Stone Co 1Q22 Earnings Conference Call

June 2, 2022

Operator:

Good evening, ladies and gentlemen. Thank you for standing by. Welcome to the StoneCo first 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. 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 on the call we have our CEO, Thiago Piau, Lia Matos, Chief Strategy Officer, and our CFO, Marcelo Baldin.

Today, we will present our first 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 highlights of our performance and some key insights starting on page 4 of our presentation. Thiago?

Thiago Piau – CEO

Thank you Rafa, and good evening, everyone. As I said in our previous earnings call, I believe we are well positioned to drive strong growth and improving profitability in 2022. Our 1Q22 results show that we are on the right track.

We produced strong TPV and revenue growth, together with a significant improvement in our operating margins.

Our growth engine remains strong. Despite seasonality, we achieved our all-time high revenue of R$2.1 billion; that is 10% above the mid-range of our guidance. As a result, proforma revenue growth accelerated to 87% in Q1, up from 51% in the fourth quarter, our highest growth rate since the 4Q18.

This strong revenue growth was driven by two key factors: i) a higher client monetization, driven by our new pricing policies and ii) an accelerated MSMB TPV growth, which reached 93% in 1Q22, exceeding the top of our guidance of 83%. This strong TPV growth was a result of both active client base growth and a continued improvement in our go to market strategy for Ton and Stone products.

On the profitability side, our adjusted EBT reached R$163 million in the quarter, which was 16% above our guidance, representing an almost tenfold increase on a sequential basis.

As we mentioned last quarter, we reorganized the company into two segments – Financial Services and Software, because we believe this will increase transparency, reduce complexity and enable us to better manage our business. As you can see from our reporting, both of our segments performed well in the quarter.

Within financial services, revenue increased by 107.8%, driven by solid expansion of client monetization. As a result of our new pricing initiatives, MSMB take rates reached 2.06%, which was 35bps above the previous quarter, and the quality of our client mix improved within both Ton and Stone products. The net addition of clients decelerated in the quarter, but this was mainly driven by the churn of lower profitability clients. Finally, we continued to expand our banking platform with transactional products, generating more engagement, and increasing opportunities to monetize clients in the future.

In our software segment, proforma revenue growth reached 27%, driven by a strong performance in the Core software and the consolidation of certain acquisitions made in the period. Within the Core, we generated revenue growth of 32%, driven by stronger new sales and higher average ticket per client. We are also gaining operating leverage in the software segment, with 12% adjusted EBITDA margins in 1Q22, a significant improvement compared with 9% adjusted EBITDA margins in 4Q21.

To help us execute our extensive roadmap, we will be welcoming two seasoned leaders to our team: a new CTO and a new Head of Credit. We have also assigned a new VP of Finance for our Software division. The company has also recently welcomed two new board members, resulting in a board composed of 90% independent members, with very diverse backgrounds and deep experience in technology and financial services.

I am pleased with the direction of our results in 1Q22, and I think this is a solid first step to producing strong results in 2022. I am also encouraged that we are seeing the same positive trends so far in the 2Q22. With that, I will now pass it over to Lia who will provide more details about our first quarter performance and strategic updates. Lia?

Lia Matos – Chief Strategy Officer

Thank you, Thiago, and good evening, everyone. I will start today with some performance highlights and then do a quick deep dive on the main drivers of our performance. On page 5, we show a summary of our main financial and operating highlights, and I just want to touch on a couple points here. As Thiago mentioned, our total revenue surpassed a record mark of R$2 billion this quarter, with growth accelerating to 139%, or 87% proforma for Linx. I think one takeaway of our strong growth performance is it does confirm our ability to implement the new pricing strategies laid out in the 4Q21 while maintaining strong TPV growth. These strategies, together with a tighter cost management, enabled us to also see a significant recovery in profitability, with an Adj EBT margin of 7.9% compared to 0.9% in the 4Q21.

Moving to page 6, as you can see we are presenting our financial results in two segments. Our fintech businesses are managed in our financial services segment and our vertical POS/ERP solutions as well as the digital commerce solutions are managed within our software segment. Lastly, we have a third bucket for non-allocated activities, which we manage separately. This change in reporting aligns with how we manage the business and is consistent with the changes we have implemented in our leadership team and management systems. We have made the historical data for these segments available for your review in the appendix of our earnings release.

Let’s now take a closer look at each of our two businesses. I’ll talk first about Financial Services on pages 7 to 12, and then move to Software on slide 13.

In financial services, we produced very strong growth during the quarter with more than R$1.7b in revenue, more than doubling compared with last year and increasing on a sequential basis, despite historical seasonality.

Perhaps more importantly, profitability rebounded significantly with Adjusted EBT of R$146 million, a more than fourfold increase from the previous quarter and a 620 bps sequential margin improvement. I think this begins to show a shift in our profitability trajectory which we will continue to focus on throughout 2022.

On slide 8 I want to talk about our client base trends. During the quarter, we reached 1.9 million MSMB clients and a net client addition of 168 thousand. As anticipated in our last earnings call, we saw a sequential deceleration in net adds, but this deceleration was mostly a result of churning of lower profitability clients. Taking a closer look, the 168 thousand net adds was comprised of, 184 thousand new additions in the TON product while the Stone and Pagar.me products experienced a decrease of 15 thousand clients.

Let me take a moment to break this down further and explain to you what is happening. As we’ve mentioned, we have shifted the commercial strategy to onboard smaller clients onto the Ton product as opposed to Stone product, because it better suits their needs and has a better unit economic profile for us. As a result, there are two effects taking place here: first, the majority of our new sales for smaller clients are directed towards Ton and second, the majority of our churn comes from less profitable, small clients still using the Stone product.

Moving on to slide 9, we can see that our strong TPV growth was a result of not only the client base growth, but also of the improvement in the quality of our client base. TPV in the MSMB segment grew over 93%, above the top range of our guidance, while the average TPV per client also increased in both Stone and TON products, as a result of the shift in commercial strategy that I just mentioned.

Take rates also improved materially in the 1Q22 to 2.06%, an increase of 35 basis points compared with the previous quarter.

As a result of our evolving commercial strategy, where we are optimizing our client mix of solutions based on customer needs, we are increasingly focused our overall MSMB TPV and client base metrics, versus thinking about our business separately between Stone, Pagar.me and Ton. To align with this strategy and provide investors a better and more consistent perspective on our performance, we will focus our reporting on overall MSMB metrics rather than by specific products, starting now in the second quarter.

In slide 10, we highlight the continued expansion and engagement with our banking platform. This quarter we surpassed half a million clients actively using our digital banking account, more than double compared with the previous year. We have been growing our base while also increasing ARPAC, which reached R$33 in the first quarter, growing 32% sequentially.

Shifting to slide 11, I want to quickly update you on our credit business. Our legacy credit portfolio is performing in line with our expectations. This quarter we had a cash inflow of around R$250 million from clients paying us back and we are on track to entirely de-risk principal capital. Given this performance our portfolio was recognized at a fair value of R$268 million in our balance sheet in the 1Q22, compared with over R$2.0 billion one year ago.

Finally, on slide 12, we show some KPIs for our Key Accounts business. TPV grew 9% versus last year as we continue to de-prioritize sub-acquirers. In contrast, our platform services business continues to grow fast, accelerating its growth to 114%. Our take rate for the Key Accounts business continued to improve at 0.84% for the quarter, increasing sequentially as a result of both repricing and mix shift towards platform services, which have higher take rates than sub-acquirers.

Now let's shift to give some highlights of our software business performance on slides 13 and 14. Starting with the top line, Software revenue reached R$327 million in the quarter, up 27% Pro-forma for Linx and our proforma adjusted EBITDA margin improved 370 bps this quarter to 12.3%.

On slide 14, I want to touch a little bit on the drivers of this performance and the progress of our software strategy.

- First, the core software business produced a strong growth of 32% as a result of the increase in number of locations using our POS/ERP solutions and an increase in average ticket, while the digital segment revenue decreased 2% as a reflection of tougher comps and the need for performance improvement.

- Second, we are gaining scale and improving margins: with an annualized revenue of R$1.3 billion, we are able to continue to generate operating leverage from our integration efforts and efficiency gains in costs and expenses and we expect this trend to continue.

Finally, we see plenty of room to grow organically in current verticals, expand vertical coverage with new investments, increasing our reach to help merchants become more productive, sell more and grow.

Now I would like to pass it over to Rafael, 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. Starting on slide 15, without going into too much detail on the numbers that Thiago and Lia have already walked you through, I do want to note three things: first, we see strong continued growth trends. Second, we see these results in both software and financial services segments. Third, and most importantly, we are starting to see our profitability rebound.

On slides 16 and 17 we show our P&L and adjusted P&L for the quarter. As we have already discussed topline trends in detail, I will move directly to slide 17 to focus on our costs and expenses, pro-forma for Linx.

In this quarter we observed operating leverage across all our costs and expenses line items both on an sequential and annual basis, with the minor exception of selling expenses quarter over quarter, which were impacted by additional marketing expenses that are part of our contract with Globo. It is important to note here that most of this institutional marketing will not affect our cash flow since we prepaid R$230 million of marketing expenses in the first quarter of 2021, which was fully funded by cash received from Grupo Globo.

Now, let me highlight the most relevant efficiency gains quarter over quarter:

- Our costs with TAG, our platform of receivables, decreased from R$ 64mm in the 4Q21 to close to R$32 million in the quarter. We still have room to improve on this line, and we expect to continue gaining operating leverage in our cost to serve in the coming quarters.

- We gained almost 200 bps margin in administrative expenses, due to better cost control in third party services, facilities, travel expenses, among others and
- For the first time over the last year, we saw financial expenses decrease as a percentage of revenue, by 260 bps. Despite continued increase in interest rates in Brazil, our new pricing policy more than offset the higher absolute level of financial expenses

Now, moving to page 18, as we indicated in our previous earnings call, we are taking important steps to reorganize the business and bring in additional seasoned and talented people to strengthen our team. This quarter, I am happy to announce that we are welcoming:

- **Marcus Fontoura**, formerly at Microsoft, Google, Yahoo and IBM, as our Chief Technology Officer, and
- **Gregor Ilg**, former Head of Santander Brasil SMEs Retail Risks, who has 15 years of experience in credit and is expected to join the team as Head of Credit after his garden leave.

Also, Osmar Castellani, who has joined our team last year, was designated as the new VP of Finance for our Software division.

We would also like to highlight that we welcomed two new independent Board members: i) **Patricia Verderesi Schindler**, former JP Morgan Chief Risk Officer, Chair of Audit Committee at Raizen and board member at Credit Suisse Brazil and ii) **Mauricio Luchetti**, who has 19 years experience at Ambev, deep expertise in HR and Management and also an extensive board experience. As a result, our board is currently comprised of 90% independent directors.

Lastly, as we just announced in a separate filing, we have recently approved a new incentive plan pool, an important step towards attracting and retaining talents to support the execution of our strategy and to align incentives between our shareholders and the management partners who will lead the next phase of our growth.

With these steps, we believe that we are moving in the right direction to strengthen our team and governance practices, increasing the long-term value generation for our stakeholders.

To finalize our presentation, let´s move to page 19, where we share our 2Q22 outlook for the business:

- For 2Q22, we expect a Total Revenue and Income between R$2.15 billion and R$2.2 billion, representing year over year proforma for Linx growth between 148% and 154%. If we exclude the credit product, which had a negative impact on our 2Q21 topline, the proforma revenue should grow between 70% and 74%;
- We expect revenue growth to be driven substantially by the growth of our MSMB business, projected to reach TPV between R$67 billion and R$68 billion, representing year over year growth between 71% and 73%;
- Because of the extent of the repricing that took place in the first quarter, we still expect our net clients adds to continue to be affected in the second quarter
- Regarding our EBT guidance, we expect our business to continue improving profitability, with Adjusted EBT above R$185 million in the 2Q22, when adjusting for financial expenses of our bond. This compares with R$ 163 million achieved in the 1Q22.
- From the second quarter onwards, we have decided to stop adjusting the financial expenses related to the bond from our adjusted P&L. This decision was driven by the partial sale of our stake in Banco Inter, an investment which was fully funded by the issuance of our bond. We have sold

21.5% of our stake in Banco Inter through the cash-out option offered in their corporate restructuring.

- With this change in adjustment, the Adjusted EBT should be above R$90 million in the 2Q22, compared to R$82 million in the 1Q22 considering the same metric.

We believe 2022 marks the recovery of our profitability while maintaining strong levels of growth and advancing on our purpose of serving Brazilian Entrepreneurs.

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