1Q 2024 Earnings - Transcript

Webcast Presentation Q1 2024

Earnings Call Prepared Remarks May 14, 2024 5:00 pm ET

Good afternoon everyone and thank you for joining the First Quarter 2024 Earnings Call today. If you have not seen the Earnings Release, a copy is posted in the Financials section of the Investor Relations website. On the call today, you have Pedro Arnt, Chief Executive Officer; Mark Ortiz, Chief Financial Officer, Maria Oldham, SVP of Corporate Development, Investor Relations and Strategic Finance and Soledad Nager, Head of Investor Relations.

A slide presentation has been provided to accompany the prepared remarks.

This event is being broadcast live via webcast and both the webcast and presentation may be accessed through dLocal's website at investor.dlocal.com. The recording will be available shortly after the event is concluded.

Before proceeding, let me mention that any forward-looking statements included in the presentation or mentioned in this conference call are based on currently available information and dLocal's current assumptions, expectations and projections about future events. While the Company believes that our assumptions, expectations and projections are reasonable given currently available information, you are cautioned not to place undue reliance on those forward-looking statements. Actual results may differ materially from those included in dLocal's presentation or discussed in this conference call for a variety of reasons, including those described in the Forward-looking Statements and Risk Factors sections of dLocal's filings with the Securities and Exchange Commission, which are available on dLocal's Investor Relations website.

Now I will turn the conference over to dLocal. Thank you.

Pedro Arnt, Chief Executive Officer

Thank you to everyone for joining us today.

2024 has gotten off to a contrasting start.

We started the year once again posting a record quarterly TPV of 5.3 billion dollars, a growth of nearly 50% year-over-year. TPV growth was solid across many verticals, with Ecommerce nearly tripling, Remittances practically doubling, and Ride-hailing, SaaS, each growing north of 50% YoY. All this is a testament to the value our solution offers merchants from varying verticals, and our increasingly strong competitive position and sustained SoW gains. We believe nothing sets us up better for long term success than this kind of sustained TPV growth compounding over multiple years.

As we move down our P&L, the quarter is less of a clear cut success than our TPV growth indicates. We delivered solid revenue growth, north of 30% YoY, while gross profit growth was flat YoY, leading to declining Adjusted EBITDA.

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Mixed results during the first quarter are explained by a few relevant drivers.

First, we saw one of our largest merchants achieve a new level in our tiered pricing scheme, and also re-negotiate fees, as their contract came up for renewal. Given our still high concentration on Top 10 merchants, such a renegotiation directly impacts revenue growth.

Second, our product mix shifted towards lower monetizing pay out volumes, as core pay -in verticals such as e-commerce and advertising are seasonally weaker in Q1.

Additionally, a few important new launches that were scheduled for Q1 were delayed by our merchants, slowing down anticipated volume ramp-ups that should have offset declines in take rates caused by the abovementioned events.

And finally, we decided to sustain our planned investment increases that will support long term growth, even with the current gross profit level. We have confidence our gross profit will rebound, and see these OPEX investments in capability building, internal mechanisms, and technology, as strategic for our long term success.

Trendwise, performance got better as the quarter progressed, with a weak first two months of the year, totalling $37M, while March gross profit came in at $25M, above Q4 levels.

Maria and Mark will now take you through greater detail on our Q1 results in detail in just a few moments; but let me first spend some time providing an update on our execution against our execution priorities.

Our cross border businesses returned to 9% QoQ growth, and hit a new record of $2.4B in TPV during the first quarter, after witnessing declining growth in the fourth quarter driven by, among other things, a temporary slowdown in XB transactions in Argentina. XB remains the core of our value proposition, and seeing a return to sequential growth is a great indicator.

The local to local processing business, despite being flat QoQ driven by seasonal effects, delivered TPV growth at nearly 80% YoY. The continued success of our local processing dispels one of the structural concerns that exited with our business. It confirms that our world class orchestration offering, where our AI powered smart routing is able to optimise traffic routes to deliver higher conversion rates, robust fallback and redundancy offering, efficient fraud prevention engines, best in class KYC/compliance layer, and merchant specific features, offer global merchants a superior offer to what they can receive through direct integrations to local acquirers.

The investments we have made in adapting our infrastructure to meet the needs of global remittance partners and marketplace merchants is also paying off handsomely. Our payouts business grew 17% QoQ and over 50% YoY. The quarterly pick up is particularly interesting, and driven by a strong Q1 ramp-up in remittance corridors for our partners. This growing number of corridors not only represents an interesting vertical in itself, but it also generates opportunities for cross border growth in pay-ins as it improves the liquidity and pricing we can offer our merchants.

In addition to continuing to evolve our product offering across our business, XB, local, pay ins and payouts, during Q1we also maintained our commitment in making efficient and disciplined investments in key capabilities, including growing our licence portfolio, deepening our relationships with global banking partners, and ramping up our operations and back-office effectiveness. In Q1, we were granted licences in strategic markets, such as Egypt, and new payment operator registrations in Argentina, Ecuador, the Dominican Republic and Kenya. We continue to believe our growing portfolio of regulatory approvals will constitute an increasing competitive advantage as our global merchants seek to navigate complex regulatory environments in emerging markets.

With that, I'll hand it over to Maria to take you through a more detailed overview of our first quarter results.

Maria Oldham, SVP of Corporate Development

Thank you Pedro. Good afternoon everyone.

As Pedro just mentioned, during the first quarter we delivered strong TPV growth of 49% year-over-year and 4% quarter-over-quarter, reaching 5.3 billion dollars. Record TPV was achieved despite Q1 being seasonally weak for our largest vertical, e-commerce, and strong devaluations, most notably in Argentina.

Focusing on Revenue. During the quarter we experienced 34% YoY growth reaching 184 million dollars. This growth was driven by continued strong performance in our most competitive markets: Brazil, with revenues up 89% year-over-year; and Mexico, up 50% YoY. Alongside the growth in Brazil and Mexico, we saw a 20% YoY increase in Other LatAm including growth in Colombia, Costa Rica, Dominican Republic and Ecuador coming from streaming, SaaS, on-demand delivery and ride-hailing verticals.

Revenue growth was negatively impacted by Argentina, down 31% YoY. The annual Argentina comparison is a tough one. First of all, the official rate has devalued more than 70%. Second, FX spreads have tightened, generating less fx revenues in our mix, combined with a higher proportion of L2L volume. Finally, Argentina also saw a decline in TPV given that many of our merchants have pulled back from that market given the macro instability of the last 12 months.

Chile, was also a drag on YoY revenue growth, down 13% primarily due to customer churn at one of our financial services merchants. This is not that we lost a merchant, but that one of our major FS partners saw their volumes in Chile decline significantly as they lost a key client for that market, negatively affecting our Revenue there.

In Africa and Asia the main contributors of revenue growth were Egypt, South Africa, Turkey and Philippines. Egypt growth was driven by (i) the general growth of our business there, with TPV up 71% YoY, (ii) the wide spreads on FX rates between official and market rates, and (iii) our strong liquidity position for that market, given that we had a solid combination of XB Pay-in and Pay-out flows during the quarter.

South Africa Revenue was driven by the expansion of two large e-commerce merchants into that market: one of these merchants grew volumes significantly during 2023, the other one is a merchant that we onboarded at the end of 2023 and started processing volumes in South Africa in the first quarter of 2024, rapidly becoming the second largest merchant in the region.

And finally the biggest drag on YoY revenue growth was Nigeria where revenues were down $20M over last year, mostly driven by: (i) the tightening of spreads between market and official rates after the Naira devaluation in February 2024, generating less FX fees and (ii) higher proportion of L2L volumes in 1Q 2024.

Now let me give a brief overview of the key drivers of QoQ evolution of Revenues.

Compared to Q4 2023, revenue decreased by 2%. This sequential decline was mostly driven by seasonality, with Q4 being a very strong quarter for our ecommerce vertical. Additionally, we saw one of our largest merchants achieve a new level in our tiered pricing scheme, and also re-negotiate fees, as their contract came up for renewal. As Pedro mentioned, given that our merchant concentration still remains high, such a renegotiation directly impacts revenue growth. These two factors largely explain the 14% and 4% decrease in Brazil and Mexico revenues, respectively.

In addition, we saw a decrease in revenues in Chile driven by lower volumes from some merchants in the commerce vertical due to seasonality, compensated by higher volumes from financial services pay out flows, albeit at lower gross take rate compared to the commerce volumes.

The lower revenues in Brazil, Mexico and Chile, were partially offset by Argentina, with revenues up 31% quarter-over-quarter, mainly explained by higher cross-border settlement. As we indicated in the last quarter, we believe that merchants will continue to gradually grow XB volume as liquidity improves.

Other Latam also helped QoQ revenue growth, increasing by 9% driven by a reacceleration of growth in the ride-hailing and on-demand delivery verticals mainly in Central America and Peru.

Revenues increased 5% QoQ in Africa and Asia.

As mentioned earlier in the YoY commentary, Revenues in Egypt more than doubled quarter-over-quarter driven by widening spread between the official and the market exchange rates in the first 2 months of the year.

We also experienced solid QoQ growth in South Africa, Indonesia, Turkey and the Philippines, with the same dynamics playing out as those described year over year.

Revenues in Nigeria were strongly affected by the devaluation, down 74% sequentially off-setting a large part of the gains in the other African and Asian markets. In addition to the devaluation, revenue was negatively impacted by a 35% sequential decline in TPV as our Financial Services vertical saw a material drop in volume after the devaluation, with less fx trades occurring on our merchants' platforms.

Now moving to gross profit.

As you can see in slides 8 and 9 form the accompanying earnings material, from this quarter, we have included gross profit breakdown by region. Therefore, I'd like to walk you through in some greater detail on the GP variation we experienced .

During the quarter we experienced 2% YoY growth, to 63 million dollars. In LatAm gross profit was 49 million dollars, decreasing 8% YoY. This result was significantly impacted by Argentina, with gross profit down 71% YoY, given the lower FX revenue, as in the past we benefited from the wide FX spreads. This, together with the lower cross border share, explains the contraction in gross profit margin in Argentina from 89% a year ago to 37% in 1Q 2024. In 1Q 2023 Argentina corresponded to 29% of our gross profit and in 1Q 24, 8%.

Excluding Argentina, gross profit in LatAm grew 24% YoY, driven primarily by the strong performance in our most competitive markets with Brazil up 63% and Mexico up 44% YoY. Gross profit margin in Brazil contracted 7pps YoY driven by: (i) recent renegotiation as explained by Pedro; (ii) growth of other Tier 0 merchants, and (iii) higher share of PO and L2L. Gross profit in Chile contracted 18% YoY driven by lower volumes of XB due to customer churn at one of our financial services merchants, as previously explained. In Other latam we saw gross profit slightly up YoY at 1% mainly driven by Tier 0 merchants growth.

Looking into the Africa & Asia region, gross profit grew 60% YoY supported by a strong growth in Egypt with gross profit up by 4x driven by our merchants' growth in that country. Similarly to Argentina, in Egypt we benefited from the wide spreads and our liquidity position having developed XB flows of Pay-ins and Pay outs. We observed YoY gross profit margin contraction in Egypt due to lower liquidity in our platform driven by more accelerated growth of PI XB compared to PO XB. The gross profit growth in Egypt was partially offset by Nigeria performance as discussed earlier.

On a QoQ comparison, gross profit contracted by 10%.

In Latin America GP fell only in Brazil and Chile.. This was mainly driven by:
- First, the previously mentioned key merchant renegotiation,
- Second, ecommerce seasonality driving lower volumes in this higher net take rate vertical,
- Third, increased PO mix,

In addition, in line with the revenue decrease, we saw a 18% decrease in gross profit in Chile.

These negative variations were partially compensated by Mexico, Argentina and Other LatAm.

- In Mexico, although revenues dropped QoQ, we saw gross profit growing 7%, driven by improvements in our cost structure as we gained scale and negotiating power vis a vis processors.
- In Argentina, with gross profit growing 30%, in line with revenues,
- and in Other LatAm, with gross profit growing by 16% QoQ,

In Asia and Africa, Egypt and Nigeria QoQ variations in gross profit follow the same dynamics we observed on the YoY comparison. Nigeria declined by $1M while Egypt grew by $1M.

Although we acknowledge the quarterly growth profit results are disappointing, we do not see a structural issue. On a YoY basis the Q1'24 GP is of greater quality and sustainability, with the mix of Argentina FX revenues having fallen significantly. QoQ, we have been impacted by merchant re-pricing, but we believe that over time we will offset these pricing negotiations with increased global volumes from this merchant.

Let me now hand it over to Mark to continue working our way down the P&L.

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Mark Ortiz, Chief Financial Officer

Hi everyone. Thank you, Maria. I am delighted to be here today and very excited about our future prospects after my initial month at dLocal.

While we will continue to invest in our capabilities, as Pedro mentioned in his opening remarks, we are also looking for ways to be more efficient across all areas of our business.

During the quarter we have continued to further invest in building out the team, capabilities, and establishing processes and systems to support our long term growth ambitions. As a result of these investments, which we trust will pay off in the mid term, overall operating expenses reached 36 million dollars for the quarter. The main areas of expense increases QoQ were: tech-related expenses, including engineers, software licences and infrastructure expenses; and salaries and wages across our operations, compliance and finance teams. As a result, Operating expenses represented 57% of gross profit. For a more detailed view, please refer to slide 16 from the accompanying earnings material. Let me also add that our global team has grown to 951 people after adding 50-net FTEs during the quarter, with most of the hires in tech, sales and operations in Uruguay, Argentina, Brazil and Spain.

All of this resulted in an Operating Profit of 27 million dollars for the quarter, down 32% YoY and 34% QoQ. Similarly, Adjusted EBITDA came in at 37 million dollars, down 19% YoY and 25% QoQ with Adjusted EBITDA margin of 20%, down 6 percentage points QoQ. Approximately half of this decrease was driven by the gross profit compression discussed earlier and the other half by increased Operating expenses I just mentioned. Along the same lines, the ratio of Adjusted EBITDA to Gross Profit was 58% for the quarter.

Net income was 18 million dollars for the quarter, decreasing 50% YoY and 38% QoQ. The earnings presentation provides a detail of the QoQ evolution of net income which was mostly impacted by the lower EBITDA. In addition, our effective income tax rate increased to 29% from 21% last quarter, as a result of the mix in revenues shifting towards higher tax entities.

Moving on to cash flow, during the quarter we generated 12 million dollars of Free Cash Flow (own funds). And with that Our net income to free cash flow conversion came in at 69% for the quarter. Having said that, our net income to free cash flow conversion continues to be above 100% when looking at the last twelve months.

We ended the quarter with a strong liquidity position of 320 million dollars including 212 million dollars of available cash for general corporate purposes and 108 million dollars of short term investments.

Considering the robust cash position, the Board has authorised a up to $200 million dollar share buyback program to purchase Class A common shares. The plan will expire on the earliest of May 2025 or upon reaching the $200 million dollar repurchase limit.

Our business continues to generate strong margins and solid cash conversion. This Share buyback program reflects where our current capital allocation framework stands.

We are allocating a portion of that cash, as we have already mentioned a few times, towards strengthening company capabilities by improving our internal systems and teams. This is seen in the margin compression in the short term in our P&L.

On the corporate development front, we will take a very disciplined approach, but should attractive opportunities arise, we still have an under leveraged balance sheet to deploy to complement our cash reserves.

And finally, taking into consideration that cash generation should continue to be strong going forward, we are confident this buyback program represents an added element to the capital allocation framework. It is an attractive use of capital given the trajectory we believe dLocal can have over time, as it executes against its enormous opportunity. So, this buyback program underpins our confidence in the prospects of our business going forward and our ability to continue to generate sufficient future cash to carry out our ambitious strategic plan.

With this, let me hand it over back to Pedro for closing remarks.

Pedro Arnt, Chief Executive Officer

Thanks Mark. I am pleased to have you on the call today. I have enjoyed working together with you and the rest of the leadership team in Montevideo over the past weeks.

Now, wrapping up here.

Our actual performance versus guidance will hinge mainly on our own execution, but will be affected by a few exogenous variables: fx rates, macroeconomic conditions, merchant go live timing on signed contracts, and regulatory changes, to name a few. We manage and de-risk these variables as much as possible, but they still hold a level of unpredictability that is characteristic of emerging markets. That is simply the reality of our business.

With that context in mind, we are working on delivering on our 2024 plan that is aligned with the guidance that we shared at the beginning of the year. At this point, and to the best of our current data and expectations, we believe we are tracking towards those objectives, although with greater likelihood of coming in towards the lower end of the issued ranges. Our mandate for the remainder of 2024 is to land and improve on that.

Short term volatility aside, we are highly encouraged by our general progress, and remain incredibly positive on the bigger picture opportunity to compound profitable growth over the long term. Emerging markets still represent an unrivalled market opportunity for digital businesses, and payments remain a major friction point. Mark's announcement earlier on of our new share repurchase program, and summarised outline of our capital allocation framework, is a = testament to our confidence in both our company and its potential.

With that we can take your questions now.