research

Brazil Payments

Acquiring new perspectives

Initiating coverage of PAGS and STNE

We are initiating our coverage of payments with a Buy rating and YE24 TP of US$19.0/sh. for PagBank (PAGS) and a Neutral rating and YE24 TP of US$19.0/sh. for Stone (STNE). Even though we have concerns about the structure of the payment sector, where competition has always been a factor, we see a somewhat clearer outlook in the short term. Alongside a less intense competitive environment, we believe that the beginning of the monetary easing cycle will benefit players who serve the SMB segment with a unique ecosystem that integrates banking, credit, and other value-added products and services.

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PAGS and STNE shares have performed strongly recently, on the back of the fall in US treasuries, but also in anticipation of a more benign scenario ahead given that the two companies are very well positioned to integrate banking activities into their acquiring business.

Despite being an industry with structural challenges, especially in terms of competition, which has been destroying value in recent years, **we believe that the sales channel originating from acquiring should create value in the coming years** for companies that manage to cater well to more profitable niches by offering: (a) a high level of service translated into a high NPS, reducing churn (ii) evolution in banking services, monetizing services beyond POS rentals (iii) credit offers with competitive products and UX integrated with merchants' systems. **In parallel, we see the current dynamic of interest rate cuts as another tailwind benefiting healthier profitability going forward.**

We recognize that the recent tender offer for Cielo (not covered) may represent some risk of increased competition, however we see that the peak of fiercer competition and, consequently, negative impact on industry returns seem to be behind us.

In this context, **we prefer PAGS (Buy) over Stone (Neutral)**. We believe that **PAGS offers a more discounted valuation** and, in our view, stands to benefit the most from the current scenario of monetary easing and lower NPLs. **While Stone is considered best in class in the sector**, its valuation at 11.3x P/E24 suggests that much of the positive credit execution is already priced in. On the other hand, PagBank, trading at 8.3x P/E24, offers a more attractive risk-reward profile in our view. We favor players who effectively integrate their ecosystem strategy, particularly with regards to banking services.

Figure 01: XP Estimates

Company	Ticker	rating	Price (US$/share) Current	Price (US$/share) Target	Upside (%)	P/E 2024E	P/E 2025E	P/B 2024E	P/B 2025E	Div. Yield 2024E	Div. Yield 2025E
Payments											
Stone	STNE	Neutral	16.24	19.0	17%	11.3x	8.5x	1.4x	1.3x	0.4%	0.6%
Pagbank	PAGS	Buy	13.73	19.0	38%	8.3x	7.1x	1.3x	1.2x	0.6%	0.7%

Source: XP, Company Reports, LSEG Refinitiv.

Summary

Payments Market Overview

Brazilian Ecosystem

PagBank (NYSE: PAGS)

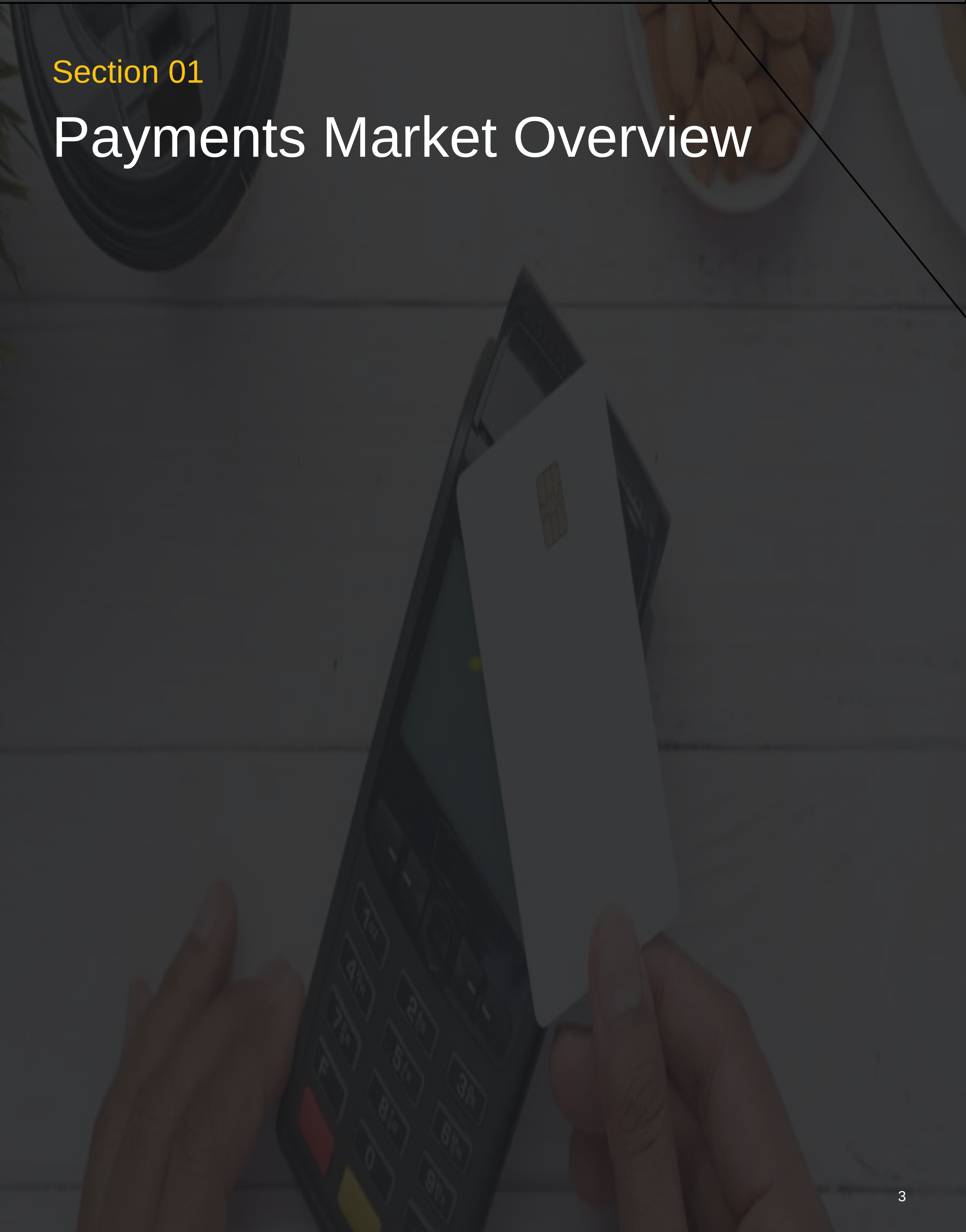
Initiating coverage with a buy rating

Stone (NYSE: STNE)

Initiating coverage with a neutral rating

Section 01

Payments Market Overview



Payments Market

Brazilian Ecosystem

Starting from the basics: Card processing is a complex system that involves several steps to ensure a transaction is successfully completed.

Every payment transaction or purchase with a card necessarily goes through an electronic authorization and settlement platform created with the participation of three major players: card networks, issuers, and acquirers.

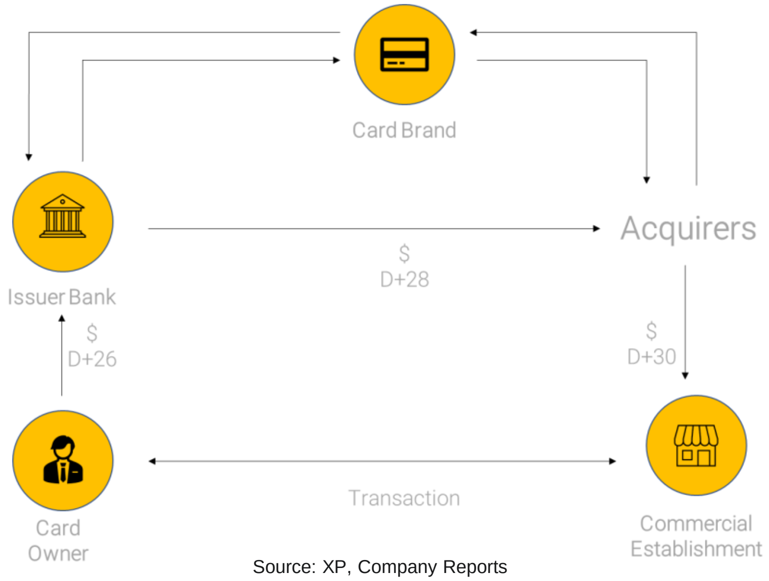
Card networks are companies responsible for defining the business rules for card purchases, such as Visa, Mastercard, Elo, Amex, etc. They set the standards by which acquirers and issuers must process transactions made through this payment method (each network has its own rules). Additionally, they have a clear role in supervising and overseeing this payment arrangement. In return, they charge an interchange fee as compensation.

This fee is received every time a transaction is made and is deducted from the total amount charged to the merchant.

Issuers are banks and institutions that provide cards to users within their network (account holders or affiliated customers). They establish credit limits and are responsible for approving transactions. As compensation for providing an electronic payment and/or revolving credit instrument, they receive a fee that reflects a percentage of the transaction value, known as the interchange fee, which varies according to the type of transaction (debit, credit, installment, etc.).

This fee is received every time a transaction is made and is deducted from the total amount charged to the merchant.

Figure 02. Acquirer's ecosystem



Source: XP, Company Reports

Payments Market

Brazilian Ecosystem

Acquirers, or processors, are companies that conduct extensive efforts to accredit merchants for the use of POS terminals or payment gateways (online purchases) and, every time a transaction occurs, they mediate and process electronic financial transactions. They are responsible for charging the end customer the transaction amount and passing it on to the merchant, already deducted from the Merchant Discount Rate (MDR), which is a fee that reflects the percentage of the transaction value used to remunerate all participants in the arrangement (the acquirer itself, networks, and issuers) according to the distribution mentioned in the previous paragraphs. The connectivity between these agents depends directly on the processing technology infrastructure, which needs to be developed internally by issuers and acquirers or offered by independent processors that are specialized companies in developing solutions to meet issuers and/or acquirers individually. **The flow above illustrates the complete flow of a card transaction:**

1. **Physical vs. Digital**: Whenever a consumer chooses to use a card to make a purchase in person, the process begins with the insertion or reading of the card's chip on a POS terminal. When a consumer makes an online purchase on a website, the process is similar to that of a physical purchase, but in this case, the process begins when the consumer enters the card details on the website.
2. **Authorization:** Transaction data (such as purchase amount, card number, and expiration date) are received by the acquirer. The acquirer then forwards this data to the card network.
3. **Issuer verification**: The card network sends the transaction data to the card issuer. The issuer verifies if the card has sufficient balance and if the transaction can be approved.
4. **Authorization or refusal**: Based on the issuer's verification, the card network sends a response to the acquirer, indicating whether the transaction was authorized or refused. This response is then transmitted back to the POS terminal or website.
5. **Transaction completion**: If the transaction is authorized, the purchase amount is reserved in the consumer's credit limit, and the purchase is completed. If the transaction is refused, the consumer is informed, and the purchase is not completed.
6. **Settlement**: After the transaction is completed, the acquirer transfers the purchase amount to the merchant (deducting an intermediary fee).

It is important to note that each step of this process undergoes a thorough risk and fraud analysis to ensure the integrity of the data and the origin of the transaction. All of this occurs in a matter of seconds, providing a quick and secure experience for both the consumer and the merchant.

It is worth mentioning that in Brazil, when a transaction is made in the credit mode, the merchant receives the purchase amount after an average of 30 days, which is the maximum time it takes for the consumer to be actually charged, while in the rest of the world, this transfer from the acquirer to the merchant or service provider occurs in two days.

Therefore, a key product in the acquirers' commercial strategy is the discounting of receivables, a process by which the merchant can anticipate this period and receive the amounts in a shorter time than 30 days, in exchange for paying a discount rate on this receivable to the acquirer.

The complexity of interest-free installment payments and transformations in the payment market

Interest-free installments, a Brazilian invention, differentiate the payment system. However, this practice implies an embedded interest in the transaction, even if the retailer does not differentiate the value between cash or interest-free installments. Although the retailer benefits more from interest-free installments, they transfer the risk to the card issuer. **On average, 60% of credit card transactions in Brazil are interest-free installments, reaching 80% during holiday seasons like Christmas. The average number of installments is around 5, but it can go up to 12 interest-free installments.**

Additionally, the 30-day payment period from the acquirer to the commercial establishment and the offering of interest-free installments have brought a new source of revenue for acquirers: prepayment. To have cash on hand, retailers' resort to receivables anticipation - a credit facility that allows companies to receive sales proceeds before the scheduled due date. This process can be done in two general ways. In the first, the merchant negotiates directly with the acquirer to receive in advance the future values transacted through the card machine. As the acquirer is a payment institution, it is not authorized to provide credit to the merchant, it can only advance the payment of that direct debt. Unlike a loan, in this case, the money belongs to the company itself. In 2021, the Central Bank established a new regulation including the receivables registry model, in which the merchant can seek the best condition in the market to anticipate their future credit card receivables, generating competition and information symmetry. In the second way, the merchant offers their receivables as collateral to a financial institution - which may be the card issuer or not - to advance a certain amount of money in a credit operation. The risk of default in this case, as in any credit operation, lies with the bank. In addition to the receivables anticipation fee, acquirers in Brazil also generate revenue through the sale of equipment, as well as the take-up rate based on the TPV (Total Payment Volume). In other countries, companies in this segment also earn fees from other services in addition to the value of each transaction.

In 2019, the Central Bank instituted a Circular Letter allowing the registration of receivables from transactions in the National payment system, aiming to improve access for merchants to credit lines. After 3 and a half years since its launch, the solution is still little known to retailers. There are 4 receivables registrars in Brazil: Nuclea, Cerc, TAG, and B3, and there is still no exact agreement regarding the price applied for the service. Although it has great potential, the solution is still relatively insignificant in the payment market.

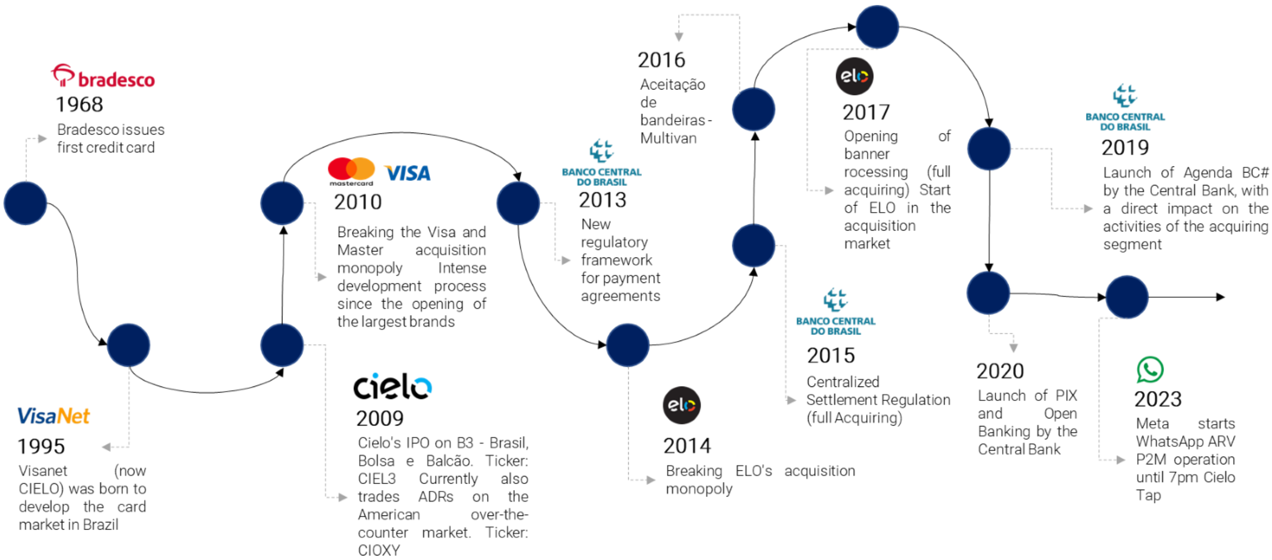
The evolution and deregulation history of the payment sector in Brazil: expanding card acceptance and the emergence of new players

Until 2010, Visa and Mastercard card acceptance in Brazil was dominated by two companies. Visanet (now Cielo) was the exclusive acquirer for Visa, while Redecard (now Rede), owned by Citibank, Itaú, and Unibanco, handled transactions for Mastercard. Visanet and Redecard played a crucial role in expanding card acceptance and capitalizing on the opportunities presented by the growing economy and consumer credit. They also invested in transaction automation through a network of devices called "card terminals" or "point of sale (POS) machines**". In July 2010, the exclusivity between Cielo and Visa ended, allowing all acquirers in Brazil to accept major card brands like Mastercard and Visa.** This created room for the emergence of more domestic and foreign acquirers.

In addition to the emergence of “payment facilitators” that allowed consumers to use cards for online purchases, the payment sector in Brazil experienced significant growth. One notable player in this space was PayPal, which provided consumers with secure online payment options without sharing their card data with unknown parties. This paved the way for the rise of online payment facilitators in Brazil, such as PagSeguro and Mercado Pago, who not only facilitated online transactions but also started selling card terminals, creating a new category known as “sub-acquirers”. These sub-acquirers specialized in accrediting commercial establishments in specific regions or sectors of the economy, adding complexity to the payment value chain.

With the market opening in 2010, the once-dominant payment model in Brazil, which was characterized by two card brands, two acquirers, and large issuing banks, became more dynamic. It is estimated that Brazil has over 560 payment card issuers, over 30 domestic acquirers, and 250 sub-acquirers.

Figure 03. Brazilian Acquiring History

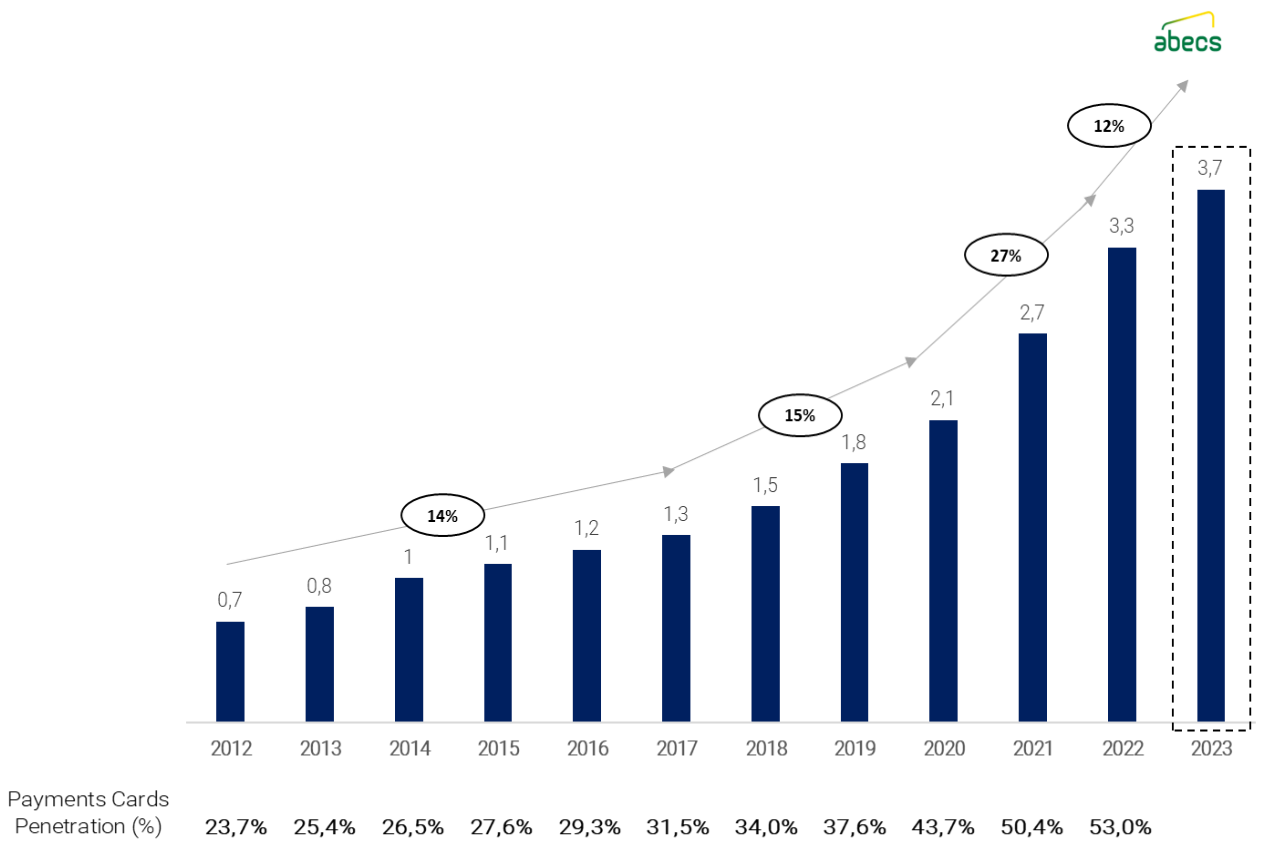


Source: XP, Company Reports

The Brazilian payments market is constantly evolving, with **digital payments expected to represent 80% of total payments by 2025**. The number of active credit cards has significantly increased, from 81 million in 2011 to 208 million in 2021. Credit card transaction volume has also grown considerably, reaching 16.2 billion in 2022, nearly four times more than in 2011. The adoption of PIX has been massive, with approximately 80% of the adult population using it, and many establishments accepting this payment option. Major technology companies, such as Google and Amazon, have entered the payment market. Partnerships between acquirers and digital wallet companies have proven to be effective strategies. Transaction volume continues to grow, with a 24.9% increase in 2022 compared to 2021, reaching R$ 3.2 trillion. The segment is driven by GDP growth, household consumption, and the formalization of work. Competition has increased since 2010, with the entry of new players and differentiated strategies. The main risks faced by the sector include purchase reversals, default, market competition, technological development, sales reduction, among others. The industry is being impacted by the rise in mobile transactions, contactless payments, apps, and other trends such as blockchain, PIX, open banking, and digital currency.

The growing adoption of digital banks in Brazil has significantly driven the payments industry. This trend brings some advantages, such as reducing operational costs, maximizing revenue through customer attraction and retention, as well as new technologies and advances in the regulatory framework. Brazilians have responded positively to this adoption, with 44% of them having an exclusively digital bank account in 2020, according to the Global Digital Banking Index report by Accenture and N26. **Brazil stands out not only for having the second-largest number of digital bank customers in 2020 but also for being the second-fastest-growing market between 2018 and 2020, with a growth of 73%.** Furthermore, trust has been an essential factor in the acceptance of digital banks by consumers, with over 78% of customers stating that they trust their data to digital banks. This trust further drives the growth and evolution of the payments industry in Brazil.

Figure 04. TPV and Card Penetration (R$ trillion)



Source: XP, Abecs

In our view, there is still room for Brazil to expand the penetration of both physical and digital cards compared to developed countries. However, the increase in digital payment penetration can also be driven by other forms of instant payment, such as PIX. PIX has proven to be a convenient and cost-effective alternative to cards, which can attract a larger number of people to digital payments. Additionally, PIX offers a fast and secure payment experience, which can further encourage the adoption of this payment method. It is important to note that PIX does not completely replace cards but can complement and drive the digitization of the payment market in Brazil. Therefore, it is likely that the increase in digital payment penetration in the country will be driven by a combination of physical cards, digital cards, and other forms of instant payment, such as PIX.

Figure 05. Credit Card Penetration (%) and Family Consumption per capita (US$ '000)

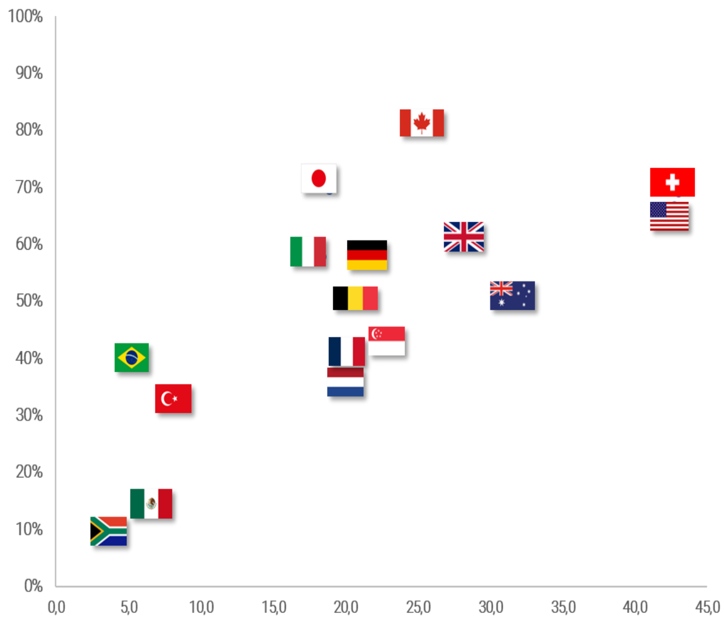
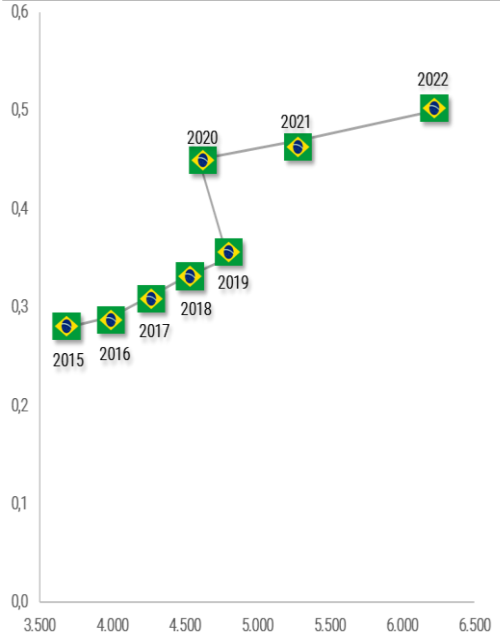


Figure 06. Credit Card Penetration (%) and Familiy Consumption in Brazil (R$ bi)



Source: XP, Company Reports, World Bank; CardMonitor

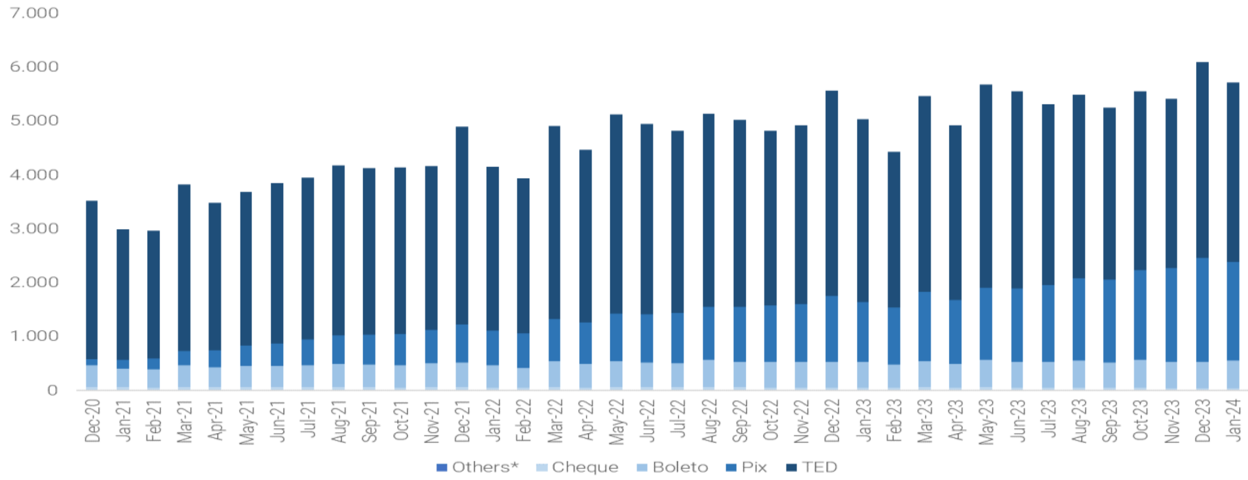
The Impact of PIX; New Challenges

PIX, launched by the Central Bank of Brazil in November 2020, emerges as a potential threat to credit and debit cards**. With 77% of the Brazilian population using it by last year**, PIX transactions in the first quarter surpassed cards, totaling 8.1 billion. Its success is due to its convenience, free of charge, and the option of installment payments through PIX Garantido or PIX Credit, particularly attracting those who do not have access to cards.

For those who believe that pix would be a threat to acquirers, the biggest concern is the potential acceptance of payments without the use of POS. The consulting firm Roland Berger released a study on the impact of PIX on the payment industry, and according to the consultancy, in the scenario of the highest impact for acquirers, the revenue decline can reach up to R$ 13.4 billion, representing a 63% decrease. Although we believe that a portion of the transactions may take place outside the acquirers' system, we see this impact as limited, as POS are able to receive payments through PIX, facilitating bank reconciliation for merchants.

In addition, so far the pix threat seems to be greatest in the debit card segment. For credit, however, extending the payment period without incurring interest still seems to be a barrier to bigger adoption of PIX. Banks are launching their own versions, such as PIX Parcelado, generating new sources of revenue, typically using the same approved credit lines for credit card use. Companies like MasterCard and Visa are seeking to reposition themselves as technology companies. Internationally, banks in advanced economies lack a system similar to PIX. The evolution of PIX might impact acquirers, reducing terminals and fees. Acquirers respond with innovations and integrations, competing for efficiency and meeting market demands. PIX transformed the payment landscape in Brazil, challenging cards, and driving innovation in the financial and acquirer industries.

Figure 07. TPV of the main payments methods (R$ bln)



*Others are incluing DOC and TEC; Both payment methods were descontinued by Central Bank in 2024. Source: XP, Brazil's Central Bank

Since the launch of PIX in 2020, the tool has been widely accepted within the Brazilian economy, **currently being the most used means of payment in terms of transaction volume,** with over 4.2 million transactions recorded in November 2023. In terms of transaction value, PIX ranks 2nd, moving a total of R$ 1.7 billion, second only to TED transfers, which moved R$ 3.1 billion by the end of November 2023.With regard to the nature of PIX transactions, according to the Central Bank of Brazil, in November 2023, 53% of transactions were between people (P2P), while 36% were between people and companies (P2B). P2B transactions have increased consistently from the 18% mark presented at the beginning of the series in March 2022.The other types of payment methods have remained constant over the past two years, with DOC, TED, and checks being the methods with the lowest transaction value, totaling: R$ 1.5 million, R$ 1.7 million, and R$ 40 million, respectively, by the end of November. Boleto, which was previously the 2nd highest-value payment method, was surpassed by PIX in May 2021 and currently processes a total value of R$ 490 million.

Market Trends

In Brazil, competition in the payment market has led acquirers to reduce their profit margins in order to attract and retain customers. This benefits merchants who now have more options and can negotiate lower MDR rates. The government has also played a role in reducing MDR by implementing measures to encourage competition among acquirers. The advancement of technology and the increasing use of digital payments have influenced the negotiation for lower MDR rates. With the popularity of digital wallets and payment apps, consumers have opted for these solutions due to their lower fees. The rise of e-commerce has also driven the development of technologies that streamline transactions. The impact of PIX, a preferred payment method for many consumers, has put pressure on acquirers to reduce MDR rates. Many acquirers have responded by offering more attractive conditions to merchants who accept payments via PIX.

Given the current scenario, where the traditional acquirer processing model has become more commoditized and less profitable, many companies are seeking to diversify their revenue sources by expanding their ecosystems. One strategy being adopted is offering banking services such as digital accounts, loans, and investments. This expansion allows companies to leverage their existing customer base and offer more comprehensive financial solutions.

Additionally, companies are exploring business opportunities in other segments, such as Value-Added Services (VAS). Credit, for example, can be offered to customers as a way to finance their purchases or invest in their businesses. VAS can include services such as insurance, loyalty programs, and partnerships with other companies. These ecosystem expansion strategies aim not only to compensate for the decline in revenue from MDR but also to strengthen the relationship with customers by offering more comprehensive financial solutions and becoming a trusted financial partner.

Regarding the construction of service ecosystems for SMEs, acquirers are seeking to adopt digital methods to reduce the administrative burden and costs for these businesses. They offer complete solutions, such as ERP for accounting and cash flow management, as well as other tools that meet the specific needs of these clients. With strategies focused on alternative payment methods and the construction of service ecosystems, acquirers stand out in the digital payment market, meeting consumer demands.

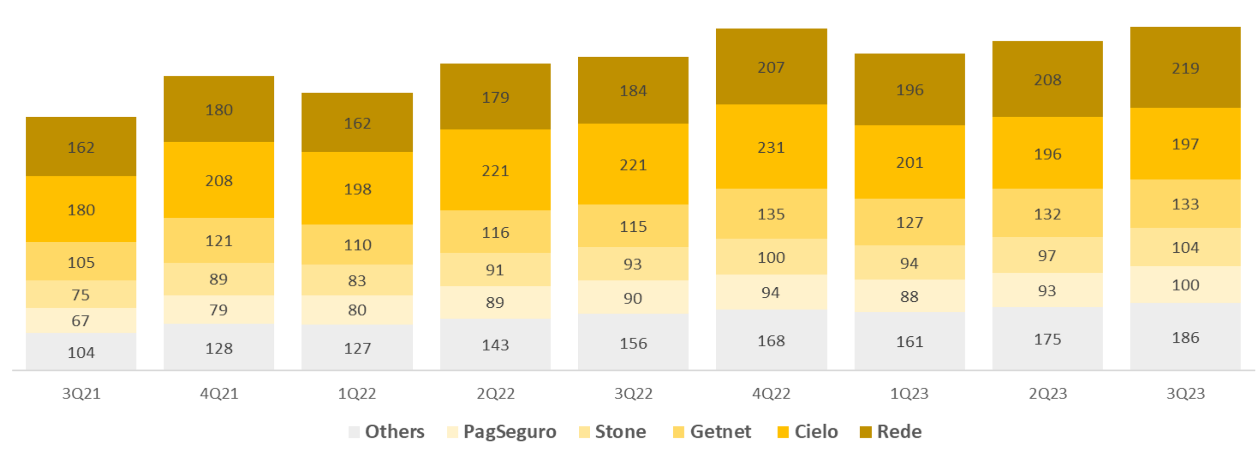
However, it is important to note that in Brazil, the IT infrastructure of SMEs is modest and limited, making it difficult to integrate ERP and payment systems. Selling software solutions to SMEs is more complex and consultative, requiring time and a specialized sales team. Despite being complementary services, the “go-to-market” strategy is different, requiring specific approaches to achieve success in this segment.

Another important market trend is the movement of other technology players advancing in payments. Companies like iFood and Rappi have launched payment systems and digital accounts, increasing the digitization of commerce and payments in Brazil. Furthermore, payment companies like Stone and PagSeguro are adding financial and technology services. Technology companies like TOTVS and Linx are advancing in payments and financial services, known as techfin. This digital transformation of commerce in Brazil is driving the construction of ecosystems, where companies like Magalu and Mercado Livre can attract both consumers and merchants.

Competitive Environment

Despite the large number of players, there is a significant concentration and a highly competitive environment. It is estimated that the top 10 players hold 80% of the acquiring volume in Brazil.

Figure 8. TPV (R$ bln) of Each Acquiring Company



Source: XP, Company Reports

Figure 9. TPV Market Share (%)

	3Q21	4Q21	1Q22	2Q22	3Q22	4Q22	1Q23	2Q23	3Q23
Others	18%	19%	20%	21%	22%	22%	23%	24%	25%
PagSeguro	11%	12%	13%	13%	13%	12%	12%	13%	13%
Stone	13%	13%	13%	13%	13%	13%	13%	13%	14%
Getnet	18%	18%	17%	17%	16%	18%	18%	18%	18%
Cielo	31%	31%	31%	32%	31%	30%	28%	27%	26%
Rede	28%	27%	26%	26%	26%	27%	28%	29%	29%

Source: XP, Company Reports

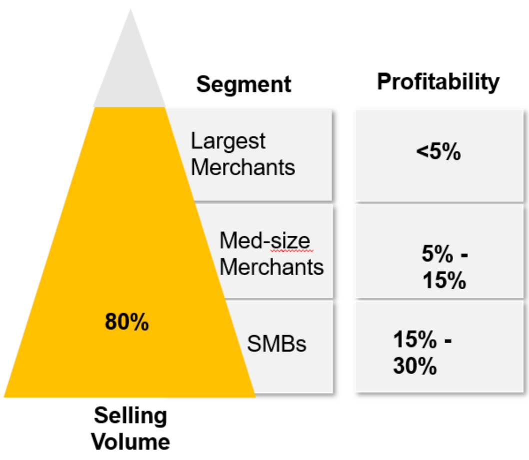
The payment and acquiring market is one of the most competitive in the financial sector. The intense competition is known as "The war of the card terminals". This fierce competition is driven by the pursuit of capturing a larger market share and attracting new customers.

One of the strategies adopted by companies is the reduction of fees and charges imposed on merchants. This strategy aims to win the preference of merchants by offering more attractive conditions for the use of card terminals. In addition, some companies also offer additional benefits such as cashback, loyalty programs, and receivables anticipation as a way to differentiate themselves from competitors.

The competition in the card terminal industry extends to technology, with companies investing in innovative solutions for more efficient and secure transactions. This includes internet-connected terminals, integration with management systems, and mobile applications. Marketing and advertising also play a significant role, with companies employing aggressive campaigns and partnerships to capture merchants' attention. This competition benefits merchants, who have a variety of options and can negotiate better conditions. However, companies in the industry must continuously innovate to stay competitive in this evolving market.

The level of competition in the acquiring segment has been more intense among the largest merchants and softer at the base of the pyramid. This explains the difference in profitability between players depending on their focus.

Figure 10. Distribution of acquiring company sizes and selling volumes

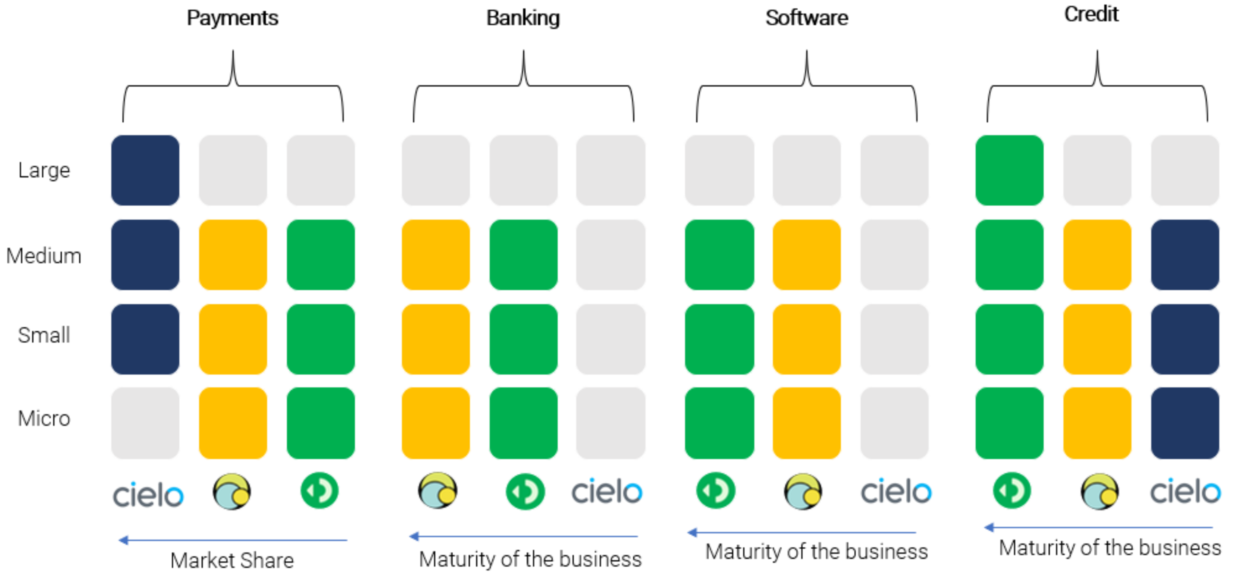


Source: XP

Brief Overview of Stone, Cielo & Pags:

Stone and PAGS are two independent players that were born with ambitions beyond just being payment acquirers. Like PAGS, Stone also started its operation digitally and achieved success by expanding into the physical world. However, they have different business models with distinct approaches. While PAGS sells POS machines to the long-tail market with a low-cost customer acquisition plan, Stone adopts a different strategy. Their strategy is not solely based on minimizing Customer Acquisition Cost (CAC), but rather on maximizing customer lifetime value by advancing in other avenues of their ecosystem, such as banking and credit.

Figure 11: Market Share Changes per Quarter (%)



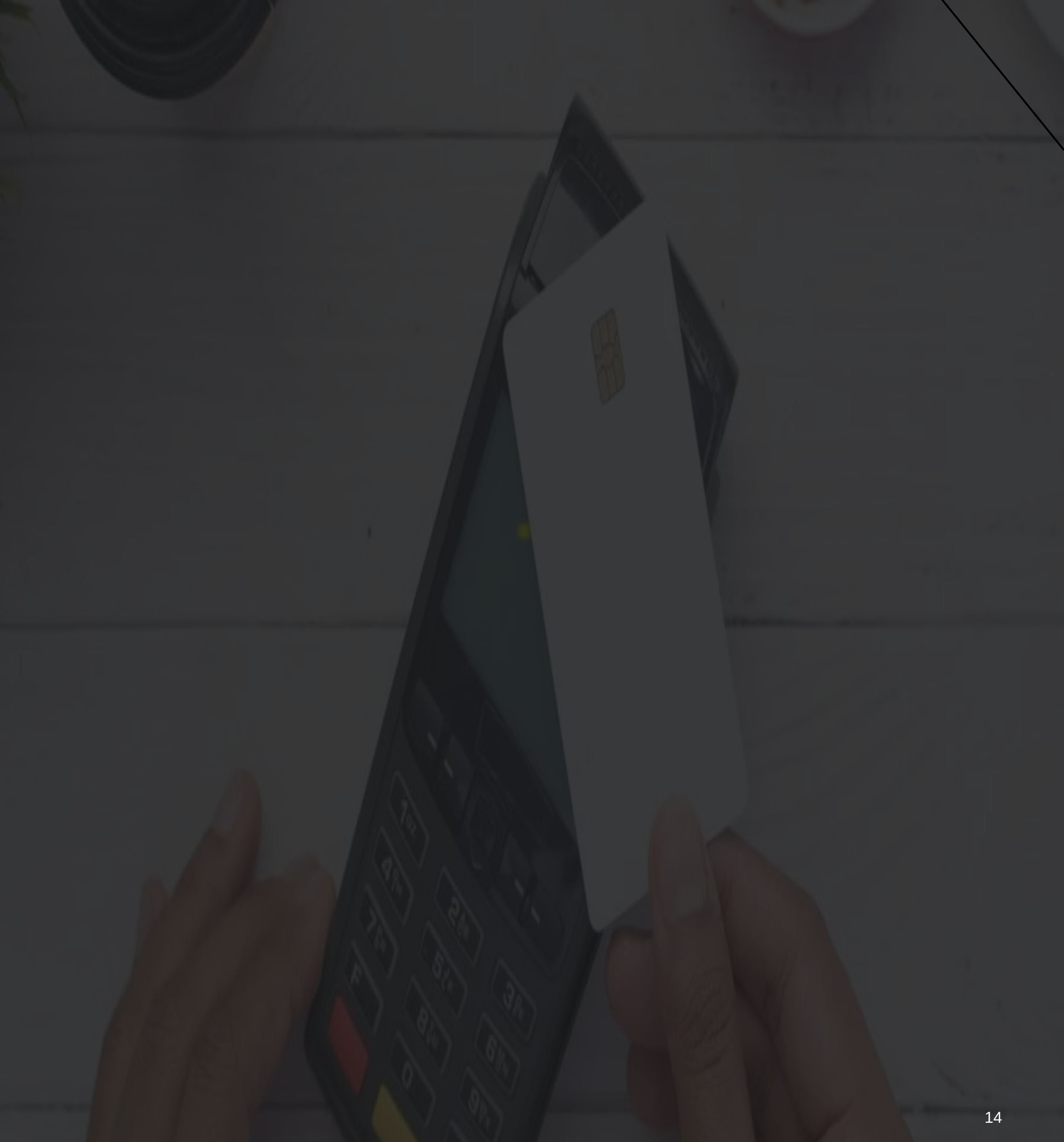
Source: XP, Company Reports

PAGS created a "new market" by targeting small merchants, many of whom were informal, in the long-tail segment that typically did not accept card payments. On the other hand, Stone created its own physical distribution channel, directly competing with traditional acquirers in its core payment means market. Acquiring has become a very important credit channel to access larger SMB clients.

Cielo continues to serve larger clients with a higher average ticket size compared to Stone's clients. Cielo does not seem to want or be able to integrate a software and banking product ecosystem like PAGS and Stone. The credit aspect is handled by its shareholders (Bradesco and Banco do Brasil).

Section 02

PagBank (NYSE:PAGS)



PagBank (NYSE: PAGS)

Initiating coverage with a Buy rating

We initiate coverage of PAGS with a Buy rating and YE24 TP of US$ 19.0/share, yielding 38% upside potential. Our investment thesis is based on: (i) PAGS' comprehensive and integrated ecosystem, strong track record of execution, and compelling value proposition in payments and banking services; (ii) its differentiated approach in serving small merchants (MEIs), delivering high service levels at a low cost; (iii) a relatively less competitive landscape in the MEI segment; (iv) an attractive valuation, with PAGS trading at 8.3x P/E ratio despite significant recent appreciation. We believe that solid execution and growth in the credit portfolio may lead to revisions in earnings projections. Additionally, the current environment of Selic rate cuts is expected to further benefit PAGS.

Best poised to serve smaller merchants. PAGS chosen to enter the market targeting especially the "MEIs". Although riskier due to the higher bankruptcy chances, the combination of a low-cost operation with higher MDRs charged led the company to reach above average profitability.

Banking business as perfect match. The world of low interest rates, created as a response to the 2008 financial crisis, has driven the emergence of a myriad of fintechs. In Brazil, specifically, the opportunity arising from the combination of technology and low interest rates has allowed a number of companies to be created with the aim of competing in the banking sector, a market with a history of large profit pools, but quite oligopolized. Despite the rise in interest rates, the foundations of these recently launched companies had already been strengthened, allowing then to became profitable and proving the thesis that there was room for new players in the Brazilian banking market. As a result, we see the bundle of an acquiring company with a bank as an advantage in terms of lowering the funding costs, paving the way for PAGS to achieve a healthy level of profitability despite the fact that the acquiring industry is known as highly competitive.

We see stock's valuation leaving enough margin of safety to offset the risks of increased competition. We see PAGS shares currently trading at 8.3x P/E for 2024E vs. 15.7x of the industry and 20x of historical levels. Additionally, our DCF Model prints an upside of 38% vs. current prices. As we see a combination of an attractive valuation and future growth opportunities, we believe the company is in a good position to deliver shareholder return.

PagBank (PAGS)	Buy
Target Price (US$/sh.)	19.00
Current Price (US$/sh.)	13.73
Upside (%)	*38%*
Market Cap (US$ mln)	4,519
# of shares (mln)	320
Free Float (%)	*59.1%*
ADTV (US$ mln)	38.3

Figure 13: Performance vs IBOV

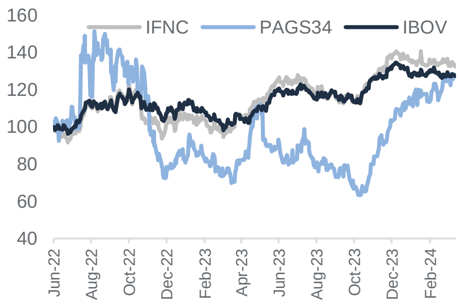


Figure 12: XP Estimates (R$ mln)

PagBank (PAGS)	2023A	2024E	2025E	2026E	2027E	2028E	2029E
Net Revenue from Transaction Activities and Other Services	**9,027**	**8,894**	**9,644**	**10,908**	**12,074**	**13,056**	**13,846**
Financial Income	6,653	7,357	8,350	8,853	9,801	9,278	9,397
Total Revenue and Income	**15,948**	**17,062**	**18,830**	**20,852**	**23,201**	**23,904**	**25,107**
Total Costs and Expenses	-13,931	-13,961	-15,046	-16,408	-17,966	-18,559	-19,416
Recurring Net Income	**1,654**	**2,480**	**3,027**	**3,511**	**4,136**	**4,170**	**4,439**
EBT	2,017	3,101	3,784	4,444	5,235	5,346	5,691
Net Income	1,654	2,480	3,027	3,511	4,136	4,170	4,439
P/E (x)	11.7x	8.3x	7.1x	6.5x	5.5x	5.5x	5.1x

Source: XP, company reports and LSEG Refinitiv.

Summary

PagBank: Investment Thesis

A one stop shop acquirer

PAGS has undergone a transformation, transitioning from a purely digital acquirer to a key player in the acquiring market. It was a pioneer in selling (rather than leasing) affordable POS devices, offering an innovative value proposition that enables small merchants (MEIs) to accept credit/debit cards. This approach has tapped into an untapped market with higher profitability. Additionally, PAGS offers a full end-to-end banking solution for merchants and consumers through its PagBank solution. We believe that PAGs will be the player that will benefit most from the monetary easing cycle.

Our investment thesis in PAGS reflects: (i) The company has a comprehensive and integrated ecosystem, with a strong track record of execution and a compelling value proposition in the payments and banking services segment, positioning it as one of the largest neobanks in Brazil. (ii) PAGS demonstrates a differentiated approach in serving smaller customers, delivering high performance in service level agreements (SLAs) while maintaining a low cost of service. (iii) The competitive landscape is relatively less intense in the MEI customer segment, providing PAGS with a competitive advantage. (iv) Despite experiencing significant appreciation, PAGS still offers an attractive valuation, trading at 8.3x P/E. The company's solid execution and growth in the credit portfolio may lead to future revisions in our earnings projections. Additionally, the current environment of Selic rate cuts is expected to benefit PAGS further.

Unlike other new entrants, PAGS chose not to compete directly with the incumbent giants in their core markets, particularly in serving larger customers. By adopting a strategic approach, PAGS found the right formula to target a different and untapped market segment, while keeping customer acquisition costs low. Thanks to its excellent execution, the company has experienced rapid growth since its IPO in 2018, being the player that gained the most market share in recent years.

The company has adopted a differentiated approach by integrating banking and payment services through a single customer interface. Its free digital account platform allows customers to manage all their payment flows, whether online or digital. This integrated ecosystem enables the company to generate rapid revenue growth beyond acquiring, particularly through revenue streams such as receivables anticipation and other credit lines for its customers. The company has also captured cross-selling opportunities with PagBank and Value-Added Services.

We believe that the current economic cycle, with gradually declining household delinquency rates and lower interest rates, will benefit players that serve the long tail market segment, with PAGS standing out among the listed players. In this environment of interest rate cuts, we expect PAGS to experience lower customer sensitivity and elasticity, resulting in a slower transmission of lower rates and benefiting the company.

PagBank at a glance

Company Overview

PagBank is a leading Brazilian fintech company offering a comprehensive range of financial and payment services to both individuals and businesses. **Founded in 2006, PagBank has rapidly emerged as a disruptor in the Brazilian financial services industry**, leveraging innovative technology to provide convenient, accessible, and cost-effective solutions to its customers.

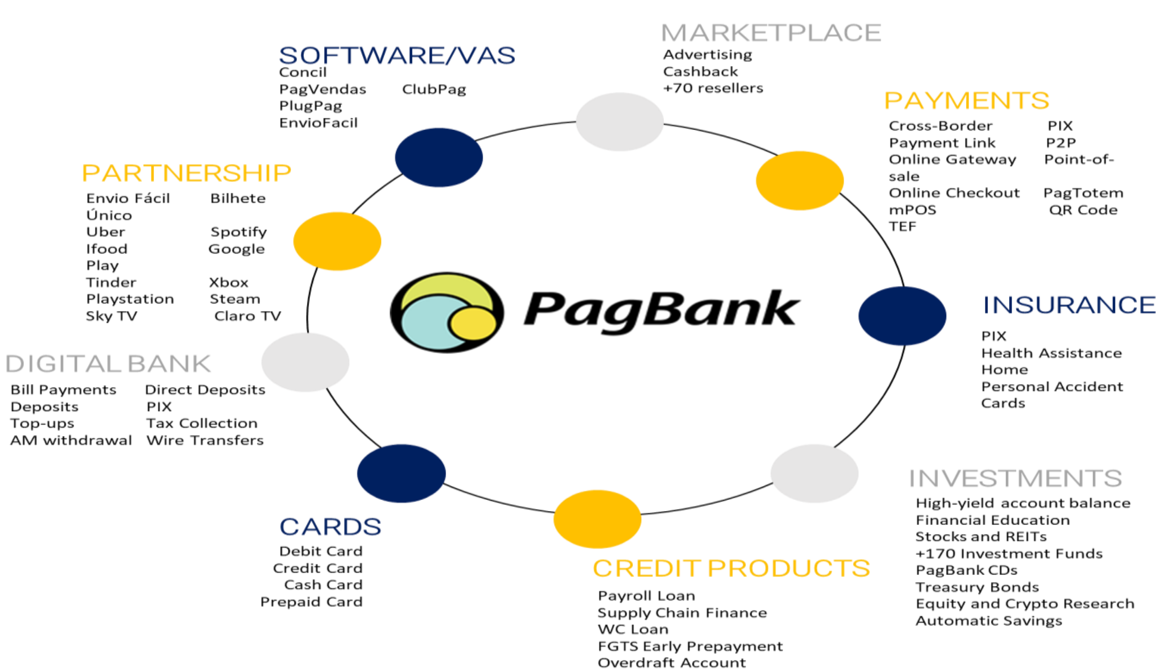
The company **targets specifically: consumers, individual entrepreneurs, micro-merchants, and small and medium-sized enterprises (SME) in Brazil.** As one of the first acquirers to target smaller businesses, PagBank was able to unlock new revenue streams in previously untapped markets by incumbent players.

According to the company's proprietary research, in December 2022, 52% of the merchants who acquired one of the entry-level POS, did not accept card payments prior to PagBank. By promoting affordable and comprehensive solutions, the company was able to create a completely new market niche and created a blue ocean of new clients.

As the years went by, the company was incrementing its payments offerings and has now an integrated and diverse ecosystem, covering many pillars such as payment solutions, a digital platform with proprietary solutions for business management, cross-border PSP in Latin America and Europe, and digital banking services.

The payments side consists mainly of providing POS and Online payment systems to merchants, and this segment comprises 90% of its gross profit. The segment achieved a TPV of R$ 394 billion, in 4Q24 LTM, with a R$ 65 thousand TPV per merchant. As merchants mature their businesses and PagBank improve its service offerings, the company has been able to acquire clients with higher TPVs.

Figure 14: Ecosystem Overview



Source: XP, Company Reports

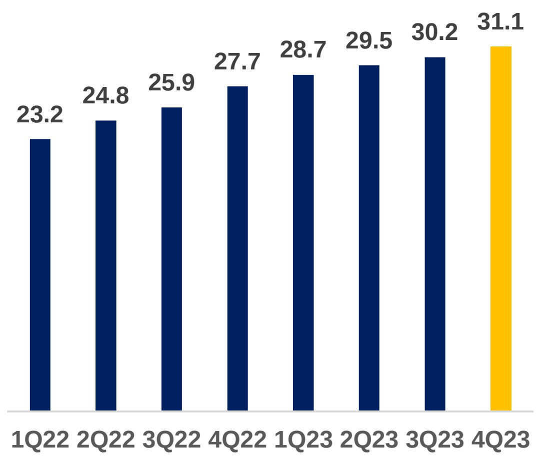
PagBank at a glance

Company Overview

The financial services segment represents 10% of gross profit left and consists mainly of credit portfolio, card issuances, and receivables discounting. By combining banking services and payment services, PagBank has achieved 31 million clients, being 16.7 active ones, which places the bank as the second largest neobank in Brazil.

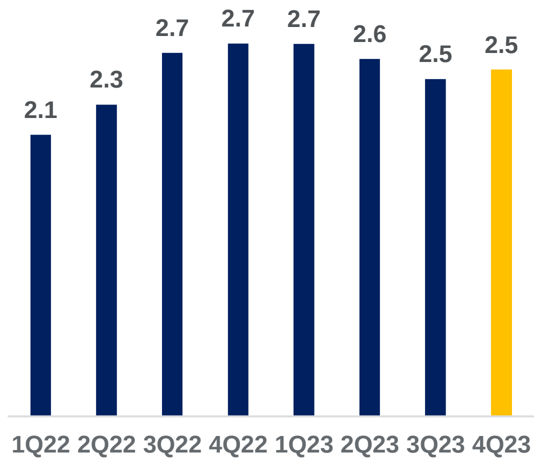
PagBank's digital account integrates seamlessly with the broader business ecosystem, allowing merchants to access complementary products and services that improve their daily operations. This value proposition has allowed the company to multiply its clients and achieve 31 mln, its credit portfolio reached 2.5 bln, and total deposits 27.6 bln.

Figure 15: PagBank's Clients (mln)



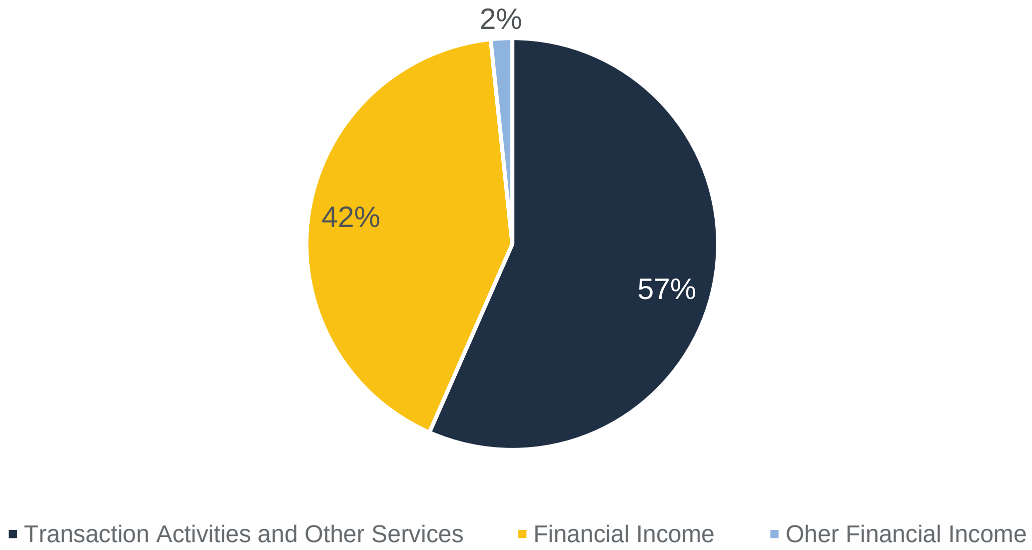
Source: XP, Company Reports

Figure 16: PagBank's Credit Portfolio (R$ bln)



Source: XP, Company Reports

Figure 17: Revenue Breakdown by Segment (R$ mln)



Source: XP, Company Reports

PagBank and Uol Partnership

An important play on customer acquisition strategy

UOL's strategic partnership with PagBank plays a crucial role in the fintech's customer acquisition strategy, covering both banking services and merchant acquiring segments. Leveraging UOL's comprehensive digital presence and its wide array of content platforms, PagBank gains unparalleled access to a vast audience spanning various demographics and interests. As of June 2019, ComScore estimated that approximately 107 million unique visitors accessed a UOL website. This access provides PagBank with a unique opportunity to tailor its marketing and promotional efforts more effectively, targeting potential customers with precision and efficiency. UOL, known for its robust digital ecosystem that includes news, entertainment, and financial services, serves as an ideal conduit for PagBank to showcase its innovative banking solutions and merchant services, enhancing visibility and fostering trust among potential clients.

The collaboration between UOL and PagBank extends beyond traditional advertising, embracing content integration and co-branded initiatives that seamlessly blend financial services into the daily digital experience of users. Through targeted content, financial education articles, and interactive tools hosted on UOL's platforms, PagBank can engage with users in a context that adds value to their online journey. This strategy not only boosts PagBank's brand awareness but also positions it as a thought leader in financial innovation and customer-centric solutions. The credibility and authority of UOL as a content provider amplify this effect, lending PagBank an aura of trustworthiness and reliability crucial for attracting new clients in the competitive financial services sector.

Moreover, **UOL's analytics and user insight capabilities play a significant role in refining PagBank's customer acquisition strategies.** By analyzing user engagement and behavior patterns on its platforms, UOL can help PagBank identify emerging trends and customer needs, enabling the fintech to adapt its offerings and communication strategies proactively. This data-driven approach ensures that PagBank's marketing efforts are not only widespread but also highly targeted and relevant, increasing the conversion rate of potential clients to active users. The ability to anticipate and meet customer needs in real-time is a competitive edge that this partnership affords PagBank, setting it apart in the crowded digital banking and payments landscape.

In conclusion, UOL's involvement in PagBank's customer acquisition strategy signifies a transformative approach to fintech marketing and client engagement. **By combining UOL's expansive digital reach and content expertise with PagBank's innovative financial services, this partnership is poised to accelerate PagBank's growth,** enhance its market presence, and redefine customer expectations in the digital banking and merchant acquiring sectors. As the financial industry continues to evolve rapidly, collaborations like these will likely become crucial for fintechs seeking to expand their user base and establish a lasting impact in the market.

PagBank: Value Proposition

Premium position within small merchants

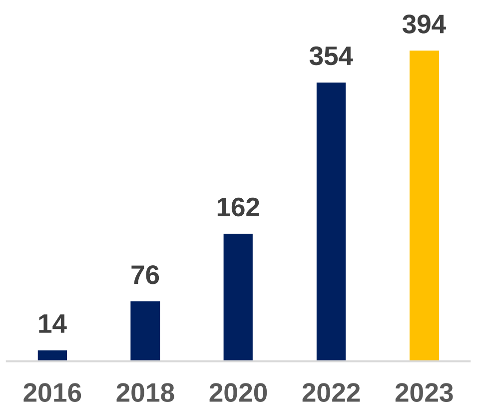
Pagbank offers a unique two-sided ecosystem for both small merchants and customers. By providing merchants with comprehensive financial solutions ranging from banking to payment services, Pagbank places itself in a premium position to compete in a large, growing, and previously untapped market.

Regarding payments, the company adopted the strategy of selling POS to micro merchants, instead of leasing them. This allowed micro-merchants to buy the POS systems in installments and made business feasible for them. The result of it was a blue ocean, the company was able to expand the payment market and achieved around 10% market share in 8 years.

The major tailwind coming from the growth in fintech and neobanks activity in Brazil, which allowed the previously unbanked part of the population to have access to bank accounts, cards, and other financial services, created a large source of growth in the Brazilian market TPV and payments industry. As there's room for the Brazilian market to catch up with developed markets in terms of electronic transactions, we believe PagBank should continue to benefit from the internal growth and capture market share in the MSMB and SMB markets.

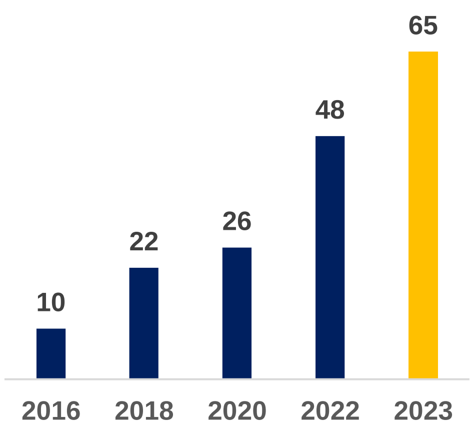
Additionally, we see the business becoming more resilient, as the company is expanding outside nano-merchants (revenue < R$ 1 thousand/month). The high level of profitability the company has been able to achieve within this niche is also accompanied by a high mortality rate. Therefore, to become healthier and more sustainable, the company decided to shift focus to SMB and MSMB, exclusively. This movement accelerated the growth of TPV per merchant over the last years and contributed to more stable results.

Figure 18: TPV (R$ bln)



Source: XP, Company Reports

Figure 19: TPV per Merchant (R$ thousand)



Source: XP, Company Reports

The banking side of the company is another growth driver, by offering financial solutions to MSMB's PagBank is well positioned to i) capture a larger share of wallet of clients, ii) increase switching costs, and iii) cross-selling services. PagBank benefits from keeping merchants' resources internally, which results in a lower cost of funding, float, and credit concession, while merchants benefit from banking services. By keeping resources internally, the company also increases switching costs and reduces churn. Finally, more access to client's data allows the cross-selling of products and services.

PagBank: Value Proposition

High-value proposition while maintaining a low cost of service

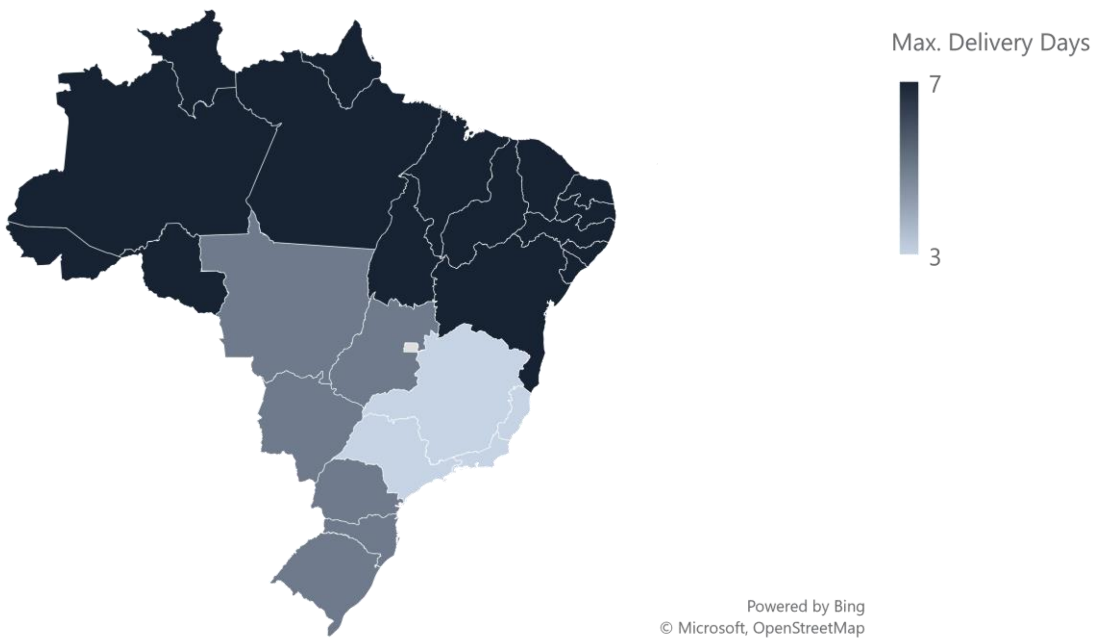
Pagbank's "One Platform, One App, One Customer Care" approach provides the company with a significant competitive advantage in the Brazilian fintech market. By offering a seamless and integrated banking experience, PagBank differentiates itself from traditional banks and other fintech competitors, attracting customers seeking convenience, simplicity, and a personalized service. Moreover, we believe PagBank's focus on customer-centricity and innovation reinforces its position as a leading fintech player in Brazil, driving customer acquisition, retention, and revenue growth.

PagBank is able to keep its costs low by selling the POS terminals and, therefore, it does not incur expenses related to maintenance, replacement, and the supply of paper print as other incumbent players incur. The only expense PagBank has is a 5-year warranty, which has proven to be a cost-effective strategy. These nuances have allowed PagBank to have a lower cost to serve smaller merchants and be profitable.

Along with a complete platform, the company has a robust logistics system, allowing the delivery of the POS within 2 to 3 days in the southeast, 3 to 5 days in the south and middle west, and 5 to 7 workdays in north and northeast.

All these offerings combined are part of a solid portfolio that is, sometimes, even more complete than the ones from incumbent players. Additionally, the company provides the services for free or at a very low cost for clients. This value proposition is able to enhance not only the business experience of micro merchants but also SMBs.

Figure 20: Delivery Time by Region (Days)



Source: XP, Company Data

PagBank: Value Proposition

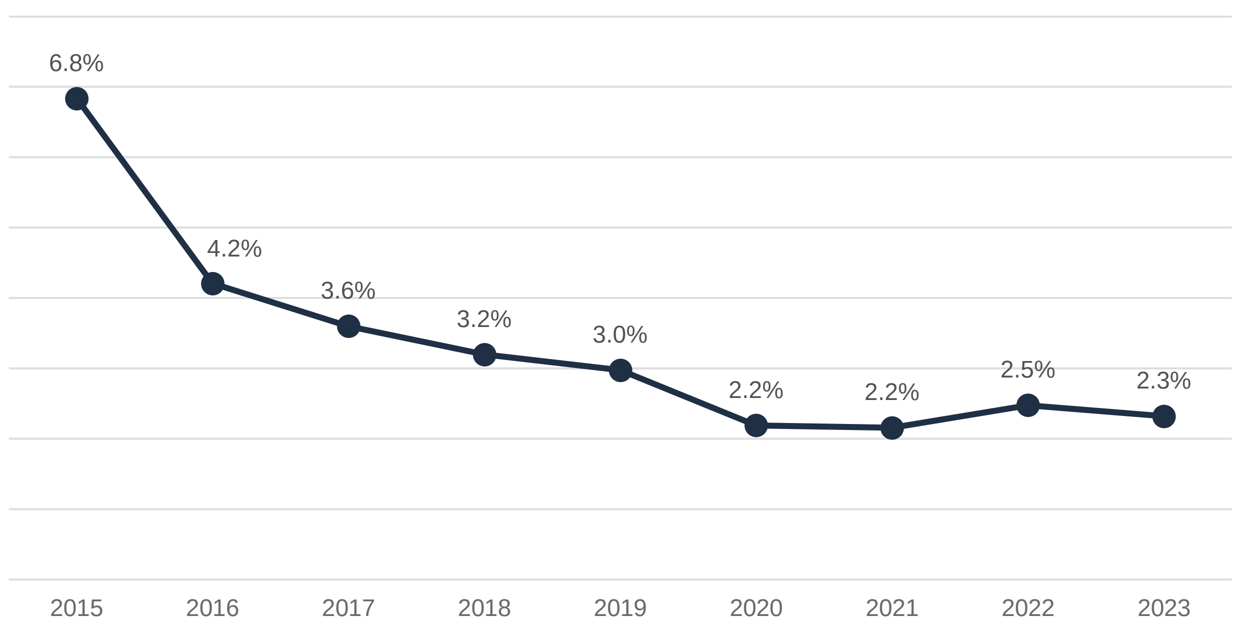
The competitive landscape is relatively less intense in its market niche

PagBank operates in a niche market with many intrinsic challenges. While acquirers that offer services for individual, micro-Merchants and SMB's most of the times are able to achive a higher profitability, they must have a lower CAC, higher scalability and lower cost of sevices. The mortality rate and delinquency of smaller Merchants is higher than on large corporates.

As the first mover into this segment, PagBank benefits from the word of mouth among smaller Merchants. By providing lower cost POS and the possibility of installment payments, PagBank has achieved a robust distribution system and scale to serve these multiple clients.

In addition to its competitive advantages, the previously untapped market that PagBank operates has fewer options of both acquirers and funding. **Therefore, PagBank is not only able to charge a higher take rate for each transaction, but also to increase its MDR as, most of the times, this is the only source of credit micro-Merchants have access to.**

Figure 21: PagBank's Net Take Rate (%)



Source: XP, Company Data

Snapshot and main numbers

XP Estimates

Figure 22: XP Estimates

	2023A	2024E	2025E	2026E	2027E
Consolidated Income Statement (R$ mln)					
Net Revenue from Transaction Activities and Other Services	**9,027**	**8,894**	**9,644**	**10,908**	**12,074**
Total Revenue and Income	**15,948**	**17,062**	**18,830**	**20,852**	**23,201**
Cost of Sales and Services	-8,133	-8,808	-9,627	-10,556	-11,630
Selling Expenses	*-1431*	*-1618*	*-1710*	*-1790*	*-1899*
Administrative Expenses	-732	-595	-600	-602	-647
Total Costs and Expenses	**-13,931**	**-13,961**	**-15,046**	**-16,408**	**-17,966**
Financial Income	**6,653**	**7,357**	**8,350**	**8,853**	**9,801**
Other Financial Income	268	811	836	1,091	1,326
Financial Expenses	-3,270	-2,483	-2,652	-3,003	-3,335
EBT	**2,017**	**3,101**	**3,784**	**4,444**	**5,235**
Income Tax and Social Contribution	-363	-620	-757	-933	-1,099
Tax rate	-18%	-20%	-20%	-21%	-21%
Net Income	**1,654**	**2,480**	**3,027**	**3,511**	**4,136**
Consolidated Balance Sheet (R$ mln)					
Total Assets	**55,108**	**62,934**	**72,329**	**82,952**	**91,630**
Accounts Receivable	41,757	47,293	53,976	60,191	65,573
Cards	39,228	44,556	51,013	56,983	62,236
Loan Portfolio	2,529	2,737	2,963	3,207	3,337
Total Liabilities	**41,867**	**47,155**	**53,675**	**60,962**	**65,711**
Deposits	11,365	12,302	13,316	14,414	14,999
Shareholders' Equity	**13,241**	**15,597**	**18,473**	**21,808**	**25,737**
Valuation					
Market Cap (R$ mln)	19,366	20,632	21,510	22,827	22,827
EPS	**5.2x**	**7.8x**	**9.5x**	**11.0x**	**12.9x**
P/E	**11.7x**	**8.3x**	**7.1x**	**6.5x**	**5.5x**

PagBank: Differential of the ecossystem is the bank

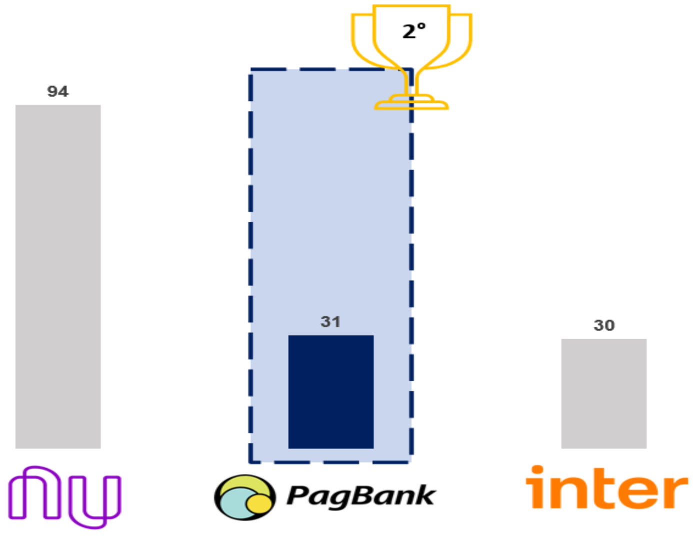
From a pure play acquirer to providing a rage of services

PagBank has an integrated and diverse ecosystem combining payments and financials solutions. On the payments side which is 90% of their gross profit and consists mainly in: POS and Online payments. The company has 53% of cards penetration, with a R$ 54 thousand TPV per merchant and a TPV of R$ 375bn, in 3Q23 LTM. The financial services represent the 10% of gross profit left and consists mainly in: Credit Portfolio and Cards issuances.

PagBank is a strong complement to increase company operational numbers. The bank is responsible to make the company funding easier with client's deposits while offers credit and financial solutions to their merchants, as transaction and digital account management. The client's can pay bills, make P2P, Pix, QR code payments, make online purchases, invest their money, have a credit/prepaid cards, insurance and access to credit. The ecosystem is complemented by a partnership with other brands as: Spotify, Uber, Google Play and Shell. Finally, they also offer health and transportation services.

PagBank incentives the deposits by remunerating them with 110% of CDI and currently have R$ 900mi under management and almost 75 million clients*, the bank also can issue bonds and have securities brokerage. The bank has 16 million active users* with 24% of growth in the year, being the 2° largest NeoBank. With an amount of 30 million of bank clients, being 16.7 active ones, the cash-in of the bank is R$ 151.2bn.

Figure 23: Ranking of Neo-banks by number of clientes (mln)



Source: XP, Company Reports

The banking solution offers 40 cash-in methods and 13 cash-out options, helping their main merchants to complement the POS and mPOS devices.

As PAGS targets are Micro and Small merchants, the free and complete bank account, accompanied with credit solutions, makes the bank an important engine for PagSeguro Business. The company helps and solve the problems for a market niche that are most part unbanked and ignored by the incumbents' banks, making them close to their clients, but not only that, but the bank also get a cheaper funding with the merchant's deposits in the digital accounts.

The fully-integrated ecosystem with payments, card issuance and credit products increases the diversity of the business, reduce funding costs improving their efficiency and finally, make a one-stop-shop payment solution to their clients, brining a more stable churn for the company.

PagBank: Credit Portfolio and Delinquency

NPL reduction is the main focus

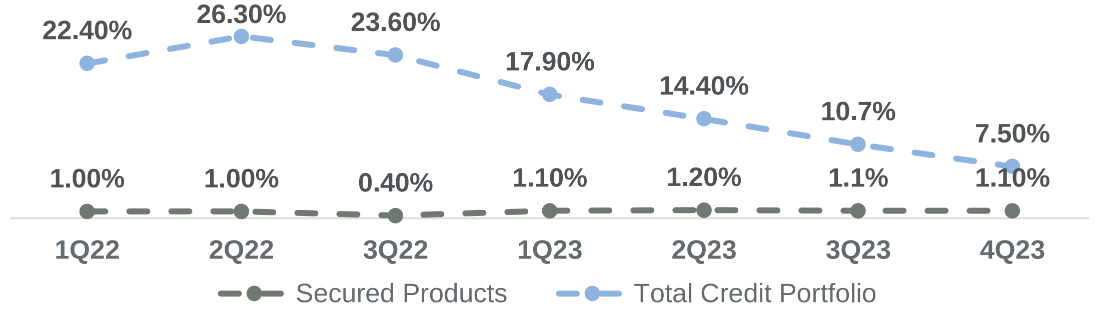
PagBank had been increasing the penetration of its credit portfolio on its vast client base. However, the concession of unsecured credit has proven to be too risky and resulted in high delinquency. As a result, the company announced in 1Q22 that it would only originate secured credit to clients, as the macroeconomic environment was not supportive and NPL was running at a high level.

Over the last quarters, the collateralized credit origination helped PagBank to keep delinquency under control and reduce its overall level. As of the 3Q23, the bank continued to keep its risk apetite limited, and the credit portfolio decreased 7.1% YoY.

In our view, credit origination could be a growth driver for the bank, but we believe it has yet to improve its credit models in order to generate solid results. Therefore, we do not see credit origination as an earnings catalyst over the next quarters, but rather as a long term source of growth.

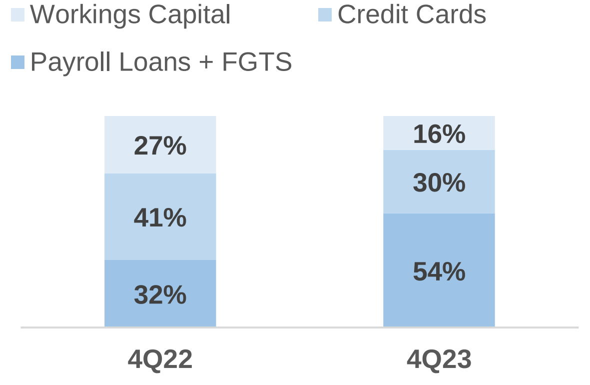
In the short-term, the bank should continue to work on keeping delinquency under control. As the macroeconomic scenario improves, there should be room for testing some of the unsecured credit lines and accelerate credit concession.

Figure 24: NPL > 90 (%)



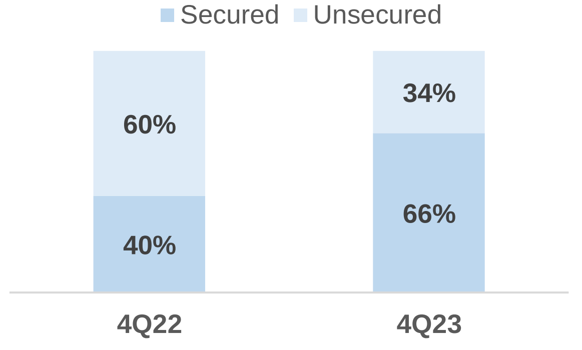
Source: XP, Company Reports

Figure 25: Credit Portfolio Composition (%)



Source: XP, Company Reports

Figure 26: Secured Credit Products (%)



Source: XP, Company Reports

Pix: Opportunity or threat?

Main impacts on both banking and acquiring sides

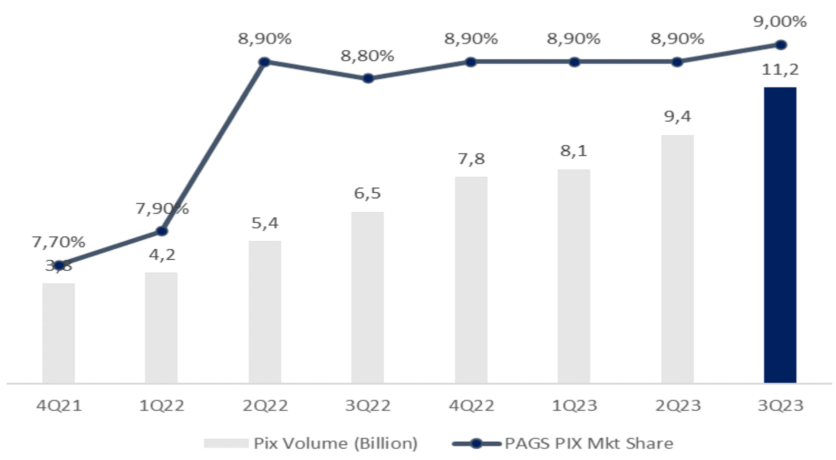
The increasing adoption of pix in Brazil has been reshaping the acquiring industry. For PagBank's acquiring arm, specifically, we see it as a relevant risk, given the following: i) micro/nano merchants are usually informal and present a low need of bank reconciliation, and ii) low-income customers have smaller credit card limits and tend to use pix more often, iii) pix direct transfers do not incur any fees for both users.

Even with a full ecosystem of software and bank reconciliation options being provided to merchants, we expect a decrease in both TPV and take rate for PagBank's acquiring business. There will continue to be a challenge on this front, since the usually informal nature of micro-merchants, makes these products less valuables vs. for larger businesses.

While the neobanks and fintechs have significantly increased the bancarization rate in Brazil, over the last years we have seen a decrease in risk apetite among incumbent banks - still responsible for larger share of the credit balance - to what is called "open sea" – clients without a banking relationship.

In order to receive pix transfers, merchants do not necessarily need an acquiring machine. Sometimes, they may find it even more advantageous to receive the transfer directly into their bank accounts, since they won't be charged any direct fees.

Figure 27: Pix # of transactions vs. PAGS market share



Source: XP, Company Reports

On the other hand, the banking business seems to be taking advantage of this new powerful tool in the Brazilian financial system. The bank has achieved a 9.0% market share of all pix transactions in Brazil and, in our view, should continue to gain market share.

Incumbent banks often charge fees for basic services, such as pix, in corporate accounts. PagBank benefits from offering a free experience to merchant and, therefore, is able tomonetize from other sources such as: float, and cross-selling. We believe the lack of fees drive a higher principality from merchants on PagBank accounts.

PagBank: Software Ecosystem

Comprehensive range of services for merchants

PAGS has also two ERPs to complement their ecosystem, Pagvendas and Concil; The first one is a simple one to help their POS clients, and Concil is a more robust one, for those who are also clients of PagBank, and has API connected to banks helping all the companies' operations.

Explaining more about the solutions:

I) PagVendas: More simple and free solutions, It's a management SaaS, which helps on the inventory control, costumers' registration, Sales reports and Fiscal notes emission.. Can be used in PagPhone, ModerninhaSmart 2, moderninha X, computer or mobile. The software also has an e-commerce and delivery solutions and attends general retail. The app has an average of 4.7 stars in Apple and Play Store.

II) Concil: More robust platform for management, having three different plans: Controle (free for PagBank Clients), Gerencie and Plus. Concil has a partnership with more than 35 acquires, focusing in: Helping on the cash flow management, Tax audit, Chargebacks and reversals management. Is focused on different segments and has clients as: Hugo Boss, Pague Menos and Ype, and can be accessed Web and Mobile.

PagBank doesn't see the ERP as a core source of revenue, but it's a complement to the ecosystem, making an integrated and complete platform of solutions to avoid the churn of their clients. Also, the ERP segment has intense competition, because is really sprayed in many companies, turning difficult the price attribution of the service, which is also a problem for scalability and profitability of the service.

The company has an approximately 586,000 active users subscribed to PagVendas, according to the company, the addressable market in 2020 was around R$ 11.1 billion, which can help the growth of the PAGS.

Figure 28: Concil and PagVendas functions

Source: XP, Company Reports

PagBank: Valuation

38% Upside

Valuation. Our 2024YE DCF-based target price of USD 19.0 per share presents an upside of 38% vs. current prices, with roughly 46% of it valued at its perpetuity. We use a DCF Model valuation approach, where our main assumptions include: (i) 5.5% long-term growth rate, (ii) 4.1% risk-free rate and (iii) and beta at 1.2, implying a cost of equity (Ke) of 15.8%.

Figure 29: Main DCF Assumptions (R$ mln)

	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E
Net Income	**2,480**	**3,027**	**3,511**	**4,136**	**4,170**	**4,439**	**4,557**	**4,914**	**5,295**	**5,702**	**6,136**
(+) D&A	1,334	1,344	1,346	1,339	1,217	1,278	1,327	1,417	1,513	1,616	1,725
(+/-) Working Capital Change	**-1,215**	**-1,358**	**-205**	**-1,395**	**-840**	**-338**	**-287**	**-231**	**-165**	**-90**	**-6**
(-) Capex	-1,957	-1,971	-1,974	-1,965	-1,785	-1,875	-1,947	-2,079	-2,220	-2,370	-2,529
(+) net debt additions	**4**	**150**	**150**	**150**	**150**	**150**	**150**	**150**	**150**	**150**	**150**
Free cash flow to equity	**646**	**1,192**	**2,828**	**2,265**	**2,912**	**3,654**	**3,800**	**4,172**	**4,574**	**5,007**	**5,475**
PV FCFE	**646**	**1,030**	**2,110**	**1,460**	**1,621**	**1,757**	**1,579**	**1,497**	**1,417**	**1,340**	**1,266**

Figure 30: CAPM Model

Ke Calculation	
Risk Free Rate	**4.1%**
Country Risk	2.1%
Equity Risk Premium	**6.1%**
Levered Beta	1.24
Inflation Differential	**2.0%**
Ke	**15.8%**

Figure 31: Historical Forward EV/EBITDA Multiple

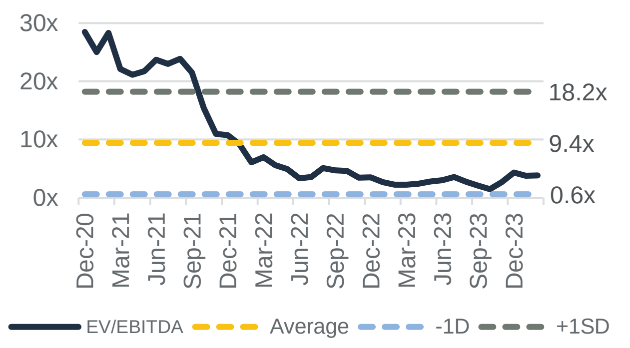


Figure 32: Historical Forward P/E Multiple

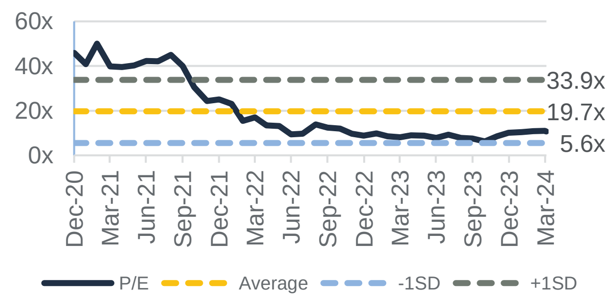
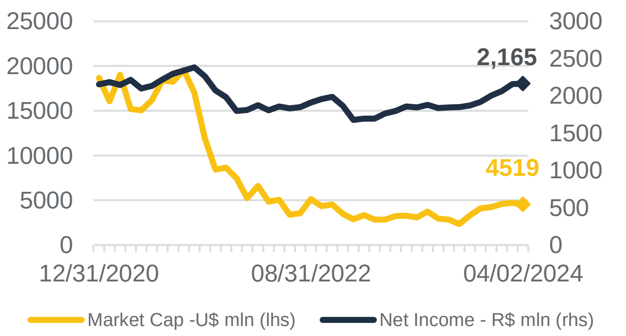


Figure 33: Multiple composition



Source: XP, company reports and LSEG Refinitiv.

PagBank: Valuation Comps

Discounted vs. Global Peers

Figure 34: Valuation Comps

Company	Market Cap ($ mi)	ADTV ($ mi)	P/SALES 2024	P/SALES 2025	EV/EBITDA 2024	EV/EBITDA 2025	P/E 2024	P/E 2025
PagBank	**4,519**	**38.3**	**1.2x**	**1.1x**	**4.1x**	**3.2x**	**8.3x**	**7.1x**
Clover	84	0.1	1.2x	1.0x	14.4x	9.1x	28.5x	15.4x
Blocks	48,769	746.4	1.9x	1.7x	16.1x	12.1x	22.8x	17.6x
Stone	5,018	81.9	1.8x	1.7x	3.9x	3.8x	11.3x	8.5x
Cielo	14,779	132.2	1.2x	1.2x	4.2x	4.5x	7.4x	7.2x
Average			**1.5x**	**1.3x**	**8.5x**	**6.5x**	**15.7x**	**11.2x**

Figure 35: XP's Financial Coverage

Company	Ticker	Rating	Price (R$/share) Current	Price (R$/share) Target	Upside (%)	P/E 2024E	P/E 2025E	P/B 2024E	P/B 2025E	Div. Yield 2024E	Div. Yield 2025E
Banks											
Banco do Brasil	BBAS3	Buy	56.2	73.0	30%	4.2x	4.2x	0.8x	0.8x	10.8%	10.7%
Bradesco	BBDC4	Neutral	14.2	19.0	34%	7.1x	5.7x	0.8x	0.7x	4.7%	6.6%
Santander	SANB11	Neutral	28.2	34.0	21%	7.7x	6.5x	1.1x	1.0x	3.3%	3.8%
Itaú Unibanco	ITUB4	Buy	33.5	42.0	25%	7.6x	7.2x	1.6x	1.4x	7.3%	7.8%
Payments											
Stone	STNE	Neutral	16.24	19.0	17%	11.3x	8.5x	1.4x	1.3x	0.4%	0.6%
Pagbank	PAGS	Buy	13.73	19.0	38%	8.3x	7.1x	1.3x	1.2x	0.6%	0.7%
Capital Markets											
B3	B3SA3	Neutral	11.7	16.0	36%	12.5x	10.7x	3.3x	3.3x	7.6%	8.8%
BR Partners	BRBI11	Buy	16.5	20.0	21%	10.7x	8.9x	1.9x	1.8x	0.4%	0.4%
BTG Pactual	BPAC11	Neutral	35.5	40.0	13%	13.4x	11.7x	3.0x	2.6x	2.8%	3.2%
Neobanks & Fintechs											
Inter & Co	INBR32	Buy	28.5	34.0	19%	15.2x	9.1x	1.4x	1.2x	0.0%	1.7%
Nubank	ROXO34	Neutral	10.0	7.7	-23%	27.5x	19.9x	6.7x	5.4x	0.4%	1.2%
Méliuz	CASH3	Neutral	5.2	11.2	114%	29.2x	21.1x	0.6x	0.6x	0.0%	1.2%

Source: XP, Company Reports LSEG Refinitiv.

PagBank: Corporate and Ownership Structure

Figure 36: Shareholder structure

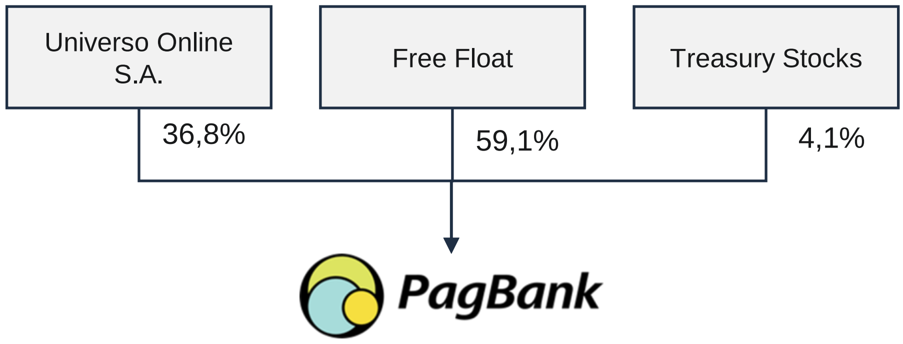


Figure 37: Executive Officers

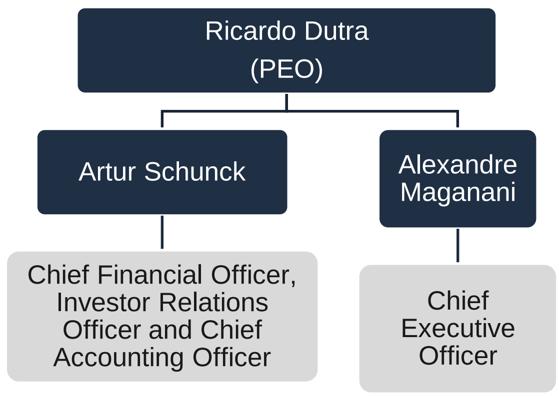
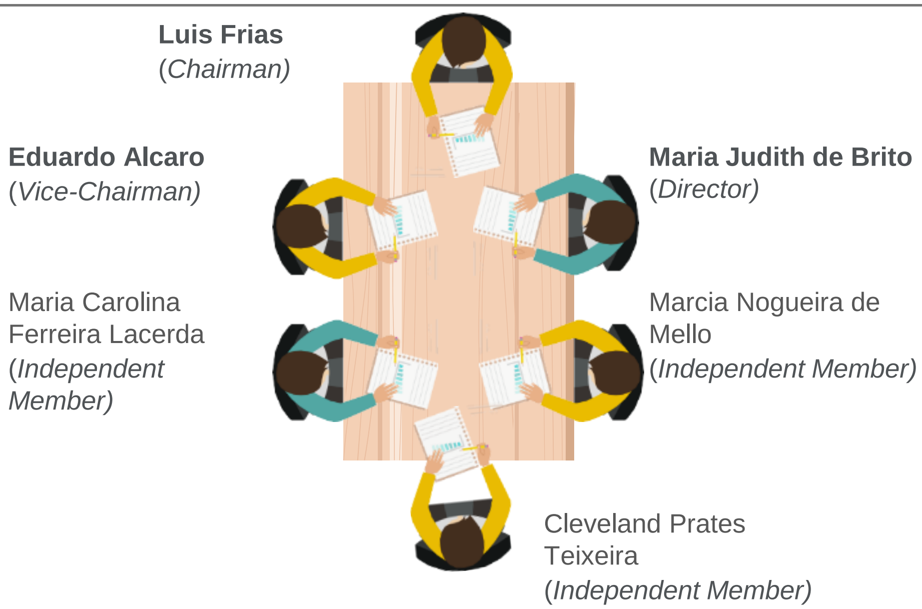


Figure 38: Board of Directors



Source: XP, Company Reports

PagBank: History

PagBank is 5th largest acquirer and 2nd largest NeoBank in Brazil, having a payment volume of R$ 353bn in 2022, and more than 30 million clients. The company focus is offering payments solutions and financial services to the segment of small and medium-sized business, being 94% of their gross profit from payments in 3Q23.

The company competes with Rede, Cielo, GetNet and Stone in payments business holding around 11% of market share. On the financial services, the main competitors are Nubank and Inter.

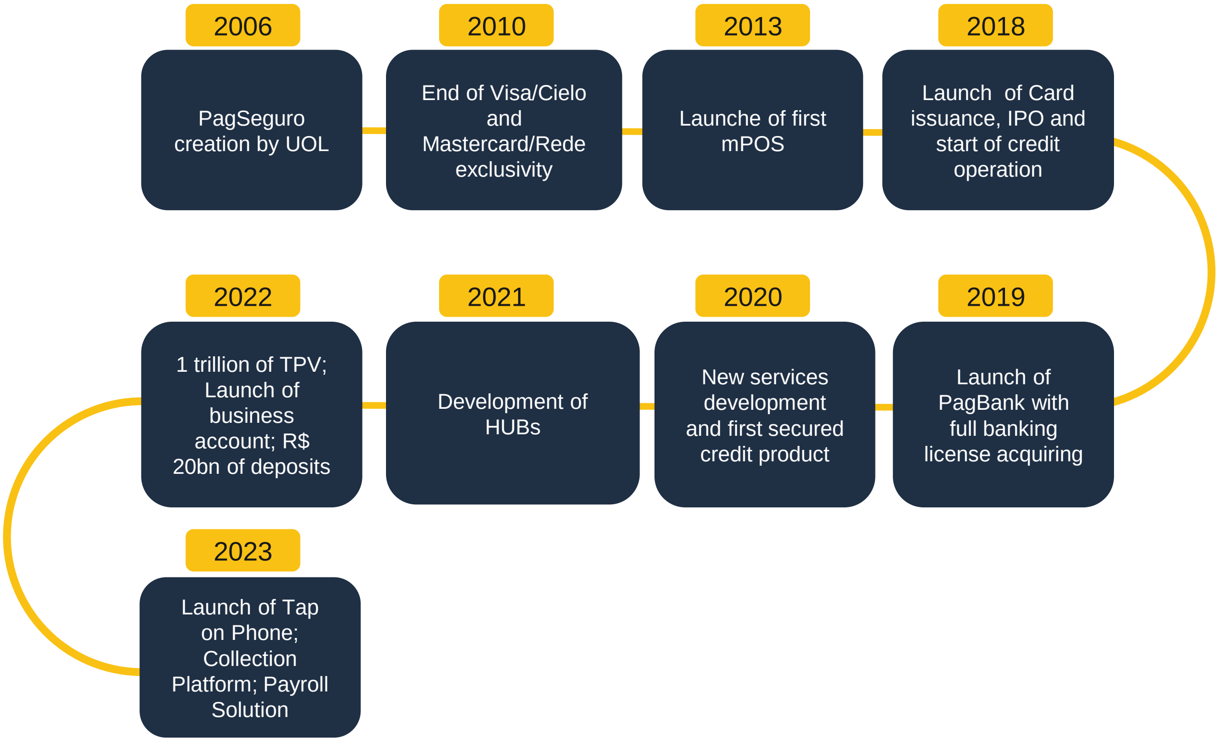
PagBank was primarily launched as PagSeguro in 2006 by UOL, which is one of the largest internet content, digital products service companies of Brazil with more than 107 million of unique visitors in 2019. PagSeguro platform was focused in provide a digital payment platform for the e-commerce.

After the end of the exclusivity agreement between Visa/Cielo and Mastercard/Rede in 2010, PagSeguro entered in 2013 on POS payments, focusing on entrepreneurs, Micro-Merchants, and SMEs, realizing their first mPOS. In 2018, the company launched their credit and card issuance business and did their IPO in NYSE, one of the largest among Brazil fintechs, raising US$ 2.6bn, to improve their operations.

In 2019, the company launched PagBank to integrate their acquirence business, changing the brand name from PagSeguro, after acquiring their full banking license for R$ 60mm.

In 2022, PAGS achieved R$ 1 trillion in TPV and R$ 20bn in deposits, they also released their business account integrating their payments clients to their bank. In, the company is still improving their solutions as Tap on Phone, a Collection platform and payroll solutions.

Figure 39: PAGS Timeline



Source: XP, Company Reports

PagBank: Investment Highlights and Risks

Competition is the biggest risk

Investment Highlights

Banking	We see the combination with a banking operation as a differential. Not only in terms of bundling other services, but also lowering the cost of funding.
Brand recognition	Although young, the company has been able to create a relevant share of mind in the acquiring industry.
Complete portfolio	Through acquiring and banking the PagBank can offer a myriad of financial services, which leads the company to be seen as the primary service provider for consumers, individual entrepreneurs, micromerchants and SMEs.
Well positioned for an M&A	Although the company has been able to thrive in such an competitive industry, we see acquiring as one part of a wider offer. Therefore, we understand that the company could be seen as a good fit for a player that offer complimentary services for individual entrepreneurs, micromerchants and SMEs.
Double-digit growth	PagBank disrupted the acquiring industry in the country. However, we still see room for healthy growth in years to come.

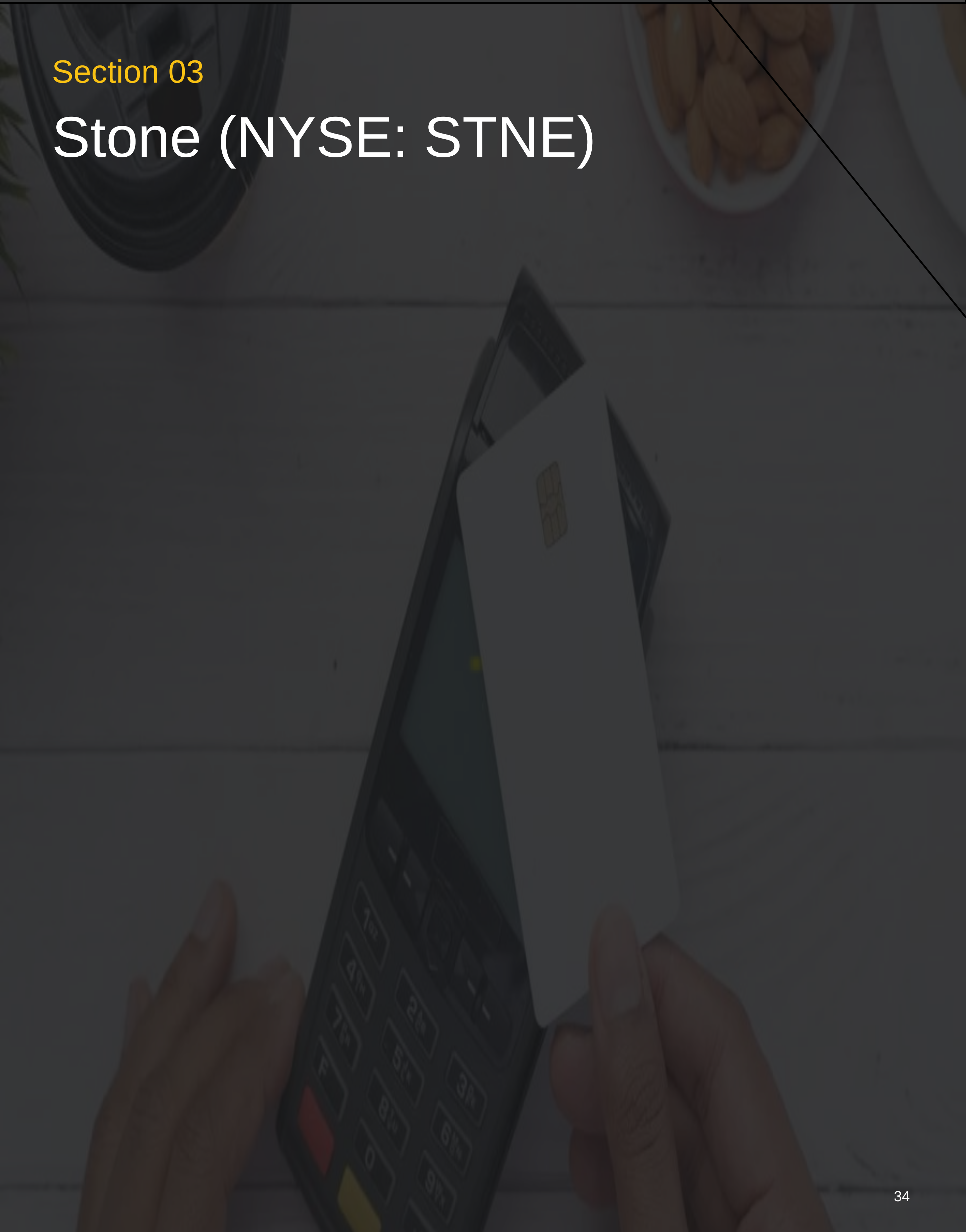
Investment Thesis Risks

Granting credit in Brazil has always been a challenge. If Pagbank set the wrong parameters in its credit models and suffer from higher delinquency, this could jeopardize its future.	Credit offer to clients
Economic downturns may affect the acquiring industry as a whole, including PagBank.	Economic downturns
The emergence of competitors, especially fintechs, as well as a greater aggressiveness of current competitors' offers can affect the company's results.	Competition
Brazilian market is largely dependent on the interest-free installments ("parcelado sem juros"), any change to the maximum financing period can affect the company's results.	"Parcelado sem juros"
As a bulk of an acquiring company revenues comes from pre-payment, higher interest rates could impact company's ability to pass on the increases, potentially reducing its profitability.	Interest rates hikes

Source: XP, Company Reports

Section 03

Stone (NYSE: STNE)



Stone (NYSE: STNE)

Initiating coverage with a neutral rating

We are initiating our coverage on STONE with a neutral rating and YE24 of US$ 19.0/share. While we recognize its potential as a long-term winner in the acquiring segment, driven by ecosystem advancement and improved execution post-organizational change, we believe the current valuation reflects the positive outlook. Some competitive advantages include: (i) a distribution network equipped with technology, including large national centers and efficient digital channels; (ii) superior customer service, reinforced by fast delivery of POS devices and responsive customer support; and (iii) a comprehensive commercial platform that expands into a wide range of financial products and integrates with software solutions. Despite this constructive view on the thesis, in our opinion, the current valuation reflects the positive outlook ahead.

Opportunities in banking and credit: In the past, the company began a strategy of granting credit. However, defaults were much higher than expected, leading the company to discontinue the offer and revise its strategy in the credit business. Recently, however, Stone restructured its credit operation with new teams and products and is beginning to reap good results in terms of portfolio growth and delinquency. Given the relationship already built with Merchants, we see the company as fit to grow this business line. Yet, it's not clear to us if the company will be able to be a relevant player in a market dominated by banks. On top of that Stone is also integrating payments and banking into a single solution, although with major results yet to be captured.

Advancing into the MEI segment: driving TPV growth. With a strong presence in the SMB segment, which is the middle of the pyramid, Stone has a clear foundation to continue growing in this market where the distribution channel is crucial for scaling the business. At the base of the pyramid, the company is structuring itself to continue growing with differentiated solutions in a market with a high degree of informality. To grow in this market, the company has adopted a new brand called Ton, adapting Stone's value proposition to the specific needs of these micro-entrepreneurs in an economically competitive way. This movement, combined with the solid execution of its acquisition strategy, has led the company to expand its take rate (+22bps YoY in 4Q23, above its peers)

Valuation: Although we see the company with some optionalities in terms of credit and software, we believe that the strong recent appreciation of the shares has left the valuation unattractive. Trading at 11.3x P/E 24 (vs Pags 8.3x), we believe that this valuation is only justified if the company greatly accelerates its growth beyond its core payments. Yes, we believe in the potential for growth in credits and software optionalities, but we think the guidance the company gave for 2027 is very aggressive and we prefer to be conservative

Stone (STNE)	Neutral
Target Price (US$/sh.)	19.00
Current Price (US$/sh.)	16.24
Upside (%)	*17%*
Market Cap (US$ bln)	5.02
# of shares (mln)	314
Free Float (%)	77.8%
ADTV (US$ mln)	82

Figure 41: Performance vs IBOV

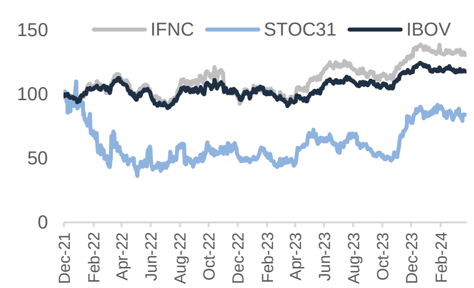


Figure 40: XP Estimates (R$ mln)

Estimates (R$ mln)	2023A	2024E	2025E	2026E	2027E	2028E	2029E
Net revenue from transaction activities and other services	3,310	3,576	4,097	4,565	5,024	5,477	5,928
Net revenue from subscription services and equipment rental	1,825	1,803	1,782	1,761	1,740	1,719	1,699
Financial income	**6,229**	**7,295**	**8,356**	**9,311**	**10,247**	**11,171**	**12,092**
Total revenue and income	**15,365**	**13,159**	**15,135**	**17,096**	**19,182**	**21,213**	**22,979**
Cost of services	-2,983	-3,251	-3,740	-4,224	-4,740	-5,241	-5,678
Adjusted Profit (loss) before income taxes	1,954	2,663	3,684	4,691	5,761	6,796	7,655
Adjusted Net Income (loss) for the period	**1,558**	**2,124**	**2,938**	**3,741**	**4,594**	**5,419**	**6,103**
P/E (x)	17.7x	11.3x	8.5x	7.1x	5.8x	4.9x	4.3x

Source: XP, company reports and LSEG Refinitiv.

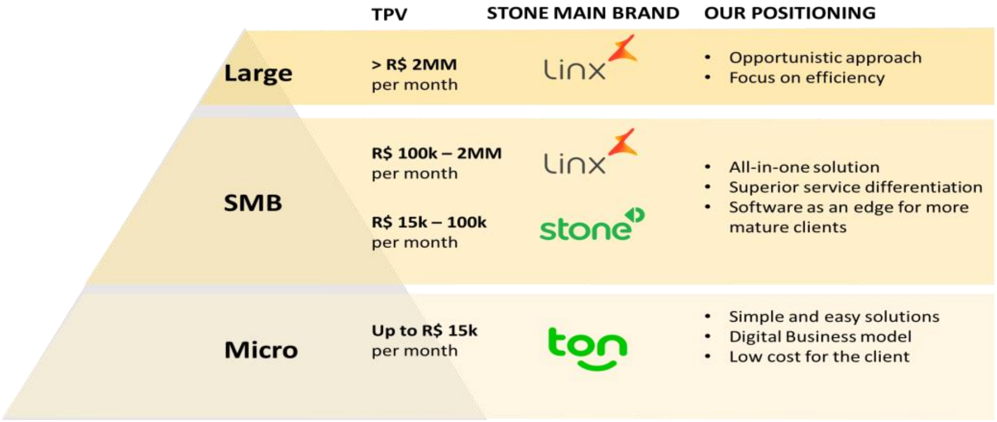
Summary

Stone at a glance

Company Overview: more than a merchant acquirer

Stone integrates financial services and software solutions, with financial services accounting for 55% of their total revenue in 2023. These services include payment offerings, digital banking, and credit solutions, all aimed at enhancing the MSMBs environment. In 2022, the Payments segment achieved an average TPV of R$ 10.9 thousand per merchant and a total TPV of R$ 395 billion in 3Q23 LTM. Software services constitute 15% of the total revenue, encompassing POS and ERP solutions for various retail and vertical services, CRM, engagement tools, e-commerce, and OMS solutions, primarily targeting both Large and SMBs. As of the end of 3Q23, the company reported a client base of 3.3 million in payment services.

Figure 42: Stone Business Structure



Source: XP, Company Reports

Delving into each segment, financial services stand as the cornerstone of Stone's operations. The company aspires to establish itself as the premier and most comprehensive ecosystem for Brazilian Merchants, catering to both MSMBs and Key accounts (platform services and subacquirers). The primary financial services include: (i) Payment Solutions: Simplified payment collection through electronic and alternative methods, ensuring swift and user-friendly transactions in both physical and digital environments; (ii) Prepayment Solutions: Financing options to assist clients in managing working capital needs and plans, featuring discounted settlements for enhanced transparency and control over receivables; (iii) Digital Banking Solutions: Cost-effective integration of digital bank accounts with POS systems, facilitating seamless payments, boleto issuance, tax payments, Pix transfers, and access to insurance solutions. This solution targets a Serviceable Available Market (SAM) of R$ 31 billion; (iv) Credit Solutions: Utilizing client data for credit options, supporting business growth beyond working capital, with a SAM for the company estimated at around R$ 60 billion.

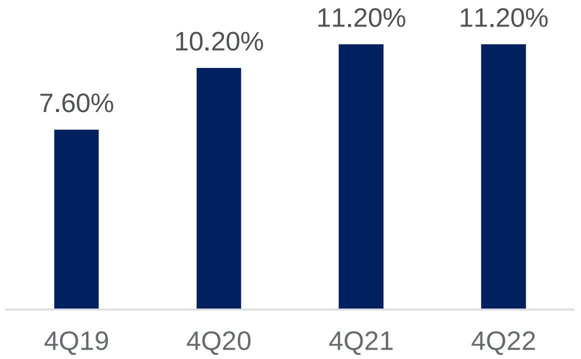
Complementing the financial services with an SAM of R$ 11 billion, the Software solutions are categorized into two subsections: (i) Core: Encompassing POS/ERP solutions, QR Code gateways, reconciliation, and CRM; and (ii) Digital: Including OMS, e-commerce platform, engagement tools, Ads solutions, and the Marketplace Hub. Stone expanded its portfolio through the acquisition of Linx, integrating its solutions since 2022.

The software collection model features low or no setup fees, charges for professional consulting services, monthly subscription fees, variable fees based on gross merchandise volume (GMV) for the company's digital solutions. This value proposition aims to reduce client churn and address the costs associated with switching vendors.

The strategic approach focuses on continuous improvement of software solutions and the integration of financial services into the software verticals. Stone has experienced significant growth in market share, increasing from 7.6% in 2019 to 11.2% in 2022, and maintaining stability throughout 2023. The company has established a strong presence in the MSMB segment, capturing 9.2% of the total market share as of December 2022.

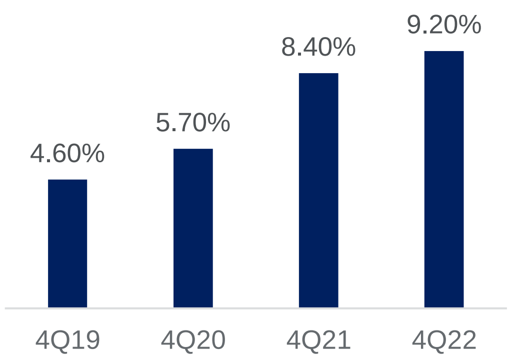
While pursuing growth in digital banking and credit, Stone currently holds a market share of less than 1% in these areas. In the software domain, Stone has achieved a substantial SAM penetration rate of approximately 13% in Brazil.

Figure 43: Stone's Market Share (%)



Source: XP, Company Reports

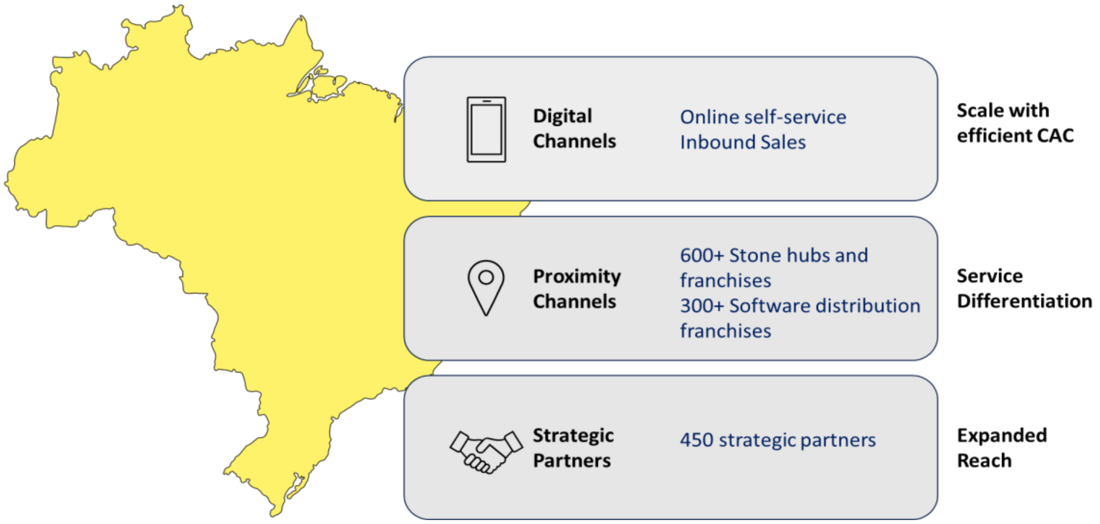
Figure 44: Stone's MSMB Market Share



Source: XP, Company Reports

By actively engaging with clients, Stone aims to gain a deep understanding of their business needs, fostering stronger relationships and creating customized solutions. The Stone Hub, the company's flagship solution, combined with its proprietary technology, distribution channels, and customer service capabilities, enables direct control over the development, implementation, and support of financial and software services. This level of control ensures a high-quality client experience, with a focus on delivering exceptional solutions and service.

Figure 45: Stone Strategy



Source: XP, Company Reports

The company's services ecosystem is reinforced by lower acquisition and operational costs compared to peers, owing to its creation within a fully-digital framework and the use of an in-house platform that minimizes reliance on third-party services.

Stone extends its offerings with additional solutions, including Delivery Much (a food delivery marketplace), Cappta (an offline gateway solution), Creditinfo (a credit bureau), and PinPag (providing financial solutions for electronic payment methods).

The integrated ecosystem of Stone, merging financial services and software, along with customer assistance, stands out as the company's primary differentiator compared to peers. This approach enables the provision of one-stop-shop solutions to clients through self-designed platforms, reducing costs and fostering a closer relationship with customers, consequently lowering churn. The cross-solution strategy opens significant opportunities for growth and monetization, with all payment solutions and Pix already integrated into software verticals, and banking solutions linked to 13 of these verticals.

Main Growth Strategies

Stone has four main pillars to keep the growth of the company:

1 - Keep the development of client reach and scale gain:

- To expand financial services distribution, Stone focuses on enhancing its extensive network of operational Hubs and franchises across Brazil, with over 5,500 city presence. This strategy, complemented by low-cost Hub construction and hiring, facilitates easy penetration, particularly in cities underserved by incumbent banks.
- Additional expansion solutions include an inbound sales team prospecting new clients and the innovative "renda-extra channel," encouraging individuals to refer Stone's TON solution to local merchants and earn commissions for each offered POS system. The company anticipates creating a network effect within cities, fostering word-of-mouth recommendations.
- Entering micro-merchant commerce in 2019 and launching TON in 2020, Stone's competitive pricing has enabled significant scale in this segment.
- For Software Services distribution, Stone employs specialized business managers focused on prospecting new customers and managing existing relationships, particularly in the retail industry. Utilizing a unified CRM software program enables cross-selling and provides sales result visibility. The indirect sales channels involve approximately 600 specialized franchisees acting as distributors in regions without Stone's sales offices. Additionally, an inbound sales channel handles customer inquiries generated through digital marketing efforts.

Stone: Main Growth Strategies

2 – Expansion of Services Offers

New Financial Solutions:

- **Digital Banking Solutions:** Stone's banking solution facilitates various financial transactions, fund transfers, boleto issuance, bill payments, insurance acquisition, Pix operations, and seamless integration of financial data. As of December 2022, Stone boasted approximately 692,800 active digital banking accounts. Additionally, the company has initiated the issuance of prepaid cards and is currently testing its debit card offering.
- **Credit Solutions:** Integrating credit solutions within its payment platform, Stone enables clients to access, monitor, and repay loans seamlessly. Following challenges in 2021, Stone temporarily paused disbursements to enhance its credit product. The relaunch in the second half of 2023 focuses on SMBs.
- **E-commerce Solutions:** Stone's developed solutions and omni-channel commerce capabilities provide significant cross-selling opportunities to its client base.

New Software Solutions: Stone continues organic growth of its software solutions alongside its expanding client base, emphasizing the importance of these solutions to clients' businesses. This approach facilitates cross-selling opportunities with financial services, creating a symbiotic relationship. The data generated from these operations helps Stone identify additional solutions, such as working capital and credit, to further increase revenue. The company not only expands organically but also explores inorganic growth by considering partnerships with other software businesses.

3 – New Markets

- Leveraging the Hub strategy, Stone concentrates on expanding its geographic footprint within Brazil and selectively venturing into new international markets, leveraging its successful business model. Exploring opportunities in adjacent sectors such as digital banking, software solutions, and credit, Stone aims to provide a distinctive value proposition for clients. This strategic approach enables the company to grow its distribution, capture new business opportunities, and remain aligned with its core capabilities.

4 – Acquisitions

- While emphasizing organic growth, Stone also adopts an inorganic strategy through acquisitions to expand its solutions and enter new markets and geographies. The company seeks small software companies to integrate into its ecosystem, with many of these acquisitions falling under the Linx structure. Since 2020, Stone has invested in 20 companies, reinforcing and complementing its business ecosystem.

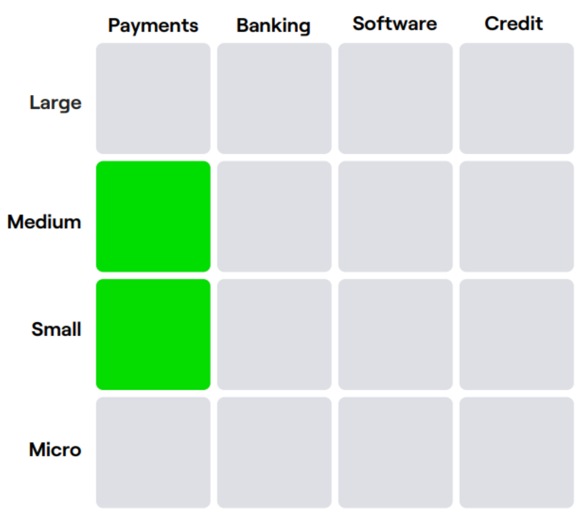
Stone: 2023 as a pivotal year for the company

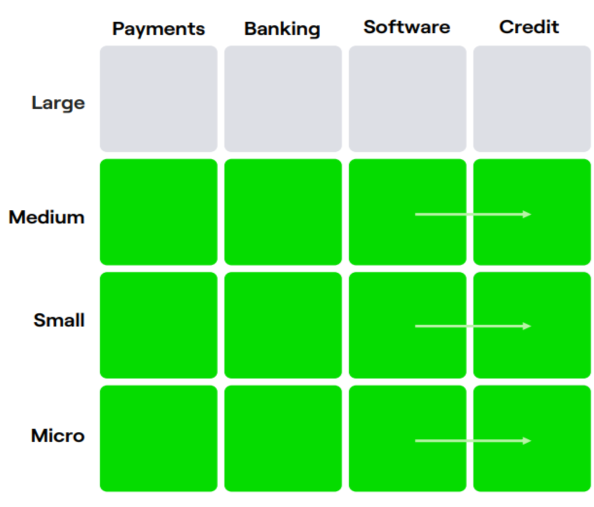
1 – Pedro Zinner taking office

- Mr. Zinner joined Stone’s Board of Directors two years ago. By the time he was serving as CEO of Eneva, a Power generating company in Brazil. After one year as a Board Member, the executive left Eneva and was elected to replace Mr. Thiago Piau as CEO of Stone.
- In 4Q23 earnings release the CEO highlighted the high-quality team, and unique client-centric culture. Among the points that need to evolve, he pointed out that the operational efficiency needs improvement as well as the ambition to chase multiple initiatives diluted efforts and potentially its impact. In response to these insights, he listed the several strategic adjustments to be made, such as: i) Organizational Structure Redesign; ii) Sharpen Strategic Focus; and iii) Cost Management and Spending Controls. As a result, we see the new management on the right path to improve the company results even further.

2 – Identification of opportunities and guidance

- During the Investor day held in November 2023, The Management presented, among other things, its “Business model evolution and strategic priorities”. Alongside with the guidance for the coming years, this part of the presentation helps to understand the evolutionary process of Stone's product offerings.
- According to the company’s presentation during the Investor Day, Stone was initially launched to provide payment solutions for SMBs. They later expanded into the Micro segment, still focusing on payment. As a third step, Stone introduced its banking services. After the acquisition of Linx in 2020, the company began offering software solutions to MSMBs. Finally, Stone expanded its offerings to include credit solutions. The following images depict the initial (left) and current (right) offerings of the





3 – Founder André Street leaving the stage

- In parallel with the release of its results for 2023, the company announced that the founder, André Street, and two other board members will not seek re-election at the next Annual General Meeting. In our view, the company had already been preparing for Mr. Street's eventual departure. As a result, although the market may be concerned about possible overhang if he decides to dispose of his shares (7% of the total and 37% of the shares with voting rights), we believe that the company is now mature enough not to depend exclusively on its founder. The company also said that it is working on a non-compete agreement.

Stone: Snapshot and Main Numbers

XP Estimates

Figure 47: XP Estimates (R$ mln)

	2023A	2024E	2025E	2026E	2027E
Consolidated Income Statement (R$ mln)					
Net revenue from transaction activities and other services	3,310	3,576	4,097	4,565	5,024
Net revenue from subscription services and equipment rental	1,825	1,803	1,782	1,761	1,740
Net Revenue	**8,445**	**5,380**	**5,879**	**6,325**	**6,764**
Total revenue and income	**15,365**	**13,159**	**15,135**	**17,096**	**19,182**
Cost of services	-2,983	-3,251	-3,740	-4,224	-4,740
Administrative expenses	-1,052	-1,136	-1,179	-1,226	-1,276
Selling expenses	-1,698	-1,839	-2,115	-2,389	-2,681
Financial income	6,229	7,295	8,356	9,311	10,247
Other financial income	691	485	900	1,460	2,171
Financial expenses, net	-3,954	-3,843	-3,972	-4,106	-4,243
Adjusted Profit (loss) before income taxes	**1,954**	**2,663**	**3,684**	**4,691**	**5,761**
Income tax and social contribution	-397	-538	-746	-950	-1,168
Tax Rate	20%	20%	20%	20%	20%
Adjusted Net Income (loss) for the period	**1,558**	**2,124**	**2,938**	**3,741**	**4,594**
Consolidated Balance Sheet (R$ mln)					
Current assets	**37,153**	**42,596**	**49,131**	**57,402**	**67,260**
Cash and cash equivalents	2,176	3,811	7,383	11,285	16,358
Financial assets from banking solution	6,398	6,398	6,398	6,398	6,398
Accounts receivable from card issuers	23,896	27,302	29,634	33,020	36,083
Non-current assets	**11,541**	**11,888**	**12,286**	**12,737**	**13,242**
Loans operations portfolio	210	546	1,133	2,051	3,714
Property and equipment	1,662	2,009	2,407	2,858	3,363
Total Assets	48,694	54,484	61,417	70,139	80,503
Current liabilities	29,143	32,924	37,074	42,251	48,258
Deposits from banking customers	6,120	7,022	8,536	10,776	14,125
Loans and financing	1,375	1,375	1,375	1,375	1,375
Obligations to FIDC quota holders	505	505	505	505	505
Non-current liabilities	4,875	4,875	4,875	4,875	4,875
Loans and financing	1,375	1,375	1,375	1,375	1,375
Obligations to FIDC quota holders	505	505	505	505	505
Total liabilities	34,018	37,799	41,949	47,126	53,133
Total equity	14,676	16,685	19,469	23,013	27,370
Total liabilities and equity	**48,694**	**54,484**	**61,417**	**70,139**	**80,503**
Valuation					
Market Cap (R$ mln)	27,520	23,986	25,007	26,538	26,538
P/E	17.7	11.3	8.5	7.1	5.8
EPS	5.0	6.8	9.3	11.9	14.6
ROE (%)	8.9%	13.1%	14.4%	16.3%	17.6%

Source: XP, Company Reports

Stone: Best in Class as an Acquire Provider

Stone boasts one of the acquiring market's best customer support systems, providing a significant advantage over its main competitors. The company prioritizes high-quality customer service, employing support teams and technology tools to enhance customer satisfaction and foster strong, long-term relationships.

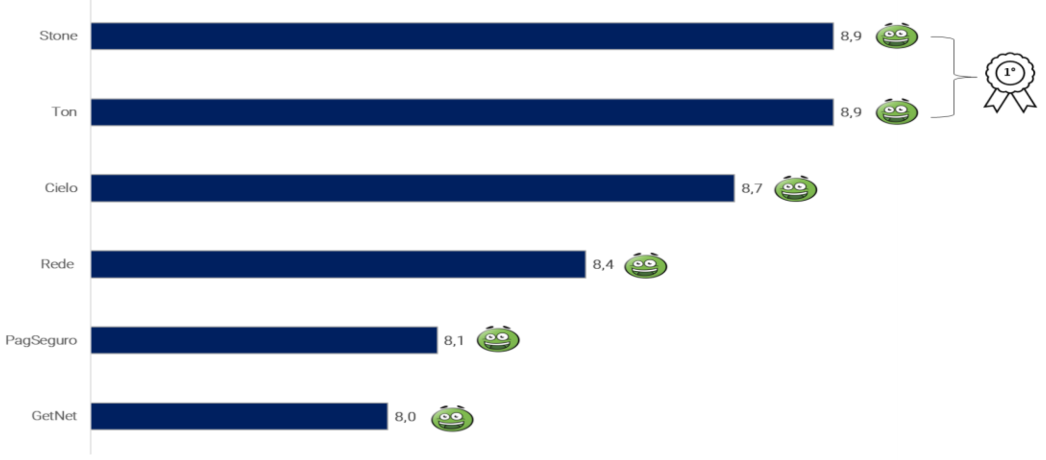
The company's differentiation lies in its client onboarding structure, which includes dedicated teams for both financial and software platform clients:

1. Client Relationship Team: This centralized in-house team is equipped with extensive training and technology tools to promptly address client issues. They achieve impressive response times of 10 seconds for calls and 40 seconds in written channels. As of December 2022, 90% of clients rate the service as excellent;
2. Client Retention Team: This team is notified when a client considers canceling services and reaches out to them within one business day. They study the client's profile and engage in conversations to understand the reasons for potential cancellation. Using data analytics, the team proactively identifies strategies to retain clients;
3. Green Angels: Local teams, known as Green Angels, provide on-the-ground support in Stone Hubs across each city where the company operates. They respond promptly to client service activation and use motorcycles to swiftly attend to and resolve client issues. This approach sets Stone apart from competitors by offering faster solutions, addressing problems within hours. The Green Angels assist with terminal delivery, installation, Wi-Fi setup, part replacements, and more.

These teams are complemented by CRM Technology, including Celebro and The Professor, offering a comprehensive dashboard with client data, integrated with a predictive model for client behavior. Stone also features a 24/7 Chatbot Team and an exclusive Linx Support team.

Stone's commitment to customer care earned them the leadership position on ReclameAqui in 2022, scoring 8.9 points, maintaining this position in 2023 with 8.8 points – surpassing the sector average.

Figure 48: ReclameAqui Stone and peers Rating



Source: XP, ReclameAqui

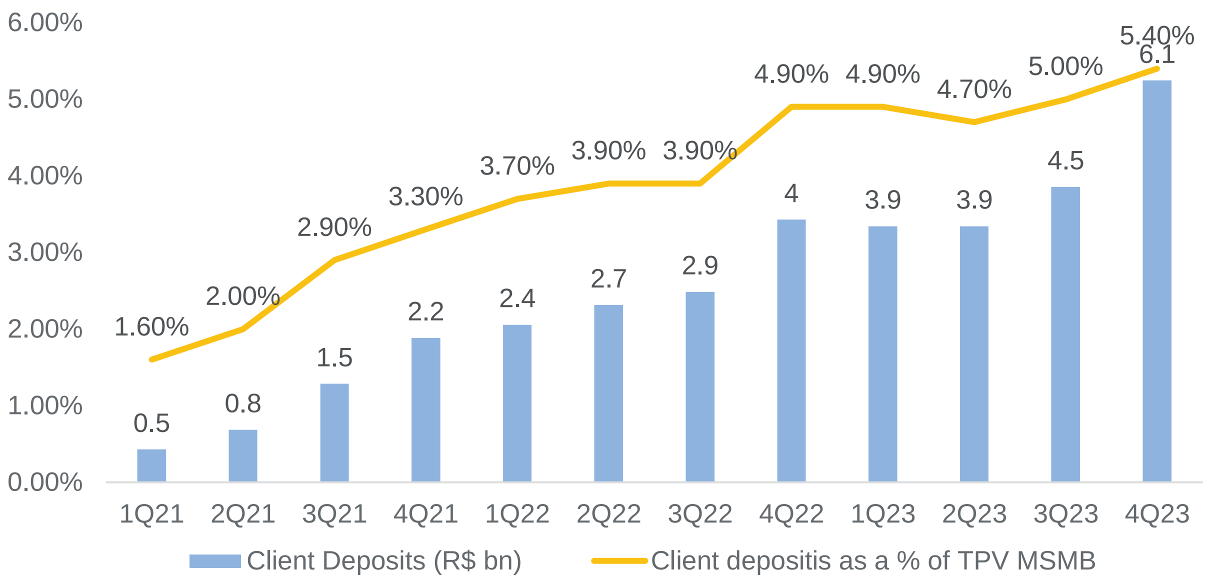
Stone: the differential of the ecosystem is credit

Making progress on credit origination

In 2019 Stone expanded its business into Banking, building a proprietary banking platform from scratch; integrated payments and banking solution with bundled pricing capability; Scaled with minimal incremental CAC; Converting payment volumes into deposits.

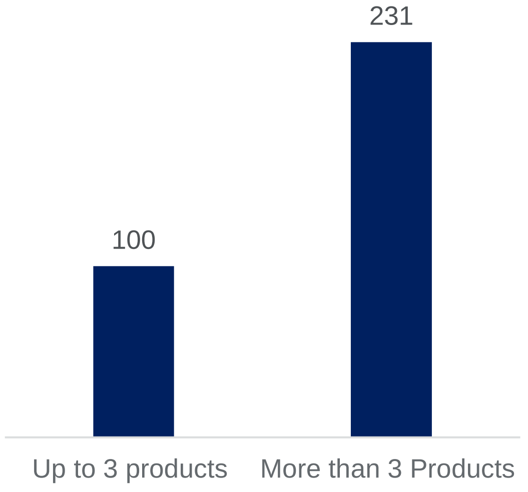
As a result, the company was able to monetization beyond payments, with deposit growth as a result of TPV money in and have been increasing banking penetration client base. The main goal is to lock in the client for them to use the Banking services of Stone.

Figure 49: Total client Deposits – R$ bln (and as a % of TPV MSMB)



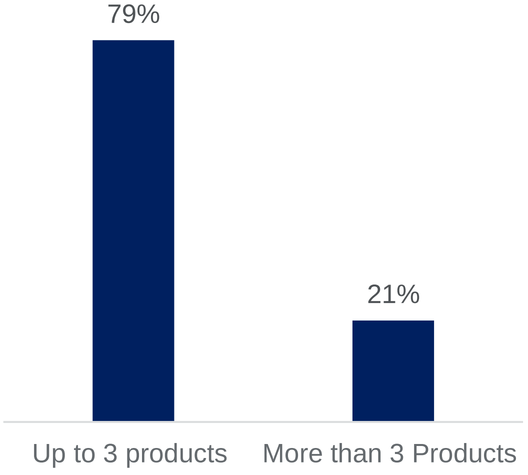
Source: XP, Company Reports

Figure 50: Net ARPAC by number of products used (R$)



Source: XP, Company Reports

Figure 51: Share of clients by number of products used

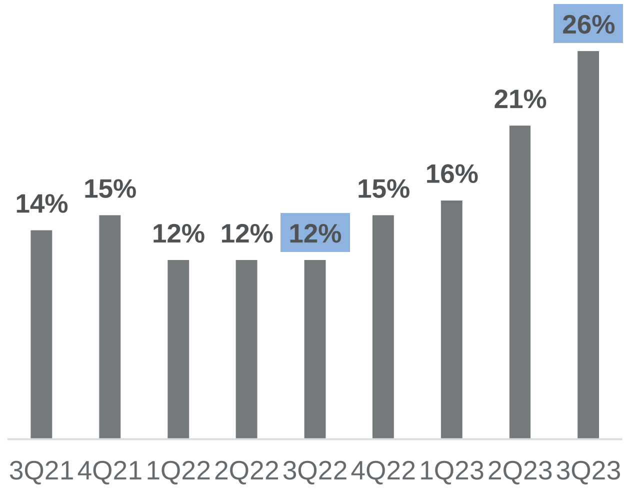


Source: XP, Company Reports

Stone: the differential of the ecosystem is credit

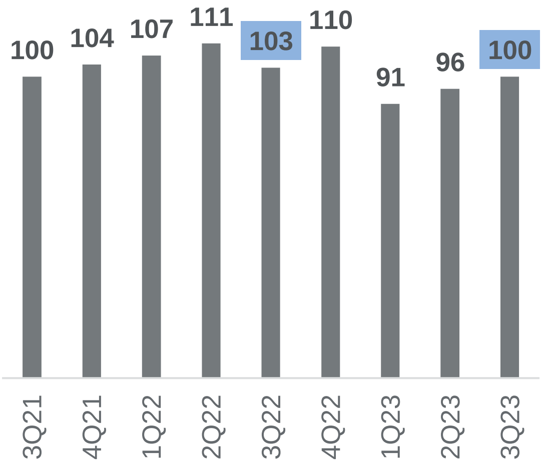
Making progress on credit origination

Figure 52: % of clients with more than 3 products by sales cohort



Source: XP, Company Reports

Figure 53: Client Acquisition Costs (CAC)



Source: XP, Company Reports

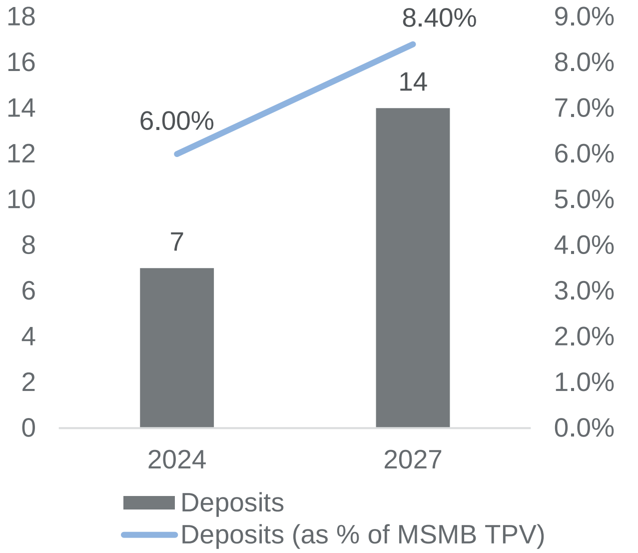
Stone have rebuilt their credit solution, with an integrated experience and innovative repayment schedule. To help merchants keep up with repayments, Stone introduced monthly installments (12 to 18 months) and a new way to pay as they sell daily “pay as you sell” and daily amortization to reduce risk.

In Stone 2023 Investory Day, management highlighted that for 2024, the credit division will (i) scale up Working Capital facility for SMBs; (ii) launch an overdraft facility; (iii) build up their product-market fit in Micro to better understand the credit dynamics of this specific segment

Stone: the differential of the ecosystem is credit

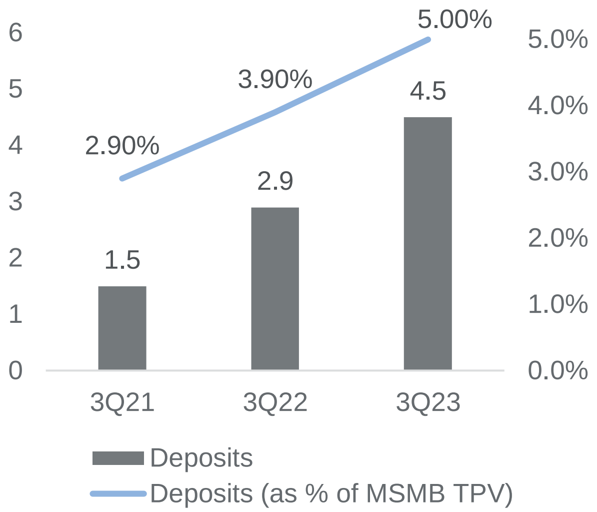
Making progress on credit origination

Figure 54: Depositis (R$ bln) and % of MSMB TPV



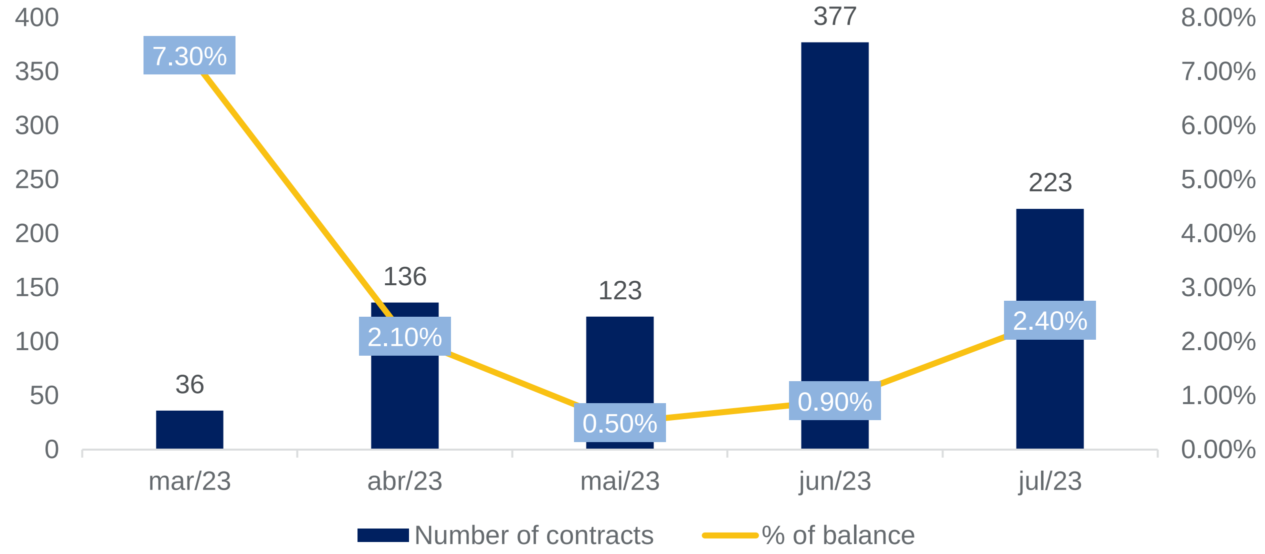
Source: XP, Company Reports

Figure 55: Depositis (R$ bln) and % of MSMB TPV



Source: XP, Company Reports

Figure 56: Non-performing loans by vintage over 30 days in the third month

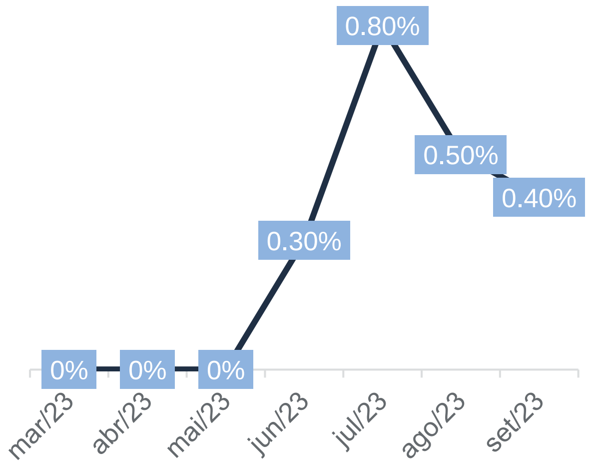


Source: XP, Company Reports

Stone: the differential of the ecosystem is credit

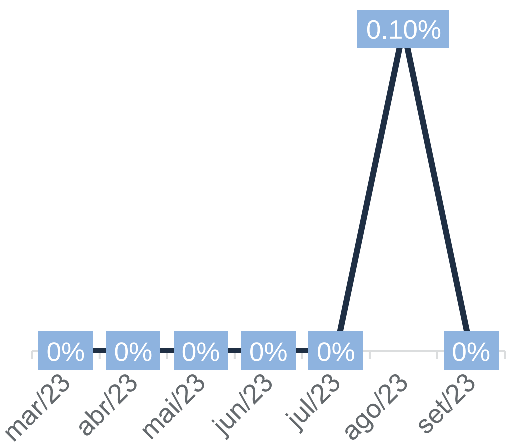
Making progress on credit origination

Figure 57: NPL 15-90 (%)



Source: XP, Company Reports

Figure 58: NPL Over 90 (%)



Source: XP, Company Reports

In December 2023, Stone unveiled a $467.5 million credit facility from the United States International Development Finance Corporation (DFC) to bolster the working capital of micro, small, and medium-sized businesses (MSMBs). This facility, featuring a seven-year final maturity and a six-month availability period, involves acquiring accounts receivable from over twenty Brazilian financial institutions, predominantly credit card issuers, on a non-recourse basis. It aimed to enhance Stone's capacity to offer receivables prepayment solutions to MSMBs, enabling them to optimize cash flow, enhance financial flexibility, and refine management practices.

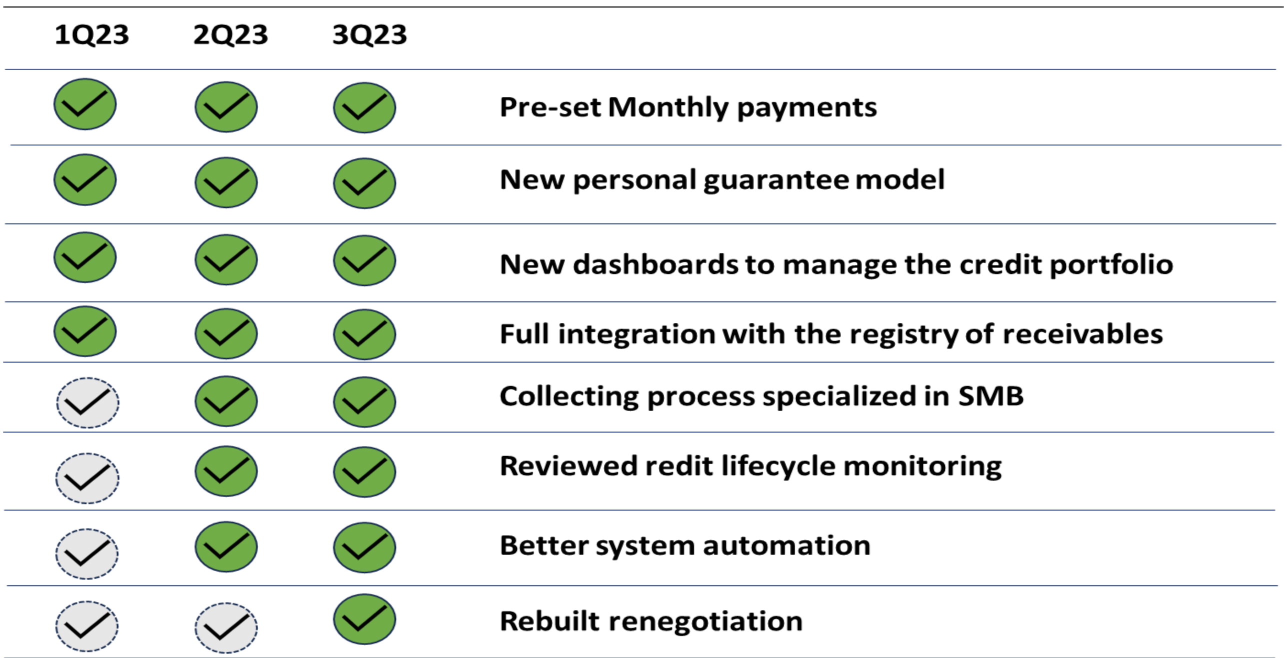
Stone launched its credit offer in 3Q19. As the company itself described, risk management was suboptimal, causing defaults to severely hurt its results. As a result, the company stopped the credit offer in mid-2021. In the past, defaults were very high. Now, in this new attempt by the company, we see defaults showing some signs of deterioration. However, so far, our view is that the increase is natural and linked to the growth of the loan portfolio. We believe that the current credit offer is better structured and corrects some of the mistakes made in the past. All this said, in the absence of guidance on the level of NPLs, we assume that the current rate should reach a level similar to Nubank's(~6%). We chose to use Nu as a benchmark, since both portfolios are mostly unsecured.

Differential of the ecosystem is credit

Stone goal in financial services is to offer a complete financial operating system for Brazilian merchants, from where they can manage their financial lives in an integrated way. This segment encompasses the company's financial services offering for both MSMBs (micro-merchants and SMBs) and key accounts (comprised of platform services and subacquirers). The solutions include payments, digital banking and credit:

- **Payment Solutions:** Streamlining payment collection, Stone accept various electronic payments and alternative methods, such as payments slips (boletos) and Pix transactions. Services cover a transactions in both physical and digital storefronts. Additionally, they offer digital enhancements like split-payment processing, multi-payment processing, recurring payments for subscriptions, and one-click buy functionality to enhance merchants' consumer experiences.
- **Prepayment Solutions:** Assisting clients in managing working capital needs and future planning, Stone provide prepayment financing options. This involves settling card transactions with clients at a discount before the original due date. This working capital solution offers transparency and control over receivables, enabling better cash flow management to support business growth.
- **Digital Banking Solutions:** Offering clients a digital bank account integrated with POS, Stone facilitate payments, issue payment slips (boletos), pay taxes, and make Pix transfers in a cost-effective and user-friendly manner. Additionally, they act as a broker for store, life (regular or whole life), and health insurance solutions.
- **Credit Solutions:** Providing clients with credit for additional funding beyond working capital solutions, Stone leverage client data proactively and cost-effectively. Clients can access credit through various channels in a simple and transparent manner. The credit offering facilitates loan repayment through automatic retention of a percentage of credit card receivables for monthly fixed installments. Although the company temporarily suspended new credit solution offerings starting in July 2021 due to credit design errors, the company has evolved and redefined its process to build a fully automated credit subscription system. With new policies and a redefined credit model, the company has accelerated in the credit front throughout 2023 with greater accuracy.

Figure 59: Main stone product improvements



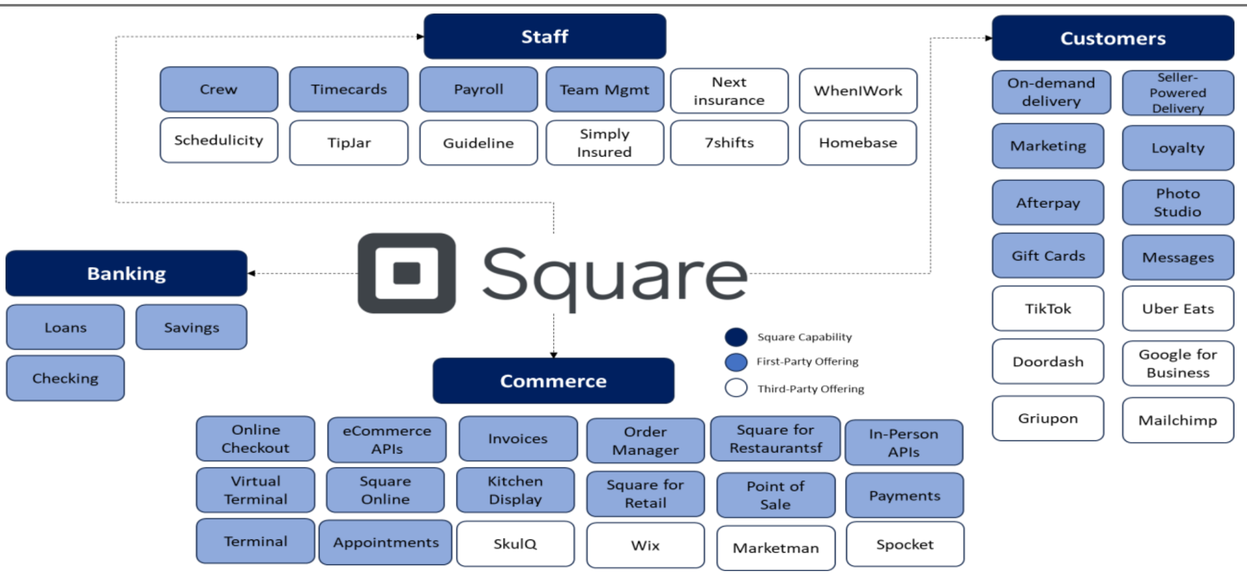
Source: XP, Company Reports

Stone vs. Square

It's honorable to mention Square as an important peer of Stone. Both companies focus on the same type of costumers, offering a complex ecosystem of payments and software solutions as platforms, constantly adding new products over time. A brief introduction of Square History. The company was founded in 2009 and started their business more familiar with PagSeguro focusing on Microbusiness with a card reader for mobile devices, being the pioneer of the segment. In 2015 , Square did their IPO and changed their focus to formal retailers with physical stores. The company entered in software solutions for all corners of retail businesses in 2016. In 2017, they launched an all-in-one payment device (POS Terminal).

Square made relevant acquisitions as Weebly, powering e-commerce platforms offering for their clients and the acquisition of Afterpay, improving the payments methods accept of their clients. In 2021, Square entered in banking Solutions offering products to manage cash flow, saving and capital. And in 2022, they released their Tap to Pay on IPhone, letting sellers accept card payments with no additional hardware needed. Square currently has operations in Europe, US, Canada, Australia and Japan, being US their main source of revenue.

Figure 60: Square Ecosystem



Source: XP, Company Reports

Stone has a stronger similarity with Square than their Brazilian peers. Their main common characteristics are: They both leverage technology to simplify and streamline the payment process for SMBs. Both companies offers additional services beyond payment processing, providing software solutions, and banking solutions. Furthermore, they value the relationship with their clients by prioritizing the customer support and service. Both companies strive to provide excellent customer experiences by offering dedicated support teams and resources to assist businesses with any issues or inquiries they may have.

Their main differential are Square has more than only POS terminal, they offer a long chain of hardware solution, as a register machine, a Stand and portatif and mobile terminals. In the solutions, Square has a hole ecosystem of costumer relationship. The company also has an integration with many software solutions and Stone is focused on Linx, and finally, Square works with large corporate companies, differently from stone.

Stone vs. Square

We see a clear similarity from both business. Square doesn't operate in Brazil and it's not a direct competitor of Stone. If stone keep improving and expanding their solutions, the company can get closer from Square ecosystem, getting even closer to their goal to be a one-stop-shop and improve their market share in Brazil.

Finally, Looking to the financial and operational numbers, Square finished the year of 2022 with a revenue of R$ 35.5 billion with a TPV of R$ 982.3 billion (considering FX of 5,27 EoP 2022) vs. R$ 9.6 billion of Stone, with a TPV of R$ 367,4 billion.

Stone: Linx – Trying to fit?

Strategic acquisition

In mid-2020, Stone made a significant move by acquiring Linx, the largest Brazilian retail software development company, for R$6 billion (US$1.1 billion), closing the deal in mid-2021. This strategic acquisition, representing a 30% premium over Linx's market value at the time, aimed to bring together Linx's expertise in software development, particularly its recent foray into payments with Linx Pay, and Stone's role as an acquirer venturing into providing additional solutions for its retail clients, including management software.

While the realization of synergies has been somewhat slower than initially expected, notable changes, such as the closure of Linx Pay and the identification of back-office synergies, have been implemented.

Looking ahead, Stone envisions expanding its client base through strategic acquisitions, with a specific emphasis on gaining market share among software clients. The company aims to integrate products, fusing software capabilities with financial services to offer a comprehensive package and extend its reach into both client bases. Notably, the current Linx solution caters more to larger clients compared to Stone's typical clientele.

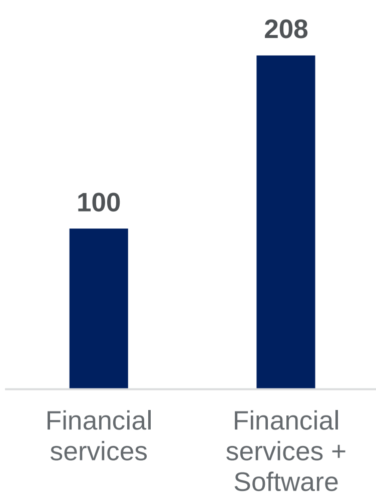
As part of its future strategy, **Stone plans to ascend into higher-value markets within SMB, leveraging the Linx acquisition to strengthen its presence in verticals such as retail, gas stations, food, and pharma.** This strategic move is anticipated to improve growth rates in medium-sized clients, unlock value through the creation of bundled services, and enhance unit economics, especially in priority verticals. Stone asserts that clients benefit from improved unit economics and engagement when utilizing integrated software and financial services.

Following the acquisition, Stone has positioned itself as the leading retail management software company in Brazil, securing approximately 13% penetration of the software SAM, translating to R$11 billion in revenue, according to the 2020 IDC Survey.

Figure 61: Net ARPAC

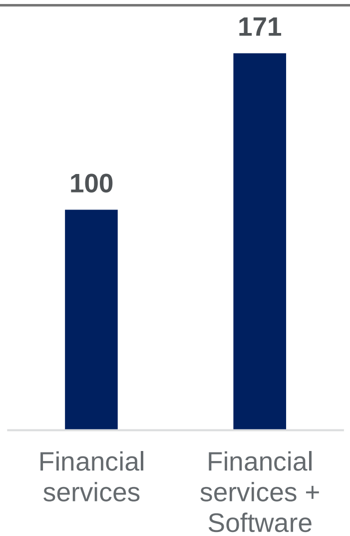
Source: XP, Company Reports

Figure 62: Avg Money in per client



Source: XP, Company Reports

Figure 63: Number of money out transactions



Source: XP, Company Reports

Stone: Valuation

17% Upside

Valuation. Our 2024YE DCF-based target price of USD 19.0 per share presents an upside of 17% vs. current prices, with roughly 32% of it valued at its perpetuity. We use a DCF Model valuation approach, where our main assumptions include: (i) 5.2% long-term growth rate, (ii) 4.1% risk-free rate and (iii) and beta at 1.4, implying a cost of equity (Ke) of 16.6%.

Figure 64: Main DCF Assumptions (R$ mln)

DCF (R$ Million)	2024E	2025E	2026E	2027E	2028E	2029E	2030E	2031E	2032E	2033E	2034E
Net Income	**2.124**	**2.938**	**3.741**	**4.594**	**5.419**	**6.103**	**6.887**	**7.534**	**8.079**	**8.631**	**9.192**
(+) D&A	809	930	1.051	1.179	1.304	1.413	1.534	1.639	1.732	1.827	1.924
(+/-) Working Capital Change	**-27**	**1.186**	**808**	**1.221**	**-2.175**	**-2.449**	**-2.123**	**-2.220**	**-2.649**	**-3.168**	**-3.798**
(-) Capex	-1.156	-1.329	-1.501	-1.685	-1.863	-2.018	-2.191	-2.342	-2.475	-2.611	-2.749
(+) net debt additions	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Free cash flow to equity	**1.751**	**3.726**	**4.099**	**5.310**	**2.685**	**3.049**	**4.106**	**4.611**	**4.688**	**4.679**	**4.570**
PV FCFE	**1.751**	**3.195**	**3.015**	**3.350**	**1.453**	**1.415**	**1.635**	**1.574**	**1.373**	**1.175**	**984**

Figure 65: CAPM Model

Ke Calculation	
Risk Free Rate	**4,1%**
Country Risk	2,1%
Equity Risk Premium	**6,1%**
Levered Beta	1,38
Inflation Differential	**2,0%**
Cost of Equity	**16,6%**

Figure 66: Historical Forward EV/EBITDA Multiple

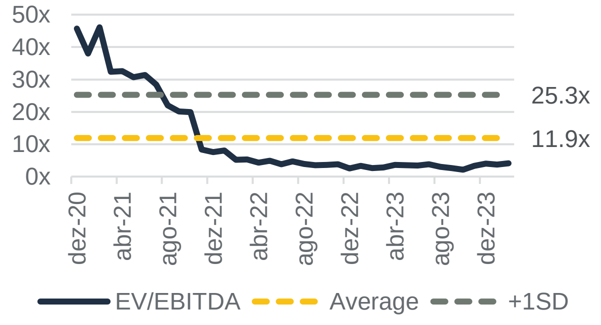


Figure 67: Historical Forward P/E Multiple

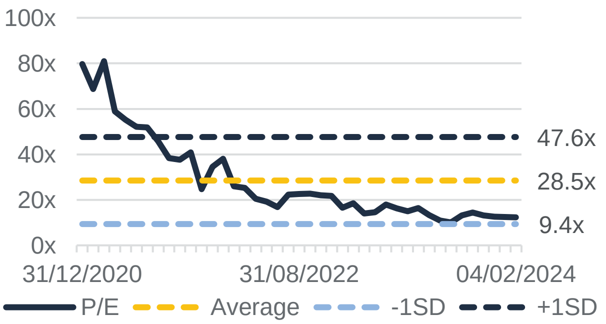
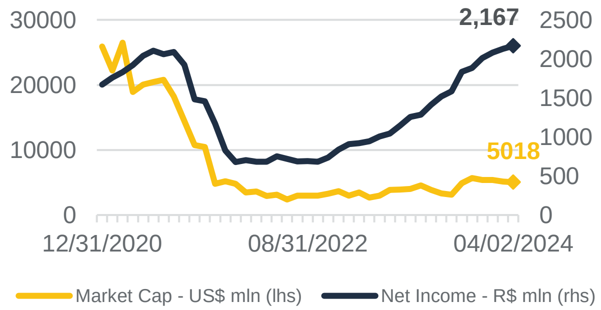


Figure 68: Multiple composition



Stone: Valuation Comps

Fairly Priced

Figure 69: Valuation Comps

Company	Market Cap ($ mi)	ADTV ($ mi)	P/SALES 2024	P/SALES 2025	EV/EBITDA 2024	EV/EBITDA 2025	P/E 2024	P/E 2025
Stone	**5018**	**81.9**	**1.8x**	**1.7x**	**3.9x**	**3.8x**	**11.3x**	**8.5x**
Clover	84	0.1	1.2x	1.0x	14.4x	9.1x	28.5x	15.4x
Blocks	48,769	746.4	1.9x	1.7x	16.1x	12.1x	22.8x	17.6x
PagBank	4,519	38.3	1.2x	1.1x	4.1x	3.2x	8.3x	7.1x
Cielo	14,779	132.2	1.2x	1.2x	4.2x	4.5x	7.4x	7.2x
Average			**1.5x**	**1.3x**	**8.5x**	**6.5x**	**15.7x**	**11.2x**

Figure 70: XP's Financial Coverage

Company	Ticker	Rating	Price (R$/share) Current	Price (R$/share) Target	Upside (%)	P/E 2024E	P/E 2025E	P/B 2024E	P/B 2025E	Div. Yield 2024E	Div. Yield 2025E
Banks											
Banco do Brasil	BBAS3	Buy	56.2	73.0	30%	4.2x	4.2x	0.8x	0.8x	10.8%	10.7%
Bradesco	BBDC4	Neutral	14.2	19.0	34%	7.1x	5.7x	0.8x	0.7x	4.7%	6.6%
Santander	SANB11	Neutral	28.2	34.0	21%	7.7x	6.5x	1.1x	1.0x	3.3%	3.8%
Itaú Unibanco	ITUB4	Buy	33.5	42.0	25%	7.6x	7.2x	1.6x	1.4x	7.3%	7.8%
Payments											
Stone	STNE	Neutral	16.24	19.0	17%	11.3x	8.5x	1.4x	1.3x	0.4%	0.6%
Pagbank	PAGS	Buy	13.73	19.0	38%	8.3x	7.1x	1.3x	1.2x	0.6%	0.7%
Capital Markets											
B3	B3SA3	Neutral	11.7	16.0	36%	12.5x	10.7x	3.3x	3.3x	7.6%	8.8%
BR Partners	BRBI11	Buy	16.5	20.0	21%	10.7x	8.9x	1.9x	1.8x	0.4%	0.4%
BTG Pactual	BPAC11	Neutral	35.5	40.0	13%	13.4x	11.7x	3.0x	2.6x	2.8%	3.2%
Neobanks & Fintechs											
Inter & Co	INBR32	Buy	28.5	34.0	19%	15.2x	9.1x	1.4x	1.2x	0.0%	1.7%
Nubank	ROXO34	Neutral	10.0	7.7	-23%	27.5x	19.9x	6.7x	5.4x	0.4%	1.2%
Méliuz	CASH3	Neutral	5.2	11.2	114%	29.2x	21.1x	0.6x	0.6x	0.0%	1.2%

Source: XP, Company Reports LSEG Refinitiv.

Stone: Corporate and Ownership Structure

Figure 71: Shareholder structure

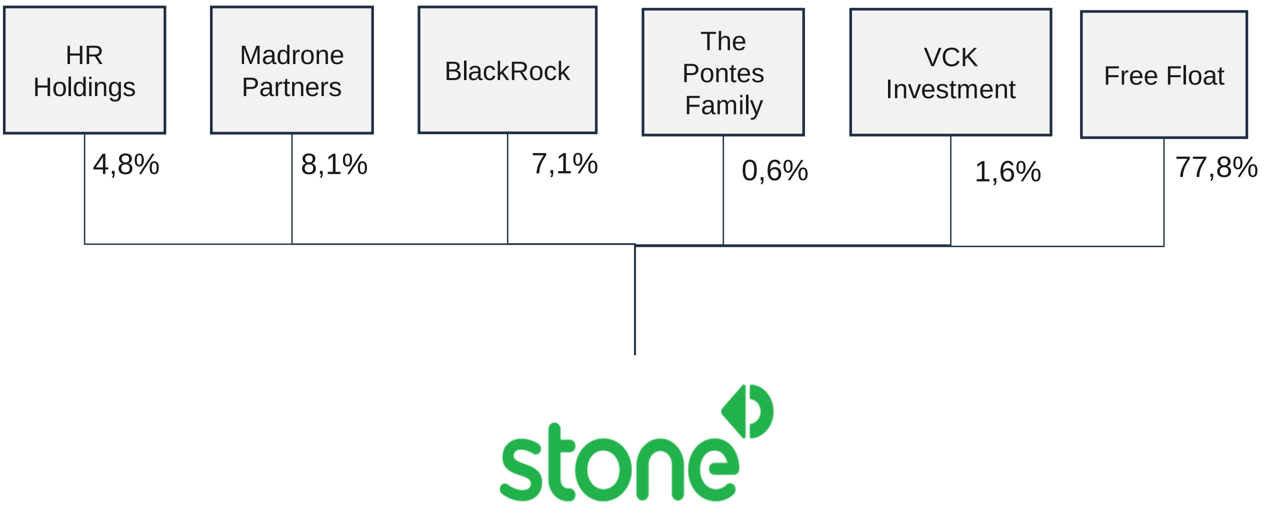
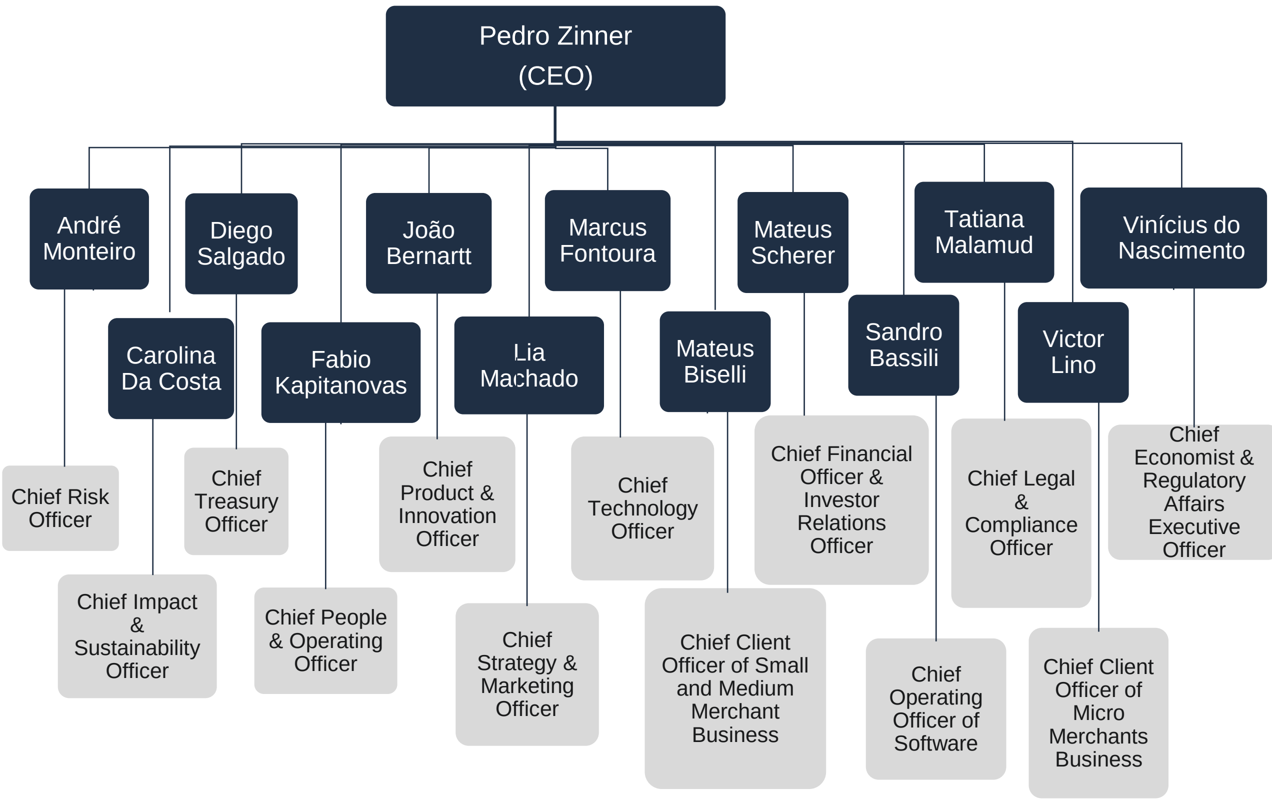
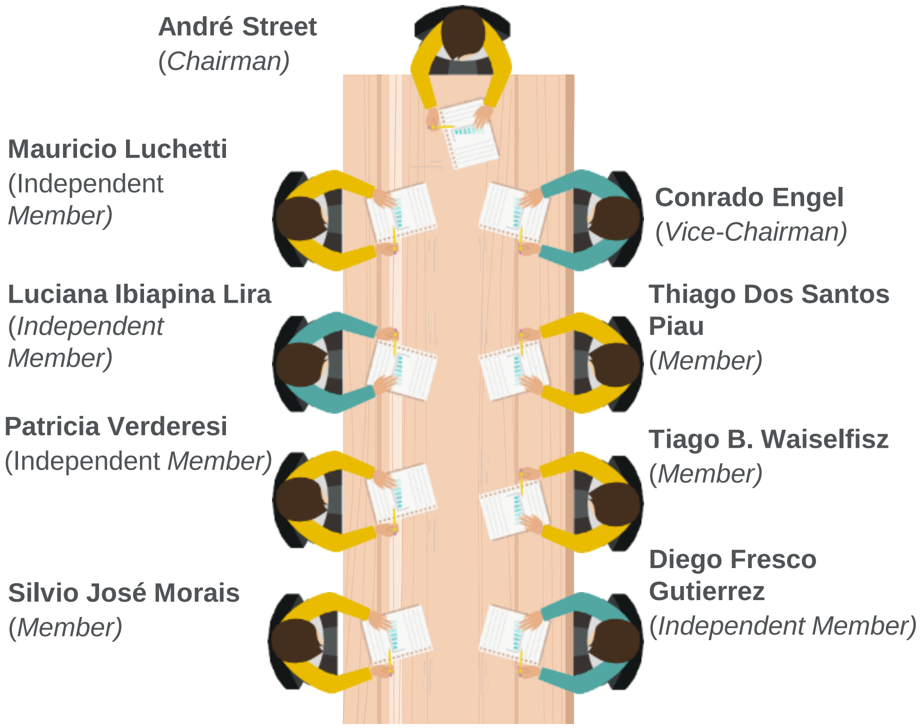


Figure 72: Executive Officers



Stone: Corporate and Ownership Structure

Figure 73: Board of Directors



Source: XP, Company Reports

Stone: History

Stone is 4th largest acquirer in Brazil, having a payment volume of R$ 367bn in 2022, and more than 2.6 million clients as of 2022. The company focus is offering financial technology and software solutions to MSMBs targeting an addressable market of 13.9 million companys. The financial services are 87% of total revenue and the rest from software services considering 3Q23. The company main competitors are Rede, Cielo, GetNet and mainly PagSeguro in payments business, and current holds around 11% of market share. On the Software services, the main competitors are TOTVS and other ERPs.

Stone was founded in 2012, after the central bank end aquirence duopolies in 2012. The company started to operate in 2013 focused in medium and small-sized companies providing payments solutions. The company had their client service internalized and in 2015, Stone created their first hub, that turned into one of their main strategies, achieving 350 hubs in 2021 and more than 500 Green angels. In 2017, Stone was the first non-bank entity to obtain authorization from the central bank to operate as a Merchant Acquirer payments institution. In 2018, the company achieved the goal of being the largest independent merchant of Brazil, and the fourth largest considering the TPV and did their IPO in United States

In 2019, Stone started to complement their payments solutions, including a diversity of financial services and also, implementing software solutions The main developments were digital banking solutions, working capital loans, POS/ERP solutions, engagement tools and CRM solutions. In 2020, Stone released in partnership with Globo Ventures their financial solution to Micro- entrepreneur, Ton. In 2021, Stone conclude the acquisition of Linx, a software company focused on retail management solutions.

On the period of 2018 – 2022, the company increased their total revenue and income at a relevant annual growth rate of 57%, and in 2022, the company got the highest score between their competitors on Reclame aqui, being with a score of 8.7 to Stone and 9.0 to “Ton” comparing with the 7.9 average score of the five main competitors.

Figure 74: Stone Timeline

Source: XP, Company Reports

Stone: Investment Highlights and Risks

Competition is the biggest risk

Investment Highlights

Software integration	With the Linx acquisition, the company has accelerated its ability to offer a superior POS/ERP integration.
Brand recognition	Although young, the company has been able to create a relevant share of mind in the acquiring industry.
“Green angels”	Stone has created a positive view of its customer service. And we see the agents, called "green angels", as key to this perception.
Well positioned for an M&A	Although the company has been able to thrive in such a competitive industry, we see acquiring as one part of a wider offer. Therefore, we understand that the company could become the target of an acquisition offer.
Double-digit growth	Stone disrupted the acquiring industry in the country. However, we still see room for healthy growth in years to come.

Investment Thesis Risks

Granting credit in Brazil has always been a challenge. In the past, the company has had serious problems with NPLs. If Stone doesn't improve its credit models, this could jeopardize its future.	Credit offer to clients
Economic downturns may affect the acquiring industry as a whole, including Stone.	Economic downturns
The emergence of competitors, especially fintechs, as well as a greater aggressiveness of current competitors’ offers can affect the company's results.	Competition
Brazilian market is largely dependent on the interest-free installments (“parcelado sem juros”), any change to the maximum financing period can affect the company's results.	“Parcelado sem juros”
As a bulk of an acquiring company revenues comes from pre-payment, higher interest rates could impact company’s ability to pass on the increases, potentially reducing its profitability.	Interest rates hikes

Source: XP, Company Reports

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