Stone Co 3Q24 Earnings Conference Call

November 12, 2024

Operator:

Good evening, everyone. Thank you for standing by. Welcome to StoneCo's third quarter 2024 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 appears 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.

Joining the call today is Stone's CEO, Pedro Zinner, the CFO and IRO, Mateus Scherer, the Strategy & Marketing Officer, Lia Matos, and the Head of IR, Roberta Noronha. I would now like to turn the conference over to your host, Pedro Zinner. Please proceed.

Pedro Zinner – Chief Executive Officer

Thank you, operator, and good evening, everyone.

Today, we will present our results for the third quarter of 2024 and provide an updated outlook for our business. I'd like to begin by highlighting some of the key milestones from our third quarter—a period marked by solid performance and significant business improvements, bringing us closer to achieving our annual targets, if not already meeting some of them.

Upon reviewing the quarter, I can confidently state that we maintain committed to executing our strategies across various areas of our financial services segment.

On the payments side, we continue to observe encouraging trends in a healthy competitive environment. MSMB total payment volume (TPV) grew by 20% year-over-year, reaching R$114 billion and serving 4 million MSMB clients, all while maintaining healthy unit economics—a key priority for us.

In banking, demand deposits amounted to R$6.7 billion, representing a 50% increase compared to the previous year. Having made significant strides in scaling our payments and banking bundles for clients, our current focus is on enhancing client engagement. To achieve this, we are improving our clients' experience by developing additional solutions, such as our savings product, which, despite being in its initial stages, has already shown positive results.

Regarding credit, we are pleased to announce that we have surpassed our annual guidance, ending the quarter with a portfolio of R$923 million—an impressive growth of nearly 30% quarter-over-quarter. This portfolio is performing better than expected in terms of non-performing loan (NPL) levels, indicating that our credit offerings are aligned with our internal expectations and risk appetite. Our specialized credit desk, which commenced operations at the beginning of the year, has delivered promising results in generating new deals and enhancing our distribution. Additionally, we have successfully executed our roadmap for loan products, making advancements in credit cards and launching Giro Fácil, a revolving credit facility. We also continue to refine the experience our clients have throughout their credit cycle with us.

In light of the performances I have just outlined, I am proud to report that our MSMB take rate has reached a record of 2.58% in the quarter, setting a positive trajectory towards achieving our annual guidance of 2.49% and indicating sustained strong results in payments.

In terms of software, we continue to see significant progress in cross-selling our financial services solutions to our software clients. Card TPV growth among these clients has exceeded twice the growth observed in MSMB volumes on a quarter-over-quarter basis. In addition, we are fully committed to executing our efficiency and cash generating initiatives; as a result, our EBITDA margin increased by 1.6 percentage points sequentially, now surpassing 18%. Given our commitment to acting in the best interests of our shareholders, we are currently evaluating options to maximize value, which I will discuss further in the end of this call.

Finally, on the efficiency front, we have seen our adjusted administrative expenses decrease by 7% year to date compared to last year, positioning us well to meet our 2024 guidance, which implies a 7% growth.

I would also like to highlight that we have nearly completed our R$1 billion share repurchase program in the third quarter. We recognize that we currently have excess capital, leaving us with a strong balance sheet position. We continuously evaluate the optimal use of capital to maximize shareholder returns and are now developing a more structured decision-making framework in consultation with our Board. We expect to provide further visibility over the coming quarters.

As a result of our adjusted net income growth of 35% and the execution of our buyback program, our adjusted basic earnings per share (EPS) increased significantly by 43% year-over-year.

Now, I would like to turn the floor over to Lia, who will discuss our performance for the third quarter of 2024. Lia?

Lia Matos –Strategy & Marketing Officer

Thank you, Pedro and good evening, everyone.

As Pedro mentioned, we are happy with our performance in the third quarter and with how we’ve been able to drive value to clients with our solutions and service.

As presented on slide 4, we saw good traction in our consolidated financial results. Our Total Revenue and Income grew 7% year over year, or 8% when we disregard the change in our internal accounting methodology for membership fees revenues held in 1Q24. This growth is mainly a result of our performance in the MSMB segment, where we continued to grow client base and increase monetization.

Our Adjusted EBT and Net Income both grew 35% year over year, with margins up 4.5 and 3.6 percentage points respectively, to 21.8% and 17.5%. This improvement in margins was driven mainly by the combination of our top-line growth and lower financial expenses. Combining our Adjusted Net income growth with the significant repurchase of shares in the quarter, our Adjusted Basic EPS grew 43% year over year to reach R$1.97 per share.

Now let's dive further into our financial services segment performance.

Starting with Payments on slide 5, our MSMB client base reached almost 4 million active clients, a 21% growth year over year. The implied deceleration in the net addition of clients in the quarter results from different factors. First, due to the phasing out of marketing investments made in the first half of the year, and second, due to a bigger focus on the quality of clients onboarded, with healthy unit economics, as well as allocating capital towards client engagement rather than purely increasing our base.

As you might also remember, we usually start the relationship with our clients with a payments and banking bundle, which opens the door for higher engagement with our multiple payments, banking and credit solutions. We are proud to see that our focus on improving such bundles and products to our clients has driven positive results illustrated by our heavy user metric, which shows the percentage of MSMB clients with more than 3 products with us. Heavy users have been growing consistently, going from 21% a year ago to 34% this quarter.

Regarding payment volumes, MSMB TPV grew 20% year over year to reach R$114 billion in the quarter. This growth is composed of a 12.4% growth in card TPV and a 2.4x growth in PIX QR Code volumes, as PIX continues to gain ground and cannibalize on debit volumes, with net positive economic benefits for us and for our clients.

As a result of (i) a stable competitive environment in payments, allowing for healthy take rates, (ii) our focus on growing with good unit economics, and (iii) the increased engagement of our clients with more solutions, we have reached a record take rate for MSMBs of 2.58% in 3Q24, 9bps higher year over year and 3bps higher than 2Q24.

Moving to slide 6, we highlight our banking performance in the quarter. Our banking active client base grew 47% year over year to 2.8 million clients. As Pedro mentioned, our efforts to sell bundled banking and payments solutions to new clients has achieved a good maturity level, since the majority of new clients today onboard with a payments and banking offer. Thus, our focus has shifted towards increasing engagement within our ecosystem.

As a result, total deposits from clients reached R$6.8 billion in the quarter, 53% higher year over year. Our "financeira" license, received at the beginning of the year, has allowed us to expand the array of solutions that we can offer to our clients. Of the R$6.8 billion total retail deposits in the quarter, R$6.7 billion refer to demand deposits and R$121 million relate to on platform time deposits from our savings products, which we haven't actively marketed yet. Though still in its early stage, we have been carefully managing the balance between time deposits and demand deposits and we have seen accretive results, while offering our clients a new alternative to manage their money within our ecosystem.

In addition to on platform time deposits, which are directed to our clients, we are also issuing time deposits distributed in third-party platforms, outside our ecosystem, which we are calling "off-platform time deposits". Those deposits have shown strong growth in the quarter, reaching R$1.7 billion in funding for the company.

Now, let's move to credit on slide 7. We have R$923 million in credit outstanding with our clients, which is already 15% above our annual guidance, with still one quarter left to go. Out of this portfolio, R$864 million is related to merchant solutions, which currently comprises our working capital solution and our revolving credit facility solution, Giro Fácil, launched in the beginning of this quarter. The other R$59 million relates to our credit card offer, which we are currently focusing on scaling within micro clients, as it is an important part of the credit value proposition for this segment.

When we look at provisions, we have been slowly converging the provision of the working capital solution to reach levels closer to the expected loss in our models. Thus, provisions related to the working capital portfolio has been decreasing from 20% in the beginning of the year to 14% in the third quarter.

As a result of this convergence, and since working capital is still our most relevant credit solution by far, total provision expenses have reduced to virtually zero this quarter, compared with R$19 million one year ago and R$18 million in the second quarter of 2024, contributing positively to our results when compared to previous periods.

Regarding NPLs, the NPL 90 days for merchant solutions continues to increase as expected while the portfolio matures, reaching 3.7% in the quarter compared with 2.6% for the previous quarter. The decrease observed in the NPL 15-90 in the quarter was due to better vintages when compared with the second quarter.

Finally, on slide 8 we summarize the performance of our financial services segment. The strong evolution of our main strategic drivers, coupled with a stable competitive environment in payments, has led to a solid financial performance. As such, financial services revenue reached R$3 billion, 8% higher year over year, with an EBT margin of 22.8%, 5.1 percentage points higher over the same period.

Now, let's talk briefly about our Software performance in slide 9.

We see positive trends from our cross-selling initiative of offering financial services to our software client base, the strategic focus for the software segment. This can be seen by the Card TPV of clients that use both our financial services solutions and software solutions, which reached R$5.8 billion in the quarter, growing more than twice the sequential growth seen in our MSMB Card TPV. This result was boosted by our financial services specialist team, which has been doing a great job driving this cross sell to strategic verticals within our Software segment.

Regarding software revenues, we have seen relatively stable performance year over year, growing 2.5% sequentially. On the bottom-line, software adjusted EBITDA reached R$72 million, with a margin of 18.3%, 1.6 percentage point higher quarter over quarter, as we continue to manage the business for efficiency and cash generation.

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

Mateus Scherer – CFO and IRO

Thank you, Lia, and good evening, everyone. I would like to start on slide 10, where we discuss the quarter over quarter evolution of our costs and expenses, on an adjusted basis.

- Cost of Services decreased as a percentage of revenue from 26.2% in 2Q24 to 25.6% in 3Q24 due to the reduction in loan loss provisions. Excluding credit provisions, the cost remained relatively stable as a percentage of revenue.

- Administrative expenses increased 5% year-over-year, or 9% quarter over quarter, resulting in a sequential increase of 30bps as a percentage of revenues. This increase was mainly attributed to higher provisions for variable compensation, which are seasonally higher in the second half of the year.

- Selling expenses increased 13% year-over-year and decreased 4% quarter over quarter, or 150bps as a percentage of revenues. This decline was mainly driven by reduced marketing expenses, considering that in the first half of the year we sponsored a reality TV show, which ended in the second quarter.

- Financial expenses decreased 13% year-over-year and increased 7% sequentially, or 50bps as a percentage of revenues. The sequential increase was driven by (i) higher funding needs due to TPV growth, (ii) lower share of equity in our funding mix following significant share buybacks this quarter and (iii) a higher number of working days. These effects were partially offset by lower average funding spreads. This quarter, our proactive liability management played a key role in optimizing our funding costs, as we repurchased 60% of our 2021 bond issuance—our most expensive debt instrument—and refinanced at significantly lower spreads through the issuance of new financial bills.

- Our Other Expenses line increased by 12% year-over-year but remained relatively stable sequentially. As our revenues grew, other expenses as a percentage of revenue decreased by 20 basis points.
- Finally, our tax rate was 20.0% in the quarter, down from 23.8% in Q2. This reduction was primarily due to the repurchase of approximately 60% of our bond and the transfer of the remaining portion to a local entity, allowing us to benefit from a tax shield on the associated interest expense. This operation had a partial impact in Q3 and is expected to further benefit the company from Q4 onwards.

Turning to slide 11, our **Adjusted Net Cash** position reached R$4.9 billion by the end of the quarter, a decrease of R$0.3 billion on a sequential basis. The main reason for the reduction was the execution of our R$1 billion share buyback program, with an outflow of R$742 million in the third quarter and R$979 million year to date.

Finally, let's move to slide 12, to discuss our guidance.

We are very pleased with our performance in these nine months of 2024. On the financial front, I feel we are well positioned to deliver our guidance, despite factors that impacted our P&L like (i) our decision to make a sizable share buyback, (ii) the internal changes in the methodology of membership fees, and (iii) macroeconomic headwinds, with the unexpected rise of the yield curve.

On the operating side, I am excited to share that we have already met our guidance for the credit portfolio, while maintaining NPLs completely under control and within our expectations or even better. On the banking front, the business is also evolving as expected, with clients engaging with our solutions and keeping their deposits within our ecosystem, placing us on the right path to reach our target.

On the Payments side, MSMB CTPV continues to be the most challenging KPI. As PIX continues to grow at a faster pace than anticipated, we are still seeing the impact on our debit volumes. While this is accretive to our P&L, it shows a negative impact on our CTPV metric.

Additionally, as the outlook for interest rates significantly changed this quarter, we decided to prioritize on the side of profitability vs. growth. While this may penalize our short term CTPV growth, we continue to believe in our ability to grow above market longer term as we continue to strengthen our value proposition towards a complete solution to our clients.

Regarding industry growth, we continue to see significant growth opportunities in the Brazilian market. We have a very dynamic and innovative environment and we see electronic payment methods expanding well beyond private consumption. While the pace of growth may differ from previous years, by engaging our clients with a broader suite of solutions, we establish a solid foundation for achieving our long-term targets.

To that end, on monetization, our year-to-date results reflect an MSMB take rate of 2.55%, exceeding our guidance of 2.49%, with significant contributions from banking and credit, and continued healthy pricing, particularly in payments. We have successfully bundled our products and maintained a dynamic pricing strategy, allowing us to increase the level of engagement with our solutions while improving our target returns. It is important to note that our banking and credit solutions are already playing an important role in our P&L, providing us with more tools to engage and monetize the relationship with our clients.

With that said, we posted yet another quarter of consistent results and continue to focus on the strategic priorities set forth in our Investor Day. Before we wrap up, I would like to hand it over to Pedro to discuss what we see for the software business ahead.

Pedro Zinner – Chief Executive Officer

Thank you, Mateus. Before we move into the Q&A session, I want to take a moment to address some recent developments by sharing our perspective on our software business, our outlook for this asset, and our strategic decisions as we move forward.

As we've consistently communicated, we are fully executing our strategy focused on cross-selling financial services to our software clients in priority verticals. Our approach also emphasizes efficiency and cash generation, and we firmly believe this strategy not only creates substantial value for our clients but also drives long-term success for us.

We remain steadfastly committed to this strategy, and I'm pleased to report that we are on track with its execution. Our efforts are resulting in the growth of bundled software and financial services solutions that address critical client pain points within key strategic verticals. While we have made significant strides with our financial services specialist distribution channel, we acknowledge the opportunity for further engagement with the Linx salesforce.

The success of our execution is reflected in our unwavering guidance and the strategic framework we established during our Investor Day, both of which remain firmly in place.

At the core of our mission is the objective to maximize shareholder value, and we approach this with an open mind towards innovative strategies. A key area we are exploring is whether we can achieve our cross-selling objectives through a commercial partnership instead of directly owning the software assets. This approach would allow for a lighter asset footprint and better allocation of our capital.

To that end, we've engaged advisors who are diligently analyzing and exploring potential alternatives for our software business. I want to emphasize that there is no set timeframe or predetermined outcome at this stage; we are thoughtfully considering all options with our shareholders' best interests as our top priority.

We are committed to keeping you informed about our progress as we navigate this assessment.

Before we begin our Q&A, I want to express my sincere gratitude to each of you for your ongoing support. We are excited about our long-term goals and our commitment to delivering value for our shareholders.

With that, operator, could you please open the call for questions?