Q2 2024 Earnings - Transcript

Webcast Presentation Q2 2024

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

Good afternoon, everyone and thank you for joining the Second 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, Strategy and Investor Relations and Mirele Aragão, 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.

Let me start us off with a summary of where things are as we hit the halfway mark in 2024.

We continue to see strong growth in our business, achieving another quarterly record of $6.0 billion of TPV during Q2 2024. The evolution of this key metric demonstrates our continued ability to grow as we gain share of wallet from our global merchant base and add new merchants to the mix as well. It also underscores our unique value proposition as a trusted partner for some of the largest and most sophisticated global companies across emerging markets.

This momentum is solid, and our pipeline remains robust, both within existing merchant opportunities and also new merchant logos, which is a promising leading indicator of long-term growth potential. During this quarter we have started processing for a few more marquee global names, such as a leading global Chinese fintech and one of the world's largest events and ticketing marketplaces. We also assisted multiple existing merchants that are among the world's largest e-commerce players in their initial forays into Africa, as they launched operations in South Africa during the last quarter, signalling our success across the very promising African continent. Finally worth noting, we continue to power the growth of cross border payments in Brazil, being a part of the recent launch of a global marketplace powerhouse in that market.

This $6 billion in TPV represents a 38% year-over-year growth, despite the tough comparison basis of 80% growth from the stellar quarter of last year. Performance was good for us across multiple verticals, including continued strong growth in the commerce, on-demand delivery, and remittance verticals; accelerating growth from SaaS and Ride-Hailing merchants, which grew 72% and 51% respectively year-over-year. This kind of sustained and well diversified TPV growth, with a focused commitment to low-risk high-reputation verticals, sets us up well for long-term success. We believe that our year-over-year growth showcases a unique in class combination of growth while focusing on reputable verticals, which is unique among relevant comps base, who either grow less, over index high-risk verticals, or do both.

Net take rates have held up sequentially, despite unfavourable events, like repricing by our largest merchant at the beginning of the year, material currency devaluations in Nigeria and Egypt more recently, and continued weakening across most emerging markets currencies.

This type of stable sequential pricing and growing TPV during the quarter translated to 11% quarter-over-quarter gross profit growth.

Our OPEX excluding non-cash share-based compensation, only grew by only $1 million sequentially, after previous quarters of sequential growth above $4 million, and this happens as we adjusted our cash spend to the weaker gross profit that began to flow through our P&L. As I've mentioned previously, there is a limit to how much we are willing to defend margins in the short term, as we are truly committed to certain investments, which are crucial for our long-term success, particularly those in our engineering pool, back-office capabilities and behind our licence portfolio. But, to balance this out, we are always revising other discretionary spending to make sure it matches our topline performance and is aligned with our general philosophy of frugality. As a consequence of this, our Adjusted EBITDA reached $43 million, reflecting our still lean structure and disciplined spending, while our cash generation also accelerated versus the prior quarter.

These highlights also come with certain challenges that we are focused on rapidly addressing. Primarily, the year-over-year gross profit performance was flat, driven by Latin America that was actually down 13% on Argentine FX devaluation; and the repricing by our largest merchant in Brazil and Mexico. Stellar Africa and Asian gross profit growth of 79% year-over-year unfortunately did not suffice to offset those two events in LatAm - still our largest region.

Let me wrap up my part by stating that, not only do we see more good than bad in the reported quarter, but, taking a step back from a short-term quarterly prism, dLocal is an incredibly strong company, with a fantastic TAM, attractive business model and extremely promising future, that at some point will be reflected in capital market performance. To keep things in perspective:

- We maintain strong product market validation as witnessed by nearly 40% year-over-year and 14% quarter-over-quarter TPV growth;
- Still run a high margin financial model with Adjusted EBITDA to Gross Profit at 60%+ and ability to scale from here to previous levels going forward;

- Cash conversion that remains very strong and growing, as EBITDA increases sequentially, with a cash conversion cycle that is still in the 100% range over the last twelve months.

When we analyse the potential of all this to compound over time, it is hard to not be optimistic about our future, despite the inherent challenges and volatility existent throughout the global south. We firmly believe that our long term future is bright, and our own ability to execute is the single most important factor behind us capturing that opportunity.

That optimism is not only being relayed in my remarks, but also reflected in our capital allocation strategy. Our business has an attractive cash generation profile, and we see upside in our stock as we grow and scale; and as a consequence of this we have bought back stock during the quarter at a rapid pace. We trust this will prove to be a savvy capital allocation decision over time.

With that, I'll hand it over to Maria and Mark to take you through a more detailed overview of our Q2 results.

Maria Oldham, SVP of Corporate Development, IR and Strategy

Thank you, Pedro. Good afternoon, everyone.

As Pedro just mentioned, during the Q2 we once again delivered strong TPV growth of 38% year-over-year and 14% quarter-over-quarter, reaching $6.0 billion.

Our cross-border business, core to our value proposition, grew 11% quarter-over-quarter and 22% year-over-year, reaching a new record of $2.7 billion in TPV. The quarterly growth is driven especially by the ride-hailing vertical.

The local-to-local processing business continues to prove our strong value through domestic flows, posting a 16% increase quarter-over-quarter and 55% year-over-year, confirming our superior offering to our global merchants compared to direct integrations to local acquirers. The quarterly increase was driven in particular by growth in commerce in Mexico and Argentina.

Our pay-ins business grew by a healthy 17% quarter-over-quarter and 34% year-over-year, driven by strong performance in commerce, on-demand delivery and ride-hailing verticals.

Our pay-outs business increased 7% quarter-over-quarter and close to 50% year-over-year. The continuous growth is driven especially by financial services, ride-hailing, and SaaS verticals.

As we move down to the P&L, we observe divergent dynamics at the revenue and profitability levels.

Revenue

Moving to revenue, we achieved $171 million, up 6% year-over-year, primarily driven by (i) Egypt, with over 100% year-over-year growth across advertising and streaming verticals; (ii) commerce and streaming in Mexico; and (iii) strong performance of Other LatAm, Africa and Asia across different verticals. These positive results compensated for lower revenues in Nigeria due to Naira devaluation in February 2024.

On a quarter over quarter basis, despite the healthy TPV growth, revenues declined by 7%, driven by the currency devaluation in Nigeria and Egypt.

The more we continue to scale and diversify our business geographically, the more we expect a dilution in topline volatility over time, as we reduce the reliance on a few markets.

Gross Profit YoY

Now moving to gross profit dynamics.

As you can see in slides 8 and 9 from the accompanying earnings material, since last quarter, we have included gross profit breakdown by region. During the quarter, gross profit was $70 million, a slight decrease of 1% year-over-year.

Starting with LatAm, gross profit was $54 million, down 13% year-over-year. Most of this decline was driven by Argentina, due to lower FX spreads following the currency devaluation in December 2023.

Mexico also impacted LatAm gross profit, decreasing 17% year-over-year due to merchant repricing and local-to-local increase. Gross profit in Chile contracted 7% year-over-year due to lower cross-border volumes. Other LatAm markets showed a 10% year-over-year increase in gross profit, driven by Tier 0 merchants' growth.

In Africa & Asia, gross profit grew 79% year-over-year, supported by (i) our overall growth in Egypt; (ii) ramp-up of our merchants in South Africa, primarily in the commerce vertical, and (iii) temporary FX dynamics in Nigeria.

Gross Profit QoQ

On a quarter-over-quarter basis, gross profit increased by 11%.

In LatAm, gross profit increased by 10% quarter-over-quarter. The main drivers were the growth in Argentina, and other LatAm markets, mainly Colombia and Costa Rica; and Brazil, with lower processing costs following renegotiation with processors, coupled with change in payment mix. Those two factors partially offset the impact of a key merchant repricing, with full impact in the Q2 compared to 2 months in previous one.

In Africa and Asia, gross profit increased by 13% quarter-over-quarter. The main drivers were temporary FX dynamics in Nigeria and growth in Other Africa and Asia.

Despite the quarterly improvement, we acknowledge that our results for this period are still challenging. However, it is important to emphasise that we do not see any structural changes in our business.

Let me now hand it over to Mark to continue discussing our financials.

Mark Ortiz, Chief Financial Officer

Thank you, Maria. Hi everyone.

During this quarter, as Pedro mentioned earlier, we are committed and continue to invest in our team's capabilities and innovation while also seeking efficiencies across many areas of our business. We are confident that this type of efficient investment, given the opportunities ahead of us, will pay off in the mid to long term.

With that, total operating expenses reached $40 million for the quarter, an increase of 72% year-over-year. OPEX, excluding share-based compensation and certain other non-cash items, grew 46%.

OPEX growth has a clear allocation tilt towards investments focused on Product Development & IT capabilities. Product & IT OPEX is up by 143% year-over-year while all other expenses grew by 55% as we also continue an investment cycle behind strengthening our back-office capabilities for future growth. We remain committed to maintaining a balanced approach to expense management balancing short term and long-term opportunity.

As a result, we delivered Operating Profit of $30 million for the quarter, up 12% quarter-over-quarter and Adjusted EBITDA of $43 million, up 16% quarter-over-quarter, representing an Adjusted EBITDA margin of 25%. This is a result of higher gross profit and disciplined OPEX investment. The ratio of Adjusted EBITDA to Gross Profit increased to 61% for the quarter, up 3 percentage points quarter-over-quarter.

On a year-over-year comparison, Operating Profit came down 37% and Adjusted EBITDA was down 18%, given the Gross Profit dynamics that Maria explained and our decision to sustain many of the long-term investments I have just mentioned.

Net income was $46 million for the quarter, up 161% quarter-over-quarter and 3% year-over-year. The earnings presentation provides a detail of the quarter-over-quarter evolution of net income, which was mostly impacted by higher finance income, mostly driven by a $23 million non-cash mark to market effect related to Argentine bonds investments used to hedge our local currency position in that market.

Our effective income tax rate decreased to 18% from 29% last quarter, closer to levels of previous quarters.

Moving on to cash flow for the quarter we generated $35 million of Free Cash Flow from own funds, resulting in a free cash flow conversion rate of 77%, up $23 million and 7 percentage points from Q1. Without taking into account the extraordinary gain from the Argentina bond, cash conversion would be over 100%, in line with our historical levels.

We ended the quarter with a strong liquidity position of $306 million including $186 million of available cash for general corporate purposes, and $120 million of short-term investments.

Before I pass it over to Pedro, let me give you a more detailed update on our share buyback program. As a reminder, we disclosed in the Q1 results that our Board had authorised up to $200 million share buyback program to purchase Class A common shares as part of our capital allocation strategy. During the Q2, we purchased $82 million, representing 9.2 million shares, using our own funds.
With this, let me hand it over back to Pedro for closing remarks.

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Pedro Arnt, Chief Executive Officer

Now, and finalising.

As you know, emerging markets are inherently volatile, which can, and often do, impact our short-term results. However, our long-term view remains optimistic as I mentioned earlier. During our quarterly bottom-up review of our pipeline and existing contracts, where we project out share of wallet, probable market growth, and new commercial opportunities on a merchant-by-merchant basis, we are getting to the following revised outlook for 2024:

- We expect TPV to come in at $23.5-25.5 billion, explained by revised downward probability of volume ramp-ups, pipeline volume mix skewed towards tier 0 merchants that have lower take rates, and a general expectation of weakening emerging markets currencies going forward;
- Gross profit forecast is in the range of $270-290 million, which besides being impacted by the factors I was mentioned in TPV, also is coming in with an expectation of higher concentration of local-to-local vs. cross-border flows, as our local-to-local business continues to be very strong;
- The current expectation for Adjusted EBITDA, therefore, stands between $170-190 million. As I briefly mentioned earlier, we do not believe pulling back from investments in certain key long-term projects, and therefore, will not move to defend short term margin structure as aggressively as we could. We need to continue hiring more IT and product talent, we need to continue strengthening our internal controls for the ever more complex business we manage, and we believe it is the right decision to continue investing in control functions that protect our merchants business and reputations, as well as ours. I'd like to point out that we still see significant operational leverage in the business model mid-term once we are through with these shorter term investments that we are carrying out.

Wrapping up, we continue to thrive across emerging markets, despite their complexities, which we embrace, as we deliver simple and effective solutions to our merchants. Our focus remains on execution and long-term growth. Our commitment to our merchants and our expertise in the regions we operate, enable us to consistently win business from these global merchants. As we scale, this growth will help mitigate short-term volatility and dilute market fluctuations. Therefore, it is crucial for us to continue focusing on TPV growth, increasing our share of wallet, and addressing new clients - all of which we have consistently delivered since the company's inception, while continuing to drive operational leverage in the business once we get through the current disciplined investment cycle we are in.

With that, we are ready to take your questions and thank you for your interest.