Stone Co 4Q23 Earnings Conference Call

March 18, 2024

Operator:

Good evening, everyone. Thank you for standing by. Welcome to StoneCo's fourth 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 CFO and Investor Relations Officer, Mateus Scherer and our Chief Strategy & Marketing Officer, Lia Matos.

Today, we will present our fourth quarter 2023 results 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.

As I have outlined in our Annual Shareholders Letter after a year into my role as CEO, I have taken a deeper look at our company, better spotting our strengths and areas of improvement. This journey has been revealing, as it has provided valuable lessons and enhanced my perspective on the opportunities we face.

Reflecting on the successful year we had, it is impressive how well our company performed. I am not only referring to our strong financial performance but also acknowledging the strategic milestones that have strengthened our position in the market and paved the way for future growth – as we detailed in our Investor Day.

In response to the initial insights and assessment in my role as CEO, in 2023 we have initiated several strategic adjustments to better position our business for the future:

1. **We have reorganized ourselves to deliver our solutions more effectively across different client segments,** from Micro to Medium businesses, tailoring our go-to-market approach to

meet their unique needs. Our new organizational structure aligns with each client segment, while it also strengthens key capabilities around engineering, product, marketing, and innovation, enhancing our ability to address client needs in an unique way.

2. **We have sharpened our strategic focus around three strategic priorities which we outlined in our Investor Day.** These three priorities, (i) to win in MSMBs, (ii) to drive engagement with our clients and (iii) to scale through platforms, helped us to set key focus areas for the coming years:

    - **The first one, defining where our focus will be in terms of the software and financial services integration efforts.** By focusing our execution around four priority verticals of Retail, Gas Stations, Food, and Drugstores, we are increasing our competitive edge and opening a significant growth avenue for the future. Lia will present some initial encouraging results we achieved in the fourth quarter.

    - **The second one, to leverage the power of the combination of Payments, Banking and Software.** There is a huge opportunity in our installed base to increase engagement with our solutions. As an example, today only a fraction of our client base can be considered "heavy users" of our solutions and there is a substantial potential to improve our unit economics as we continue to engage the base. The results we saw in our financial services segment in the fourth quarter reflect the success of this strategy around payments and banking.

    - **And the third one, the Creation of the Stone Platform.** Our rapid growth initially focused on development speed, sometimes at the expense of consistency and reusability. This resulted in the existence of multiple data platforms. But over the last year and a half, we've made a significant change. We've brought our technology teams together, streamlined how we work, and started to build a solid foundation that we all share: the Stone Platform. As we move forward, especially with new tech like artificial intelligence, we're setting ourselves up to generate new synergies and use our insights even more effectively to serve our clients.

3. **Our last strategic adjustment focused on the implementation of Cost Management and Spending Controls.** Recognizing the potential to unlock substantial operating leverage, we've embarked on initiatives aimed at enhancing profitability even further. Through sustainable cost optimization, we're setting the stage for more efficient, profitable operations. By implementing a shared-services center and a zero-based budgeting, we are enhancing our financial discipline across the organization.

While the opportunity is huge, we will seize it through a targeted approach, ensuring we do not dissipate our efforts.

Before handing it over to Lia, I would like to briefly talk about our 2023 results. Last year was a milestone for us, marking a complete rebound from the challenges faced in 2021. We closed the year with exceptional results, particularly in the fourth quarter, when we accomplished significant progress in our key strategic initiatives.

1. We posted remarkable growth, achieving a notable increase in MSMB TPV, both annually, with MSMB TPV increasing 21% to R$350 billion, and in the fourth quarter, with an acceleration from the previous period. Our banking services also recorded impressive growth, with deposits reaching R$6.1 billion by the end of December, a significant increase from 2022. This growth not only reflects higher engagement but also a better conversion of TPV into deposits.

2. Monetization improved substantially throughout the year, with MSMB take rates achieving 2.43%, up 22 bps year over year. In the 4Q we saw a slight decline of 6 bps compared to the previous quarter, but that was already expected and purely a result of seasonality. More importantly, we continued to advance in our Credit Solution - reaching a working capital portfolio of R$309 million by the end of the year, with very encouraging results regarding the health of the portfolio and NPLs strictly under control. Additionally, our integration efforts in the four prioritized verticals have just started to be fruitful, with participation in TPV from these software clients surpassing R$20 billion in the year.

3. The push to "Scale Through Platforms" yielded substantial operational leverage, boosting our EBT to R$2 billion, an increase of 3.3x over the previous year. This leap forward improved our EBT margin by more than 10 percentage points, and our adjusted net profit surged to R$1.6 billion, up 3.8x from the previous year. Our profitability also translated into cash generation, and we ended the year with an adjusted net cash position of R$5.1 billion, even after significant investments in our credit portfolio and share buybacks.

On a separate note, the software segment faced challenges in 2023, particularly in non-strategic verticals, where growth was slower. However, our efficiency initiatives already started showing results, with EBITDA margins in 2023 improving by 1.9 percentage points to 16.4%. The fourth quarter recorded a dip due to one-off restructuring costs, but these moves are poised to generate savings in 2024.

In summary, 2023 was a year of significant achievements and strategic advancements for us, and our 4Q results are positioning us in a good place to deliver our 2024 and 2027 outlook.

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

Lia Matos – Chief Strategy & Marketing Officer

Thank you, Pedro and good evening, everyone.

We had important evolutions over the last year in our strategic priorities, while we continued to balance growth with profitability, which you can see on slide 5. Compared with 4Q22, **our consolidated Revenues grew by 20%**, which combined with lower Financial Expenses led to **an increase of almost 2.3 times in Adjusted EBT**. These factors combined with a lower effective tax rate, **resulted in Adjusted Net Income increasing by almost 3-fold year over year, with an Adjusted Net Margin of 17.4%, up about 10 percentage points in the period.**

Taking a closer look at our financial services segment performance on slides 6 to 11, I will start on slide 6 with the performance of our Payments business for MSMBs.

Payments active client base **increased 37% year over year**, reaching almost **3.5 million active clients**. Sequentially, this represented a net addition of **192 thousand clients**, lower compared to the previous quarters, mainly as a result of our strategic shift towards larger clients in the Hubs and the fact that we have caught up to growth levels in the micro segment. This growth in client base also resulted in healthy and profitable cohorts in all client tiers. As you will see in the pages that follow, and in line with our strategic priorities to Win in the MSMB segment and to Drive Engagement with our solutions, besides optimizing our commercial strategy for growth and market share gains, we are also putting a lot of focus on improving bundle offerings of payments and banking to new client cohorts, both in Ton and Stone, as well as driving further engagement with our solutions for more mature cohorts of clients. As I will show on slide 7, this approach has resulted in profitable TPV growth, with market share gains in the MSMB segment versus the overall market.

MSMB TPV increased **20% year over year, growing more than twice the industry levels**. Considering PIX P2M volumes, which were almost R$8 billion in the quarter, MSMB TPV increased 25% year over year, an extra 5 percentage points of growth when considering PIX P2M in our overall TPV. We achieved this strong growth performance while also increasing take rates by **22 basis points year over year, to 2.43%. Take rates were lower versus the third quarter as a natural result of seasonality in the fourth quarter, which always presents higher debit volumes.** We are continuously evolving our pricing and bundle strategy, to achieve higher levels of engaged clients, helping them with more of their jobs to be done. We believe these strong numbers are the result of our competitive advantages around our distribution capabilities, our superior service and more and more, the ability to offer more complete solutions to our clients.

Now, a quick update on our Key Accounts performance on slide 8:

Key Accounts' TPV decreased 17.6% year over year to R$15 billion, as we have continued to deprioritize and offboard low margin clients. Year over year, Key Accounts' take rate increased 11 bps, as a result of the adjustments in our commercial policies and a mix shift within the segment.

Now, let's discuss our Banking performance on slide 9.

Banking active client base **increased 3-fold year over year, to 2.1 million active clients**. This evolution was a result of the launch of "Super Conta Ton" in the beginning of 2023 and the continued activation of banking for Stone clients through our bundle offers. The decrease in growth levels compared to the previous quarters is mainly due to the end of the migration of Ton clients to our full banking solution. This growth in client base was associated with a **52% year over year growth in deposits, which reached R$6.1 billion in the quarter**. This new level of deposits derived both from a positive impact in the cash-in level and engagement due to the effectiveness of our payments and banking bundles; and second, from a seasonal and calendar effect at the end of the quarter. As a result, ARPAC increased 11.4% quarter over quarter, to R$28.4 per month. Despite lower seasonality, this positive trend in client deposits is also seen throughout the first quarter of 2024.

On slide 10, we will talk about our Credit performance**.** As you know, we have relaunched our working capital solution to SMBs in 2023 and have seen very positive initial results.

In the 4Q23, we disbursed more than R$230 million to around 7 thousand clients, reaching a portfolio of **R$309 million, an increase of 2.7x quarter over quarter**. Loan loss provision expenses totaled R$39 million in the period, an increase of 2.1 times sequentially, as we constitute provisions of 20% of our portfolio. Although we are taking a conservative approach, the performance of our vintages is above our expectations, **with NPLs between 15 and 90 days of 1.96% and NPLs over 90 days of 0.29%**. As we have highlighted before, this is a recently launched portfolio, so the ratio of past-due loans should increase as our portfolio matures. This year, we will continue with disbursements without changing our diligence towards risk evaluation and close monitoring of market conditions. Beyond our working capital solution for SMBs, the principal driver of our portfolio growth, this year will mark also the launch of more credit solutions to our clients, such as credit cards and overdraft.

To summarize, the fourth quarter was again marked by above industry TPV growth and higher take rates, resulting in Financial Services revenue growth of 24% year over year in the fourth quarter, reaching R$2.9 billion. In turn, Adjusted EBT reached R$604 million with an Adjusted EBT margin of 21.0%, an increase of more than 10 percentage points year over year.

Moving to slide 12, let's talk about Software performance and strategic evolutions.

Quarter over quarter, **MSMB TPV Overlap between Financial Services and Software clients increased 19.3%, almost twice the growth we had in our MSMB TPV in the same period.** Among the four strategic verticals, this performance was mainly driven by Gas Stations. This relative performance illustrates our continued efforts and first signs of success of our strategy to provide an end-to-end solution that combines management software, payments and banking to our SMB clients. Going forward, we have listed three main priorities in order to drive growth and engagement in the four priority verticals: (1) first, we are focusing on setting up our go-to-market strategy in order to scale our distribution model for combined software and financial services offerings; (2) second, we are enhancing the product value proposition to seize the opportunity in the four key strategic verticals, with gas stations and retail being the main focus for 2024; and (3) third, we are integrating the post-sale process to guarantee we maintain the superior levels of service our clients expect from us. There still is a huge opportunity for us to target within our Software installed client base and to drive engagement with our bundled solutions, and this will be a key focus for the next years.

Moving to slide 13, software segment revenues decreased 3.5% year over year to R$363 million, as a result of lower revenues from the Enterprise business, which was down 16% in the period. Sequentially, Software revenues decreased 6.4% due to lower yield on cash, as well as lower revenues from Enterprise business.

As a result of this weaker top line, combined with one-time restructuring costs in the amount of R$11.5 million, Adjusted EBITDA decreased to R$59 million in the quarter, with an Adjusted EBITDA margin of 16.2% compared with 20.5% in 3Q23. Excluding this restructuring costs, Adjusted EBITDA margin would have been 19.3% in 4Q23, and as we continue to focus on diligent costs savings and process improvements in our software segment, we expect margins to improve in 2024.

As Pedro mentioned, the fourth quarter marked the closing of an important year of strategic advancements for our business. The combined evolution of our strategic priorities around Win, Engage and Scale through Platforms led to the strong results we have seen in the fourth quarter. Reinforcing what Pedro already said, I believe we are well positioned for a strong 2024 and 2027 outlook.

Now, I want to pass it over to Mateus for him to discuss in more detail 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 14, where we discuss the quarter-on-quarter evolution of our costs and expenses, on an adjusted basis.

- **Cost of Services reached R$803 million, increasing 15% year on year and 3.8% quarter on quarter.** Cost of Services was sequentially flattish as a percentage of revenues, despite (i) provisions for expected credit losses in the amount of R$39 million in 4Q as we grow our credit book and (ii) higher investments in technology. Excluding provisions for expected credit losses, cost of services would have decreased 50 basis points sequentially as percentage of revenues, showing continued operational leverage.
- **Administrative expenses decreased 6.5% year on year, leading to a 250-basis point reduction** as a percentage of revenues when compared to 4Q22. Sequentially, administrative expenses increased 14%, up 70 basis points as percentage of revenues due to (i) higher third-party service expenses, combined with (ii) personnel expenses – which are seasonally higher in the fourth quarter. As we have shared in our Investor Day, achieving efficiency in G&A will continue to be a priority going forward. We remain committed to our guidance of less than R$1.125 million of administrative expenses for 2024, which implies a growth of less than 7% for the year.
- **Selling expenses increased 2.6% quarter on quarter** and remained flat as percentage of revenues, despite higher provisions for variable compensation in the period.
- **Financial expenses decreased 10% quarter on quarter, down 430 basis points as percentage of revenues.** This evolution was a result of (i) lower interest rates, with average

CDI decreasing in the quarter, (ii) lower number of working days, (iii) a seasonal decline in the average duration of funding lines, and (iv) a lower average cash balance in the period.

- **Other expenses increased 47.6% sequentially and 120 basis points as a percentage of revenues**, because of higher civil contingencies and tax provisions related to share-based compensation as a result of the share price appreciation in the 4Q.
- Lastly, **adjusted effective tax rate reached 11.7% in the 4Q**. The lower effective tax rate in the period was a result of higher utilization of tax benefits from Lei do Bem, as well as gains from subsidiaries abroad subject to different statutory tax rates. For 2024, we continue to expect effective tax rate between 20-25%.

Turning to slide 15, our **Adjusted Net Cash** position reached R$5.1 billion, reflecting an increase of **R$1.6 billion** year over year and **R$196 million** for the quarter. The growth in adjusted net cash is especially notable as it came after the deployment of R$293 million on share buybacks within the quarter, while also continuing to deploy capital towards the expansion of our credit portfolio.

Now, I would like to turn it back to Pedro.

Pedro Zinner – Chief Executive Officer

Thank you, Mateus. To wrap it up, today we also announced a pivotal transition in our leadership. André Street, our esteemed founder and Chairman, has also chosen to conclude his tenure on the Board, stepping aside from reelection at the forthcoming Annual General Meeting (AGM) scheduled for April 2024. Similarly, Vice-Chairman Conrado Engel and board member Patricia Verderesi will not seek reelection, honoring their two-year commitment.

André will remain connected to the company, as a Reference Shareholder, bolstered by special protections under our Shareholders' Agreement and Articles of Association, including the privilege to nominate the Chairman of the Board. This transition marks the culmination of a deliberate, multi-year effort led by André to professionalize management and enhance governance standards—a mission that was crystallized by our strong 2023 results and the robust, strategically aligned team now at the helm.

The candidates recommended for the upcoming AGM will be Mauricio Luchetti as Chairman and Gilberto Caldart as Vice-Charman. Additionally, a new member will be indicated, José Alexandre Scheinkman. We have shared more details about the succession in a separate 6-K filing.

We are committed to keeping alive the entrepreneurial spirit created by our founders. Our goal is to maintain high standards of governance as our company grows and continues to be a leader in entrepreneurship and client-centricity. With a committed shareholder like André, a great team, and a strong business, we are all set to continue to advance our mission forward.

Before moving to Q&A, I would like to reinforce our guidance given for 2024:

- For our **Growth Metrics**: we expect MSMB TPV to reach more than R$412 billion, an increase of more than 18% compared with 2023, while we expect client deposits of more than R$7 billion, increasing more than 14% year over year;
- For **Monetization**, we expect our credit portfolio to surpass R$800 million, increasing 2.6x year over year with MSMB take rates higher than 2.49%, implying an increase of more than 4 basis points;
- Lastly, in **Efficiency** we expect Adjusted Net Income to be higher than R$1.9 billion, representing more than 22% year over year growth, with administrative expenses of less than R$1.125 million, decreasing 7% compared with 2023.

As we close 2023 and kick off 2024, I am more enthusiastic than ever about our business. There is growth ahead of us, and we are closer to demonstrating the power of combining.

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