generated higher profitability, with adjusted EBT reaching R$306 million in the segment and a 13.1% margin.

Moving to slide 8, I want to talk about some of the highlights in our MSMB performance. MSMB active payment clients reached 2.8 million, with an acceleration in net adds to 232 thousand. This good performance resulted from successful marketing campaigns, driven in part by our lead sponsorship of Brazil's most popular reality show, which increased our brand awareness in both Ton and Stone, and from a significantly lower churn in all client tiers. By optimizing our commercial strategy of Ton and Stone offerings across our multiple sales channels, we were once again able to drive client base growth in all client tiers this quarter. This approach continues to produce good levels of profitable TPV growth, as I will show on the next page.

As seen on slide 9, we grew TPV in MSMB clients by 25% year over year, over 2 times the industry growth, to reach R$79 billion.

We generated this growth while also increasing our take rates on a year over year and a quarter over quarter basis. Our MSMB Take Rate reached 2.39% this quarter, up from 2.21% in 4Q22, and 2.06% in 1Q22. Our Take rate improvement is a result of (i) higher monetization of prepayment, (ii) stronger growth in our Ton brand, (iii) higher contribution from banking revenues, and (iv) higher credit TPV mix compared to the fourth quarter. We continue to execute pricing discipline across our initiatives.

On slide 10, we will move to the performance of our Key Accounts segment.

Given that subacquirer volumes have become immaterial to our TPV, we have decided to stop disclosing the breakdown of our Key Account volumes this quarter to simplify our disclosure. Overall, Key Accounts TPV decreased 26% y/y, to reach R$15 billion in the quarter, as we continued to shift our priority from sub-acquiring business to Platform Services within the segment. However, as a result of our priority shift, our take rates in Key Accounts increased 31bps year over year. On a quarter over quarter basis, TPV declined especially due to first quarter seasonality and continued deprioritization of subacquirers. Take-rate remained flattish sequentially, mainly due to lower prepayment penetration.

Now I will give you some highlights of our banking performance on slide 11.

As we mentioned in our last earnings call, this quarter we launched “Super Conta Ton”, our full banking solution for micro clients. As a result of this launch, we saw significant growth in our banking active client base, to 1.3 million in 1Q23, 2.5x higher y/y and a growth of 81% q/q. This has also led to a q/q decrease in ARPAC, from R$45 in 4Q22 to R$37 in 1Q23, as Micro clients generate lower revenue contribution in comparison to SMB clients.

We have also started piloting debit cards in Stone, which is an important step in evolving our banking solution for MSMBs. Client deposits reached R$3.9 billion, which was roughly stable quarter over quarter, despite a seasonal decrease in TPV, which is an important driver of deposits as it is the main cash-in method for clients that use the complete acquiring and banking solution. With the ramp up of new clients and the launch of new features, we expect deposits to continue to grow over time.

On slide 12, I want to give you a quick update on the credit front and on the results we have so far achieved with our pilots.

We enhanced our working capital loan product by combining a flexible daily settlement mechanism with minimum monthly downpayments, which increases predictability for both our clients and for us. We are in advanced stages of improving our system automation and credit lifecycle monitoring and making our decision models more sophisticated through enhancement of data. We have also fully integrated our systems with the registry of receivables and formalized personal guarantees as a form of collateral, which has already been executed as expected. We are currently working to rebuild our recovery and renegotiation process, to give our clients the possibility to renegotiate directly through the Stone App if they wish to do so.

Until the end of April, we had disbursed around R$6.0 million to approximately 200 clients, with key credit performance indicators in line with our business model and our credit underwriting standards. We are in line with our plans to test our credit card solution in the second half of this year. As Pedro said previously, we will take a conservative approach towards the expansion of this solution and grow the portfolio depending on market conditions and the completion of the tests we are doing.

Now I am going to shift to the discussion of the performance and strategic updates of our software business in slides 13 and 14. In 1Q23, Software revenue increased to R$358 million, with a 10% y/y growth, representing a deceleration from past quarters given some weakness in our Ads business from large enterprise accounts that reduced spending this quarter. Adjusted EBITDA for Software was R$40 million in 1Q23, with a margin of 11.1%, a 120bps decrease compared to 1Q22, which was mainly driven by the softer revenue growth in the quarter and an increase in selling expenses as we invested in our sales team.

On slide 14, I want to give the main highlights of our performance and priorities.

Software revenue this quarter was positively affected by a higher number of POS/ERP locations in smaller client tiers as well as inorganic expansion. The growth in number of locations, focused on lower tier clients, was in line with our strategy to increase our presence in medium and small clients with our software solutions. This shift towards smaller client tiers is also expected to drive average tickets down, while it should open up a broader TAM opportunity ahead.

Looking ahead, I would also like to share with you our priorities for Software for this year and re-emphasize our long-term view. We have five key priorities for this year:

(i) Strong focus on cost discipline, integrating teams and functions across StoneCo, increasing operational leverage.

(ii) Continue to expand our presence by scaling our distribution channels, driving growth within medium and small client segments.

(iii) Continue efforts to build an end-to-end value proposition of software and integrated financial services in select verticals and segments. We believe this is key for us to strengthen our differentiation in some client segments where we have a relevant opportunity to address.

(iv) Streamline software assets to increase strategic focus; and

(v) Expand our addressable market by entering in new retail verticals through M&A.

In the long term, our goal is to build a unified commerce solution for our clients, and our software business is an integral part of our strategic vision. We believe we have a lot of work ahead of us, but we are on an exciting path to become the only end-to-end integrated software and financial services provider for Brazilian merchants.

Now, I want to pass it over to Rafa, so he can discuss in more detail some of our key financial metrics. Rafa?

Rafael Martins – VP of Finance and Investor Relations Officer

Thank you, Lia. I would like to begin on slide 15, where we discuss the evolution of our costs and expenses.

As we have mentioned in the past, 2023 should be a year with more cost discipline and opex control. In the first quarter, we have started to see initial results of that approach, especially in Administrative expenses, as I will detail shortly.

- Cost of Services increased 7% year over year to R$721 million. As a percentage of revenue, it was 26.6% in the quarter, 600 basis points lower than last year. Compared to previous quarter, it grew 3% mainly driven by higher investments in technology.
- As we said in our last earnings call, we expected Administrative expenses to reduce on an absolute basis and to increase below inflation for the year. In 1Q23, administrative expenses decreased 11.5% sequentially, mainly explained by lower third-party advisory expenses and more normalized levels of personnel expenses that was seasonally higher in the 4Q22. As a percentage of revenue, Administrative expenses improved 70 basis points year over year and 130 bps quarter over quarter to reach 9.7% of revenue.

- Selling expenses grew 1.6% year over year and decreased 4% sequentially, with operational leverage gains in both comparisons. The main reason for the quarter over quarter improvement was lower personnel expenses, partially compensated by higher marketing and sales commissions.
- Financial expenses increased 10 bps as a percentage of revenue, to reach 33.5%. Due to the market dynamics this quarter, we conservatively decided to hold a higher average cash position during part of the quarter, which indirectly impacted our financial expenses.
- Lastly, other expenses decreased 17.5% sequentially and 90 bps as a percentage of revenue, as our 4Q22 results were affected due to the impairment of proprietary software and write-off of some non-core assets.

Moving to slide 16, I would like to talk about our cash generation. This quarter, we have increased our adjusted Net Cash position by almost R$500 million to reach R$4.0 billion. The main driver for this was the strong cash flow from our operations, as well as the sale of our stake in Banco Inter for net proceeds of R$218 million. Compared to the first quarter of last year, Adjusted Net Cash increased by R$1.5 billion.

Now, moving to our second quarter 2023 outlook on page 17:

- We expect total Revenue and Income above R$2,875 million in 2Q23, representing a year-over-year growth above 24.8%.
- For MSMB TPV we expect volumes between R$83 and R$84 billion in 2Q23 compared with R$69.9 billion in the second quarter of 2022, representing a year over year growth between 18.8% and 20.2%.
- Finally, we expect adjusted EBT of more than R$375 million compared to R$324 million for the first quarter. This number is not adjusted for any share-based compensation expenses.

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