Stone Co 2Q24 Earnings Conference Call

August 14, 2024

Operator:

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

Today, we will present our second quarter 2024 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.

After reviewing our second quarter results and our performance at mid-year, I am pleased with our progress across our strategic priorities and believe we are on schedule to meet our 2024 goals.

In Payments, we continue to win in the MSMB market and take more market share. Our Client Base grew 30% year-over-year, TPV grew 25% and Card TPV increased over 17%. We are also executing on our pricing and bundling strategies to enhance client engagement, as we discussed during our Investor Day. As a result, our MSMB take rates also continue to expand, increasing 7 basis points year-over-year to reach 2.54%. We believe these strong results arrive from our competitive advantages in distribution, superior service, and our growing ability to provide more comprehensive solutions to our clients.

In Banking, we are making similar progress. Our Client Base grew 62% year-over-year and Client Deposits increased 65% as our team continues to cross-sell effectively. We now have 2.7 million active banking clients and R$6.5 billion in deposits, which are approaching our 2024 targets. We have also started to pilot interest-bearing products, such as time deposits, which I believe is being well-received by our clients and could be an exciting new area for us.

In Credit, we are also evolving well towards our goals, even above set targets. Our Total Credit Portfolio increased 32% quarter-over-quarter to reach R$712 million. Within that, our Working Capital portfolio grew over 28%, reaching R$682 million this quarter, with strong quality as shown with our NPL over 90 days still at 2.6%, very much in line with our expectations. I am also excited with some new initiatives underway. Our specialized credit desk, which is focused on addressing the opportunity within our larger SMB client base, successfully completed its first disbursements this past quarter, and we finalized the structuring of our Giro Fácil product. This is a short-term overdraft solution designed to address the immediate capital needs of our clients, which is set to launch in the third quarter.

In our Software business, we are making progress on our cross-sell initiatives, and we are improving the quality mix of our business towards more recurring revenues. Total Software and Vertical Software revenues growth remain modest, but we are seeing underlying signs of improvement. For example, we are getting better cross-sell traction in our gas station and retail verticals, and we generated stronger Card TPV growth from our software clients in priority verticals than our overall MSMB Card TPV growth rate. We still have a lot of work to do in our Software business over the long-term, as I have mentioned, but I am seeing some encouraging trends from our efforts.

We have also maintained our focus on efficiency gains and the streamlining of administrative expenses, which decreased by 13% year-over-year. In the quarter, we achieved a 180-basis point reduction in administrative expenses as a percentage of revenues when compared to 2Q 2023.

As a result of these positive developments, our adjusted basic EPS demonstrated strong growth, reaching R$1.61. As I mentioned earlier, we remain committed to our business plan and the targets established during our Investor Day.

In light of this commitment and considering short-term market fluctuations, we allocated capital to repurchase an additional 9.67 million shares, totaling R$724 million, bringing us closer to completing the R$1 billion share repurchase program announced in November 2023. Additionally, as part of our liability management strategy, we allocated $295 million to the tender offer for our 2028 bonds, achieving nearly 60% participation.

In summary, I am very satisfied with the trajectory of our results for the second quarter of 2024, and I have full confidence in our teams' execution.

Now, I would like to pass the floor to Lia, who will discuss our second-quarter 2024 performance and strategic updates. Lia?

Lia Matos – Chief Strategy & Marketing Officer

Thank you, Pedro and good evening, everyone.

As Pedro mentioned, we were pleased to see the progress across our strategic priorities and initiatives in the second quarter, which I think positions us well to meet our 2024 and long-term goals.

As you can see on slide 4, our consolidated Revenues grew 8% year over year, mainly as a result of consistent TPV growth and higher client monetization. It is also important to remember that in 1Q24 we changed our internal accounting methodology for membership fees revenues, deferring this revenue stream over the expected life of a merchant rather than recognizing it at the time of acquisition. This change reduced our reported revenue by around R$50 million in the second quarter. If we exclude this change, our total revenue growth would have been 10% in the quarter.

Despite this effect, Adjusted EBT increased 46% year over year. This was driven by the combination of our top-line growth and the ongoing benefits of our financial and administrative expenses efficiencies. As a result, our Adjusted Net Income increased 54% year over year and our Adjusted Basic EPS increased 57% year over year, reaching R$1.61.

Now let's dive further into our financial services segment performance on slides 5 to 9.

Starting with Payments on slide 5, our MSMB Client Base **increased 30% year over year**, reaching almost **3.9 million Active Clients**. We generated a net addition of **184 thousand clients** during the quarter. On a year-over-year basis this growth was impacted by the fact that we have caught up to the growth levels in the micro segment, and on a quarter-over-quarter basis our Net Adds were impacted by the "grow-over effect" of higher net adds in 1Q24, which benefited from our sponsorship of a popular reality TV show in the period.

As you will see in the pages that follow, besides optimizing our commercial strategy for growth and market share gains, we are also putting a lot of focus on improving our payments and banking bundle offerings to new client cohorts, both in Ton and Stone.

As you can see on slide 6, this approach has resulted in more profitable TPV growth and market share gains in the MSMB segment.

Before we dive deeper into our performance in Payments, I would like to point out that we have refined our disclosure of TPV, due to the increasing relevance of PIX QR Code in the market and in our transactional volumes. From now on, whenever we talk about TPV, we will refer to transactions settled through Cards and PIX Dynamic QR Code. When we talk about Card TPV, we will be referring to transactions settled with cards only.

Now, moving to volume and take rate results, MSMB TPV increased **25% year over year**, as a result of a 17.4% year over year growth in MSMB card TPV and a 2.6-fold increase in PIX QR Code which reached R$11.5 billion in the quarter. We achieved this strong growth while also increasing take rates by **7 basis points year over year, which reached 2.54% as a result of higher credit and banking revenues and higher prepaid volumes,** partially offset by a lower duration from prepayment transactions.

On slide 7, let's shift to discuss our Banking performance.

Our Banking active client base **increased 62% year over year, to 2.7 million active clients,** as a result of growth in both Ton and Stone payments client base, with an increase in penetration of clients using banking and payments bundles. This growth in our client base also helped drive a **65% year over year increase in client deposits, which reached R$6.5 billion in the quarter.** Despite the sequential 8.1% growth in deposits, ARPAC decreased to R$25.7 per month, mainly as a result of lower average CDI in the period.

Moving to slide 8, let me give some highlights on our credit performance.

Our credit portfolio increased to R$712 million, with the working capital portfolio alone increasing 28% sequentially, to **reach R$682 million** in the quarter. The remainder of the portfolio is a result of the very initial results of our Credit Card product, both within Ton and Stone. Because such cohorts are very early vintages, we highlight on the page the credit quality metrics of our working capital loan product alone. **NPLs increased slightly this quarter, with NPLs between 15 and 90 days reaching 2.9% and NPLs over 90 days reaching 2.6%.** As highlighted before, because these cohorts are also relatively new, the ratio of past-due loans should continue to increase as they mature. Provision expenses for working capital expected losses were R$17 million in the period, decreasing significantly quarter over quarter. This reduction reflects the beginning of a convergence of provision levels to expected loss levels as the portfolio matures, with provisions now representing 18% of the working capital portfolio, down from 20% in previous quarters.

Finally, to summarize the performance of our financial services segment, the second quarter was again marked by strong year over year TPV growth and the successful development of our banking and credit initiatives. These resulted in segment Revenue of R$2.8 billion and Adjusted EBT of R$608 million in the quarter, up 11% and 53%, respectively year-over-year, and an increase of 590 basis points in our Adjusted EBT margin to reach 21.5%.

Moving to slide 10, let's talk about Software performance and strategic evolutions.

Quarter over quarter, the card TPV of clients that use both financial services and software solutions, **increased 8%, primarily driven by the gas station and retail verticals,** which have been our priority focus since last year. This result has been mostly driven by our cross-selling efforts from our financial services specialist distribution team cross-selling bundles to software clients. And, as Pedro mentioned, cross-sell volumes outperformed growth of MSMB card TPV in the quarter by almost a factor of two. We are happy with the execution of our cross-selling initiatives so far in 2024, but I believe we still have a lot of room to grow, particularly as we gear up to enable our Linx Software channels to also sell software and financial services bundles.

On page 11, you can see the stand-alone performance of our vertical software business, where we are seeing some improvements in the quality of our revenues.

Vertical software revenue grew 3% year over year due to an increase in recurring revenue growth, offset by a decrease in non-recurring revenues in priority verticals. As a result, we believe the revenue quality of our priority verticals is improving, with recurring revenues as a percentage of total revenues, increasing more than 450 basis points year over year.

In slide 12, we present the consolidated performance of software.

As you can see, total software segment revenues reached R$384 million, remaining flattish year over year, driven by the trends I just described in our vertical software business, offset by slower growth in the enterprise business.

Adjusted EBITDA in the software segment decreased to R$64 million in the quarter, down 4% year over year and 3% quarter over quarter, impacted by a non-recurring severance expense of R$3.2 million and by our decision to focus on growing recurring versus non-recurring revenues, which has a negative impact on the short term, but should be accretive for the business in the long-run.

We continue our efforts to implement the software strategy that we presented in our Investor Day. While we are happy with our evolution in cross-selling initiatives in the gas station and retail verticals, we are still working and learning how to best enable our software distribution channels to sell financial services and software bundles via commercial incentives and systems integrations. We also continue to pursue efficiency initiatives and a more disciplined capital allocation approach within our software segment.

Now, I want to pass it over to Mateus to discuss in more detail some of 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 13, where we discuss the quarter over quarter evolution of costs and expenses, on an adjusted basis.

- **Cost of Services reached R$841 million, increasing by 23% year-over-year and 4% quarter-over-quarter.** Sequentially, Cost of Services as a percentage of revenues decreased by 10 basis points, primarily due to a reduction in loan loss provisions, which were reduced to R$18 million this quarter from R$45 million in 1Q24. This reduction reflects the beginning of the process of aligning our provision levels with expected credit losses as the portfolio matures, with provisions now representing 18% of the working capital portfolio. This decrease was offset by higher provisions for losses in the quarter on our acquiring and banking solutions.

- **Administrative expenses decreased by 13% year-over-year, resulting in a 180-basis points reduction as a percentage of revenues compared to 2Q23.** Sequentially, administrative expenses increased by 1.4%, but declined by 20 basis points as a percentage of revenues. This was driven by lower expenses in the software segment due to efficiency gains, as well as by the divestment of PinPag in 1Q24, which eliminated expenses in the non-allocated segment.

- **Selling expenses increased 27% year-over-year and decreased 0.9% quarter over quarter**, down 80 bps sequentially as a percentage of revenues. This decrease is primarily due to a reduction of approximately R$26 million in marketing expenses related to the sponsorship of a reality TV show, like Lia mentioned, partially offset by increased investments in sales teams. Looking ahead, we anticipate gradual dilution of selling expenses as these investments in sales teams mature.

- **Financial expenses decreased 20% year-over-year and** decreased 4.5% sequentially, leading to a 230-bps reduction as a percentage of revenues. This decrease was a result of (i) lower average CDI in the period, (ii) a reduction in our funding spreads and (iii) our decision to reinvest our cash generation towards the funding of our operation. These effects were partially offset by higher funding needs for our prepayment and credit operations, as well as a higher number of working days in the quarter.

- **Lastly, other expenses increased 26% year-over-year and 80% sequentially or 140 basis points as a percentage of revenues.** This variation was a result of more normalized levels of share-based compensation expenses, as 1Q24 included a non-recurring positive impact of R$40.5 million from the net effect of the cancellation and new grants of incentive plans. Excluding this effect, other expenses, net would have been flattish as a percentage of revenues.

Turning to slide 14, our **Adjusted Net Cash** position was R$5.3 billion by the end of the quarter, reflecting an increase of almost **R$1.0 billion** year on year and **R$117 million** for the quarter. We continued to deploy capital towards the expansion of our credit portfolio and executed on our share buyback program in the amount of R$237 million this quarter.

As Pedro mentioned, I would like to highlight that in July, we allocated capital to repurchase an additional 9.6 million shares, amounting to R$724 million, nearly completing the R$1 billion buyback repurchase program announced in November 2023. Additionally, we allocated $295 million in July to the tender offer for our 2028 bonds, which will further optimize our funding spreads as we move forward.

Finally, let's move to slide 15, to discuss our guidance.

We are very pleased with our performance in the first half of the year. The profitability achieved in 1H24 has positioned us favorably to meet our full-year guidance, despite several headwinds. These include a R$120 million reduction in revenues due to changes in the recognition of membership fee revenues and a challenging macroeconomic environment with a higher yield curve.

In our banking and credit solutions, which are key drivers for our long-term growth, we have exceeded initial expectations not only in volume but also in quality. This strong performance may put us on track to surpass our year-end guidance in these areas.

From my perspective, the most challenging area so far has been our MSMB CTPV. PIX QR Code penetration in the market and within our client base has been higher than we anticipated when setting our guidance in November of last year. This has affected our overall volume mix towards less card TPV and more PIX QR Code TPV. Although this trend is positive for the business, it also means that card TPV is growing a little tighter within our expected range. We ended the 1H24 with 18% growth, exactly in line with our guidance. Despite a more challenging comparable base in 2H24, we remain laser-focused on our efforts to meet this guidance.

Overall, I believe our second quarter results are trending favorably and we are on track to achieve our long-term goals.

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