Stone Co 2Q22 Earnings Conference Call

August 17, 2022

Operator:

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

Today, we will present our second 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. In the second quarter, we demonstrated consistent execution combining strong growth with improving profitability. We produced this strong performance in both TPV **and** revenue growth, while improving our operating margins in both of our segments.

We achieved total revenue of **R$2.3 billion**, which was **5%** above our guidance and up **83%** year over year excluding the negative revenue impact from the credit product in 2Q21 and proforma for Linx.

On the profitability front, our Adjusted EBT margins increased sequentially from 4.0% in the first quarter to 4.6% in the second quarter, driven by improved operating efficiencies in our Financial Services and Software businesses. As we noted previously, following the partial sale of our stake in Banco Inter, we decided to stop adjusting the bond financial expenses in our results from the second quarter onwards. As a result, our adjusted EBT in the second quarter reached **R$107 million**, **19% higher** than our **guidance** of over R$90 million.

In our Financial Services segment, we were especially encouraged by five factors:

(1) **First**, the strong evolution of our payments client base, **which crossed the 2 million mark**, with an acceleration of net adds in the quarter.

(2) **Second**, the strong MSMB TPV growth of **78% year over year**, driven by both our active client base growth and a continued improvement in go to market strategy for Ton and Stone products.

(3) **Third**, we were able to continue increasing our take rates while we increased our average TPV for both Stone and TON products sequentially.

(4) **Fourth, the expansion of our banking platform**, generating more engagement, and increasing opportunity to monetize clients in the future.

(5) **And finally, efficiency gains** in costs and expenses.

As a result, the Financial Services segment revenue grew **3.4 times Year over Year and 102%** excluding the effects associated with the credit product last year. At the same time, EBT margins in the segment **increased** from 3.8% in the first quarter to **4.3% in second quarter.**

In our Software segment, revenue growth pro-forma for Linx reached 23%, mostly driven by a strong performance in our Core software. I am encouraged by the margin evolution in Software, with sequential improvement of **almost 300** basis points in EBITDA margin, which reached over **15% in the quarter**. This improvement was the result of continued efficiency gains and back-office synergies, even though we continue to invest in our distribution, customer service and marketing capabilities. We expect to continue ramping-up our software margins in the second half of the year.

I am pleased with the consistency and direction of our results in the second quarter, and I think this is a solid step forward to producing strong results by year end. Looking to the second half of the year, we will maintain our focus on building on these achievements.

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

Lia Matos – Chief Strategy Officer

Thank you, Thiago, and good evening, everyone. As Thiago just summarized the main financial and operating highlights, I will dive a bit deeper into the drivers of our performance.

Starting on slide 7, I will focus on our client base trends. During the quarter, we reached over 2 million MSMB clients, with net adds of 196 thousand, driven by strong commercial performance in both Ton and Stone products, despite some churn impact from our continuous pricing initiatives. We have continued optimizing our commercial strategy to onboard smaller clients onto our Ton product while we focus the Stone product on bigger SMBs. This approach addresses our clients' needs more effectively and provides superior unit economics for us.

As you can see on page 8, this strategy has led to better quality in our client base for Stone and Ton, both of which grew average TPV over 30% year over year. This, combined with our client base growth, resulted in MSMB TPV of **R$69.9 billion**, **3% above** our guidance for the quarter and **78%** higher year over year. At the same time, we improved our monetization, with take rates increasing sequentially from 2.06% to **2.09%** in the second quarter.

On slide 9, we highlight the continued expansion and engagement with our banking platform. On top of the growth in number of clients actively using our digital banking account, I want to highlight the sequential improvement in ARPAC, which reached R$39 per month this quarter, compared to R$33 last quarter and 3X higher year over year, mostly driven by higher interest rates on average deposits from clients bank accounts.

I also want to briefly update you on the performance of our legacy portfolio. This quarter we received R$134 million of cash inflows which decreased the fair value of the credit portfolio on our balance sheet to R$129 million.

On slide 10, we will move on to our Key Accounts business. As we show on the left side of the page, TPV from Key Accounts had a slight decrease during the period, as we continue to de-prioritize sub acquirers. On the other hand, the TPV growth in Platform Services was strong at **95% year over year**. Due to this mix shift and the increase of CDI rates, take rate have increased sequentially to 0.86%.

Now, let's shift to our Software segment on slides 11 and 12.

Software revenue in 2Q22 reached **R$351 million** representing **23% year over year growth** proforma for Linx. At the same time, Adjusted EBITDA also improved, reaching **R$53 million with 15.2% adjusted EBITDA margin** compared to 12.3% in first quarter and 9.2% in second quarter 2021 proforma for Linx. We expect profitability improvements to continue throughout the year, as we capture efficiency gains and backoffice synergies, even while we continue to invest on several fronts.

On slide 12, I want to highlight the main drivers of this performance and the progress of our software strategy.

- **First**, software revenue growth was driven mainly by **Core Revenue growth** that was up **28% year over year** driven by the higher number of POS/ERP locations and average ticket, as well as the consolidation of *Reclame Aqui*. This result was partially offset by the Digital business, which decreased revenues by 6%. In order to strengthen our strategy of helping our software clients to sell through multiple channels, we concluded the acquisition of Plugg.to, which streamlines integrations with marketplaces. We believe we have a huge opportunity here to help our clients become truly omnichannel and increase their sales.
- **Second**, we are gaining scale and improving margins: with annualized revenue of R$1.4 billion, we continue to generate operating leverage from our integration efforts and efficiency gains in costs and expenses and we expect this trend to continue in the 2H22.

Finally, we see significant room to grow organically and through new investments in our core POS and ERP products, cross sell financial services to our existing client base and help our clients sell more through multiple channels.

Now I would like 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. Before I go over our financial results, I would like to clarify that as anticipated in our last earnings release, from 2Q22 onwards we will no longer adjust our results for the financial expenses related to our bond. To allow for like-for-like comparison, we have included in our earnings material historical numbers in the same criteria that we are now adopting.

That said, starting on slide 13, I wanted to highlight a few key points.

As we can see, our results are consistently improving, with revenue and margins from both our Financial Services and Software segments increasing sequentially. Our adjusted net income was **R$76.5 million** compared with R$51.7 million last quarter, a 48% sequential improvement. For the rest of the year, we expect profitability to keep increasing while balancing it with healthy growth levels.

As we have already detailed our topline trends, I will move directly to slide 15 to focus on our costs and expenses, proforma for Linx.

Following the trend we started seeing last quarter, we gained leverage in most of our costs and expenses lines, both quarter over quarter and year over year, with Cost of Services and Selling Expenses being the highlights for the quarter.

We will focus on our quarter over quarter evolution, which better shows our current trends.

- **Cost of Services** as a percentage of revenue **decreased 540 basis points**, driven mainly by (i) lower datacenter costs, (ii) efficiency gains related to our registry business and (iii) lower D&A.
- In **Administrative expenses**, we had a small gain in efficiency as a percentage of revenue. As our business kept growing, we had higher third-party service expenses, which was the main responsible for the absolute growth in this line. As we continue to rationalize G&A growth, we expect to continue gaining leverage in this line over time.
- Regarding **Selling expenses**, this line decreased almost **400 basis points** as a percentage of revenue, as our marketing expenses returned to more normalized levels. We will keep investing in our growth through commercial efforts in the second half of the year.
- **Financial expenses**, with the bond included in the previous quarters for comparison purposes, presented a sequential growth of around 710 basis points as a percentage of revenue mainly due to three factors: (i) first, further increases in CDI rate that increased on average 20% quarter over quarter; (ii) second, a larger mix of prepayment revenue; and (iii) finally, our decision to increase the duration of our funding lines.
- Lastly, **Other Expenses** as a percentage of revenue had an increase of almost 190 basis points, mainly explained by: (i) the write-off of assets from the discontinued Linx Pay business in the amount of R$16.6 million, (ii) write-off of POS equipment and (iii) other smaller effects.

We are encouraged by the trends we are seeing and we will keep looking for opportunities to be more efficient in the second half of the year.

In addition to our P&L evolution, this quarter we continued to generate cash and improve our liquidity. Our Adjusted Net Cash improved by **R$195.6mn** in the quarter and **R$455.6 million** in the first half of the year, reaching **R$2.6 billion**.

With that said, I will pass it back to Thiago so he can provide you additional updates about our team and our outlook for the third quarter. Thiago?

Thiago Piau – CEO

Thank you, Rafa. Before we move to our outlook for the third quarter, I would like to give you an update about some additional changes to our executive team. Marcelo Baldin, our Chief Financial Officer, is departing from the Company after 5 years of services building out our Finance functions and helping the Company execute on its IPO. Baldin will be replaced by Silvio Morais, who was named our Interim CFO. Silvio, who has extensive experience in Finance, including serving 20+ years as Controller at Ambev, will temporarily step down from our Board to assume his new duties. Also, Tatiana Malamud was appointed our Chief Legal Officer, a new role which will serve as part of the Executive Committee. Tatiana has 30 years of experience as in-house counsel and head of legal departments for different financial institutions, as well as deep experience in capital markets.

We would like to thank Baldin for his valuable contributions to Stone over the past 5 years and wish him success in his new endeavors. I am excited to have Silvio join the management team and benefit from his significant experience in Finance. Also, I would like to welcome Tatiana to our team and look forward to her developing this critical new role for the company.

Finally, let's move to slide 16, where we will share with you our **3Q Outlook** for the business.

- We expect a Total Revenue and Income above R$2.4 billion, representing a year over year growth above 63.3%.
- For MSMB TPV we expect volumes between R$73 and R$74 billion, with year over year growth between 41.4% and 43.3%
- Finally, regarding adjusted EBT we expect more than R$125 million without adjusting for the bond financial expenses, compared to R$106.7 million for the second quarter

We still have a long path ahead of us, but we believe the consistent results achieved in the first half of the year demonstrate we are on the right track, with an encouraging outlook for the second half of 2022 in which we continue to expand margins while keeping strong growth levels.

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