Stone Co 3Q22 Earnings Conference Call

November 17, 2022

Operator:

Good evening, ladies and gentlemen. Thank you for standing by. Welcome to the StoneCo third quarter 2022 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, Thiago Piau and our Chief Strategy Officer, Lia Matos.

Today, we will present our third quarter 2022 results, discuss some recent trends and provide an updated outlook for our business. I will now pass it over to Thiago so he can share some highlights of our performance. Thiago?

Thiago Piau – CEO

Thank you Rafa, and good evening, everyone. This quarter we had strong growth with market share gains, doubled our profits sequentially, accelerated our net addition of clients and generated strong liquidity with improving Adjusted Net Cash. Our profitability recovery is also gaining momentum.

Five things that I would like you to keep in mind about this quarter:

1. **First, our business is growing at a very strong pace**. Our revenue grew 71% year over year, we accelerated quarterly MSMB net additions to reach 2.3 million clients and we accelerated our market share gains in payments.
2. **We saw consistent improvement in our profitability: we doubled our profits versus last quarter**, with strong margin improvement and an Adjusted EBT of R$211 million in the quarter, significantly above our guidance of over R$125 million.

3. **Our banking business continues to perform very well**. We accelerated the growth of active banking clients and the volume of our client deposits resulting in an increase in the average revenue per client.
4. **Growth in our software business exceeded 20%** year over year driven by our Core POS/ERP solutions. The adjusted EBITDA margin in this segment increased significantly year over year and was stable quarter over quarter. We expect our adjusted EBITDA margins in Software to improve in the fourth quarter.
5. **Finally, our business continues to generate cash**. Our Adjusted Net Cash balance grew faster, increasing by R$350 million this quarter and R$813 million year to date.

I will now pass it over to Lia, who will provide more details about our third quarter performance and strategic updates. Lia?

Lia Matos – Chief Strategy Officer

Thank you, Thiago and good evening, everyone.

I would like to jump straight to slide 6, where we show the performance of our Financial Services segment. We are growing at a very strong pace, with **revenue up 84% year over year and Adjusted EBT up 70% or 111% quarter over quarter,** resulting in over **400 basis points of margin expansion in the quarter**. These strong results were driven by TPV growth, higher monetization of clients and more efficiency in costs and expenses, as we will detail further.

Moving to slide 7, this quarter we reached **more than 2.3 million active MSMB clients**, with net adds increasing **to 248 thousand.** As we have been explaining over the last few quarters this performance in net adds reflects the continued optimization of our commercial strategy to offer Ton and Stone products for each client segment needs, resulting in positive net adds in both Micro and SMB segments. I think this is a key indicator of the success we are having in our two-brand and multi-channel, go-to-market strategy.

This strong growth in our client base was the main driver of our MSMB TPV growth. As shown in slide 8, MSMB TPV **grew 45% year over year to R$74.7bn,** above our guidance range of between R$73 and R$74 billion. I am particularly encouraged that this growth resulted in **MSMB market share gains of 66 basis points** compared to the total industry. Our MSMB take rate increased 11 basis points quarter over quarter, **reaching 2.21%,** mainly a result of more repricing in the third quarter.

Moving to slide 9, our banking active client base increased 33% year over year, reaching **561 thousand clients**, with deposits from MSMBs more than doubling **to R$2.7bn.** We also increased the monetization on a per client basis, with ARPAC reaching **R$44 compared with R$39 last quarter**. I want to highlight an important trend in our banking business that will begin to take effect especially in 2023. As we sell more banking into our Ton client base, we expect to see a significant increase in our number of accounts, total accounts balance and overall banking revenues, although the average revenue per client should decrease, as micro merchants have naturally smaller revenue contribution.

I also wanted to give you a **brief update on credit**. We have started testing our new credit product and Gregor, our new Head of Credit, is already onboard. Our focus with the new credit product is to enhance our understanding of clients' ability to pay on one hand, and, at the same time, enable our clients to better manage their cash flows when they use our credit solutions. Some of the elements that we are currently testing include an increased set of variables within our credit models, automated processes that makes it easier to renegotiate the credit, and the inclusion of our hub operations in the credit lifecycle of clients. We will start with a Working Capital and a Credit Card related product, but we expect to expand our portfolio to provide a broader set of products in the future. We will take a conservative approach given the credit cycle the market is facing and expect to ramp up our credit client base in 2023.

Moving to slide 10, I want to remind you that over the last year we have been continuously deprioritizing subacquirer volumes because of their low profitability, but we remain focused on platform services. As a result, subacquirer volumes decreased 56%, **while platform services TPV grew 63% year over year.** The net result was that Key Accounts total TPV decreased 20% year over year. We expect Key Accounts TPV growth to trend upwards once we have rolled off more subacquirer volumes. Due to this mix shift and higher prepayment prices, **take rate increased sequentially to 0.95% from 0.86% in 2Q22.**

I will now shift to software on slide 11. Software revenues increased 22% year over year, reaching **R$366mn**. **Adjusted EBITDA more than doubled year over year, to R$55mn**, with a margin of 15%, relatively stable versus last quarter and approximately 830 basis points higher year over year. This quarter, software margin was affected by non-recurring cloud costs, which we expect to normalize in 4Q22. We expect our EBITDA margins to improve in the short-term.

On page 12, I want to highlight a few points on the evolution of Software:

- **Core POS and ERP solutions continue to drive the growth in the segment,** increasing revenue by **23% year over year**, mainly due to the increase in the number of POS/ ERP locations as well as average ticket.
- **Digital solutions returned to growth this quarter, increasing revenues by 10%** year over year, benefitting in part from the acquisition of Plugg.To, a solution that helps clients sell online through integration with marketplaces.
- **The integration of our financial services and software products continues to progress.** We integrated Payments and PIX acceptance in all software verticals and Stone Banking into the ERPs of 12 verticals. While we are still evolving our go-to-market strategy, I believe that this will be a strong differentiator in the way we bring Financial Services and Software to our clients, and we are monitoring our progress here very closely.

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

Thanks, Lia. In slide 13, I would like to highlight our trajectory of solid growth combined with a strong recovery in our profitability. Our revenue grew **71% year over year to R$2.5 billion** and our **adjusted net income more than doubled sequentially to R$163 million**. As Lia mentioned, our MSMB TPV grew faster than the industry, but we also gained market share on a consolidated TPV basis, even though we continue to deprioritize subacquirer volumes. Based on industry data, **our MSMB segment gained 66 basis points** of share this quarter and our consolidated payments business, including key accounts, **gained 41 basis points of share.**

As shown in slide 14, our Adjusted EBT reached **R$211mn, 69% above our guidance, representing significant year over year and quarter over quarter growth.** The outperformance relative to our guidance was mainly driven by better-than-expected revenue net of funding costs in financial services, including a successful repricing strategy.

In slide 15, I will talk about our costs and expenses, focused mainly on quarter over quarter trends.

- **Cost of Services as a percentage of revenue decreased 40 basis points to 26.8%.** This gain in efficiency was driven by strong growth in revenue, which more than offset a nominal increase of R$45mn in Cost of Services in the quarter. The increase was a result of (i) higher investments in technology and logistics, (ii) increased costs with cloud and datacenter and (iii) depreciation and amortization. Cost of Services includes upfront costs related to acquisition of new clients and despite strong growth in our client base, this line reduced as a percentage of revenues both year over year and quarter over quarter.
- **Administrative expenses as a percentage of revenue had a slight decrease to 10.0%**. Nominally, it grew R$20mn sequentially mainly due to higher personnel expenses.
- Selling expenses **had an increase of around 80 bps as a percentage of revenue**, mainly due to investments in the sales team, largely focused on the hubs as well as marketing expenses.
- Finally, **Financial expenses decreased 1.4% quarter over quarter.** This was mainly due to (i) a lower and more normalized duration of receivables sold to fund the prepayment business and (ii) the use of cash generated by our operations to pay down debt, reducing debt levels from R$6.8 billion in the second quarter to R$6.0 billion in the third quarter. Those two factors more than offset the higher prepayment volumes and higher interest rates quarter over quarter.

In addition to our P&L evolution, this quarter we continued to generate cash and improve our liquidity. Our **Adjusted Net Cash balance improved by around R$350mn in the quarter**, reaching **R$3.1 billion**. In the first nine months of 2022, Adjusted Net Cash increased by R$813 million. As I just mentioned we have used cash generated by our business year to date to pay down part of our debt given our already very strong cash position.

With that, let me turn back to Thiago, so he can comment a bit on our performance since the IPO, talk about the recent changes in our management and our outlook for 4Q22. Thiago?

Thiago Piau – CEO

Thank you, Rafa. This quarter, we are completing four years as a public company. I think that what the team has accomplished since then is remarkable.

As shown in slide 16, in the last four years **our active client base increased ten-fold**, reaching 2.4mn clients. Despite that growth, we still have only 11% market share in payments in Brazil and we see an addressable market of more than 13.5 million MSMBs in the country. So, there is still plenty of room to grow.

Over that same period, we grew TPV by 4 times, our revenue 6 times and our Adjusted Net Income by 83%.

In four years, we have also created our **banking business from scratch and currently have over 560 thousand** clients actively using our banking solutions. There is still a lot to do in banking in terms of new products and features and we have a big opportunity with our credit product. While we are in the early days of our financial platform evolution, I am very excited for the future of this business.

Since 2018 we have also evolved from having a very small presence in software, to becoming **the number 1 player for retail workflow tools in Brazil**, reaching approximately **R$1.5 billion in annualized revenue**. The combination of our financial solutions and software is a powerful differentiator in the market and puts us in a unique position to offer a superior value proposition to our clients.

While we have expanded our business significantly, we have kept our devotion to serving clients with the highest standards of service.

We also believe that our people and our culture are our most valuable assets. As you can see on slide 17 we have continued to enhance our team, to support our expansion, attracting more talent and strengthening our company for the next decade.

This quarter, we are pleased to welcome André Monteiro as our Chief Risk Officer, and Pedro Zinner, our next CEO. As we previously announced, I will become a Board member of StoneCo next year to focus my attention on developing key strategic and financial initiatives to drive the future expansion of the Company. Pedro Zinner will join the executive team no later than March 31st, 2023 and will begin working closely with me and the management team in a transition period before taking on the CEO role. I have a deep trust in Pedro and I am excited to work with him as we continue to evolve the business. I remain strongly committed to Stone as a partner and look forward to supporting the team in this new part of our journey.

With that said, I wanted to move to our 4Q22 outlook. While World Cup and the macroeconomic environment may impact our results, we continue to expect strong core growth and improving profitability in our business.

- We expect a Total Revenue and Income above R$2.6 billion, representing a year over year growth above 38.8%
- For MSMB TPV we expect volumes between R$78 and R$79 billion, compared with R$74.7 billion in the third quarter
- Finally, we expect adjusted EBT of more than R$250 million compared to R$211 million for the third quarter

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