

LendIt Fintech



Peter Renton: This is a special live edition of the Fintech One On One podcast recorded on September 27th for the LendIt TV community.

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Peter: Today's episode is brought to you by LendIt Fintech LatAm, the region's leading fintech event. It's happening both online and in person in Miami on December 7th and 8th. Latin America is still the hottest region for fintech in the world and LendIt Fintech LatAm features the leading players in the region. So join the LatAm fintech community this year where you will meet the people who matter, learn from the experts and get business done. In-person and virtual tickets are available at lendit.com/latam.

Peter: Welcome to a special LendIt Fintech Live podcast on LendIt TV. My name is Peter Renton, Chairman and Co-Founder of LendIt Fintech. We have a special treat today going down into Latin America to Brazil, where we are going to talk with the president of Stone Company. Welcome to the podcast, Augusto.

Augusto Lins: Thank you for the invitation Peter. It's a pleasure to be here with you and share a little bit of our thoughts of the developments that are taking place in the payments industry and our company.

Peter: Where are you calling in from today? Where are you located?

Augusto: I'm located right now in São Paulo. Sunny day here beautiful. Overlooking the green part of São Paulo. That's where I am right now.

Peter: All right. All right. Well, I'm in my studio in Denver, Colorado, where we always record these. And it's a sunny day here as well. Let's get started by giving the listeners a little bit of background about yourself and what you've done in your career today.

Augusto: Well, Peter, I am an engineer, I was born in Brazil, I went through college in Brazil. But I've been someone very, always inquisitive. And someone that is always looking to understand how things operate, why things happen the way they're supposed to. Why people do what they do. And that's what took me to engineering school. But at the same time, someone that's always been fenced about a music sound, for several years during college, I worked as a DJ, I and a friend organized parties and we made a little money. But most importantly, we we enjoyed ourselves. And it made sense of studying Electronic Engineering. During those days I got my first computer, it was an Apple Computer, an Apple II at the time. And I decided to learn computing, learn how to code. So when I graduated, I understood that I wasn't going to be an engineer. But most importantly, from the engineering school, I learned that I enjoyed very much solving problems.

And I think that's what engineering is all about. Solving other people's problems. And I decided to start with some friends a startup software development and training programs. And at that time, I discovered why all companies go bust. What is the main reason which takes any company and every company, down the drain? One reason, and that is the lack of customers.

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You either don't acquire as many customers as you need or you lose the customers that you have. So making sure that you deal with customers in a proper fashion. That's something that has always challenged me. And in those days, I decided, you know, there were myself and three other engineers, all of us very standard engineering way of living, very introspective, and very shy. And I decided one day I need to learn this customer business. I need to understand how to deal with customers, how to understand customers, how to listen to customers.

And doing that I ended up developing a consulting type of sales process, which essentially would go into each customer, you understand how the business operates their business model. And what are the pains in those days, my software would help them solve those problems.

So since then, I've always been engaged in consulting services and sales services. But after five years during on that startup, I realized that I didn't know anything about marketing. I didn't know anything about leadership. I didn't understand anything about accounting. So I took my MBA in the US and moved my career. Ended up the entrepreneurship career into a banking career. So I spent several years working in the UK for investment banks.

And after several years abroad, I decided to come back to Brazil and did more banking, corporate banking in Brazil. And then one day I decided to move my career into retail. Retail and credit cards, credit cards in Brazil. In the year 2000, the business was growing around 15 to 18% per annum. So growing very fast. I said, Well, you know, I think that's an industry which interests me I need to learn. So everything that has always challenged me, and the ability to learn is something that really, I discovered later on.

That was very pleasant. So I moved into retail credit card sales again, in marketing, and spent many years on that road. Until one day, I met two guys, I was already in my 50s these two guys were under 25 and 28. And they said, "listen, we're building a startup would you like to join?" And I wasn't quite sure I still had time to be an entrepreneur. But that's when I changed my career and started my second career which is at Stone.

Peter: Right, right. Okay, so maybe we can talk about Stone, you're obviously to your very well established large fintech company in Brazil. Now, why don't you tell us a little bit about what you guys do and the different business lines you have?

Augusto: Well, Stone is a fintech company, started operating in 2014. It has evolved from a standard payment company to a fully integrated software, banking, financial service and payment system.

We started as a standard POS, because in Brazil, the market for Financial Services and payments was all around the year 2010 until 2014, very concentrated and very verticalized. Which meant that for merchants, particularly the SMB merchants, that they were paying high prices for things that they didn't understand. They complained about the lack of transparency. They complained about that no innovation was arriving to them. And they were complaining that whenever they had a problem, they would have to call a call center, dial one, dial two, press one, three, and the connection would go down, they need to call again.

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And it was a nightmare for them to talk to a rep. And it was even harder to get any problems they had solved. A very attractive scenario for someone that wanted to come in, where you see a lot of pain, a lot of complaints, a lot of problems and high costs. So high costs for service, that was an opportunity to create a company.

Peter: For sure, for sure.

Augusto: And we created a company with a purpose. And the purpose was to help merchants sell more, manage better their business and grow. Instead of being on the banking side of the business, we decided to play on the customer side of the business, on the merchant side of the business. So we are a merchant centric company.

Peter: Right, right, gotcha. You said that it's a diversified sort of services and software company, but does payment processing still provide the bulk of your revenue today?

Augusto: Yes, we've been able from 2014 to 2021, we've been growing significantly. And today we have around 12% of market share. Most of the work we do provides solutions for offline businesses. So they need a device at the counter of the merchant to you know, accept different electronic means of payments. And we provide that solution. At the same time we provide solution for the online world. So companies that want to sell through e-commerce or social media apps and marketplaces and so forth.

They need a payment solution, which is a gateway, they need an anti fraud solution. So they need several different products. In Brazil, it's very common for people to buy in installments. Something similar to what you're seeing grow in the US which is Buy Now Pay Later. And this has been something that has been in Brazil for many years. And installments in Brazil can go up to 12 to 24 months. And reconciling all those payments with the actual purchase is not easy. Because the way merchants are paid is they're paid in accordance with each installment.

So I say if I sell a TV in 10 installments, I will collect from whoever bought that equipment, 10 installments one every month. And for whatever reason, there is a return of the TV, you know, you need to find those payments and you need to you know, draw them back and so forth. So it's a very complex scheme that retailers need help. So we've been providing value added service as we call it to merchants to help them continue to sell and sell more and manage all these processes. So in addition to the standard payment solutions, we've been growing the amount of value added softwares. We actually have been investing in several companies that develop and provide software solutions. We've been invested in around 15 different companies, the largest one we just finished about 60 days ago, which called The Linx . That was a \$1 billion acquisition. And they are a leader in several different segments of the retail world. So the idea is there is a convergence between banking payments products and software products. And we want to be the leading player in that field.

Peter: Right. And obviously, there's also been convergence. I mean, some of your many of your merchants, I imagine, you know, have physical stores that have people coming to their online store via like a desktop or even a mobile phone. How are you sort of integrating allowing your

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merchants to operate in any channel? And how are you integrating across the channels, I guess?

Augusto: What we're seeing is that this phenomenon has been increasing significantly over the past year or so with COVID. With COVID, there's several clients that are now using more the online space. What we're seeing is we as consumers have become more digital, we're seeing more people discovering, and being less afraid of buying online, it took us a huge amount of effort to teach our clients because we're in the SMB space. And when COVID started, we did a little survey, and we found that less than 50% of our merchants had any presence on the online space.

They didn't have a LinkedIn account, they didn't have a Facebook account, they didn't have a Instagram, they didn't have anything. So no presence in social media, no presence on on e-commerce. So we created a major program in order to help them educate them that despite the fact that their doors were locked up, they could still manage to be alive and continue to sell. We created a program on internet, we created a channel on podcast.

I mean, we did an extensive program in teaching merchants that they could, despite the fact that the door was shut, they could sell in social media, they could sell through LinkedIn through Instagram. And we created solutions that would help them collect payments from their sales through these channels. We would connect them to apps to e-commerce and marketplaces and delivery systems.

So the solutions that we've created, were highly appreciated by our merchants. But the most important thing is that particularly the small and medium sized client, is how do you integrate the management of all these? Here, we have what we call the OMS, a Order Management System that actually manages all the orders and all the delivery channels and all the inventory. And we try to maximize availability, because that can be very confusing. But most importantly, we've been creating new services.

So today, our solutions enable you to arrive at a shop at a store. And you would say, Well, I would like to buy this tennis shoes, size 11 color white. And for whatever reason, if the inventory of that product is not there available. On the app, the salesman can say "listen, we don't have in stock here for you to take, but we can deliver in two hours at your house. Or you can come and pick it up, you can pick it up at another store or we can set up a time for you to pick it up or we deliver at your house." A lot of customization. We're living in times where the consumer is empowered above all. If he decides what he wants to buy, how he wants to buy, when he wants to buy, where he wants to buy. And he also decides how he wants to pay. He can pay with electronic transfer, he can pay with a credit card, he can pay... here in Brazil, we have a very popular instant payments scheme called Pix.

So you can pay with Pix which has no cost. There's a lot, we're living in a world where things are changing. They're changing very fast in payments, they're changing very fast in retail and we want to be part of that game changing exercise.

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Peter: Interesting. So you're offering like a combination, it feels like of Square, Stripe and Shopify. It seems like you've got all three of those types of businesses all combined into one in Stone. Is that a fair comment? Do you think?

Augusto: Yeah, that's a fair comment on your cocktail. You can throw in Toast as well.

Peter: Toast, yes, there you go.

Augusto: They just went public the other day.

Peter: Yep. Yep, indeed. Given what's happened, I'd love to ask a question about Pix because Pix is, has not been a very long I think it was just launched earlier this year. And it's created a lot of interest in huge, huge numbers of people using it. I presume you were sort of ready to go when this came out. But I hear like you said, it's no cost, I mean, how are you integrating that into your offerings?

Augusto: Pix was launching in November, if I may step back a second, it's important to put into context what was happening. The Brazilian government because of COVID decided to onto grants program for the underprivileged.

And in order to have access to those emergency money, you'd have to download an app from one of the Brazilian government owned banks and this has helped digitize a lot of people. So Brazil is living through thriving times of digital inclusion, financial inclusion and social inclusion. And this has been very helpful to create the grounds which were fertile for the inception of Pix. Pix is a transfer, very similar to Venmo in the US, and it's even easier, it's very fast.

And it was created by the Brazilian Central Bank. So you have all the protection and all the governance and all the security of a central bank own payment scheme, with the easy fuse, which they coordinated, and now all the banks, all the wallets, all the digital banks, anybody that provides any service can be connected. And for the merchants, it's very simple as well.

So we were one of the first if not the first company to enable our point of sale devices to capture QR code or to read a QR code from a digital wallet or a credit card, and so forth. And it's very simple to use, there is no cost when transferring from people to people. And it's very reliable. Because all the transfers by law, they need to be affected in less than three seconds.

Peter: Wow

Augusto: So very fast. And before that, I could not send the money to you or to anybody during non office hours. So after 5pm and I want to transfer money, you know, there was no scheme that would allow. If during the weekend, I wanted to transfer money or make a payment, you know, it would only be processed on the next business day. So a major change for businesses and major change for companies to manage their money.

Most of the companies are still adapting to Pix for people that have just an individual Point Of Sale device. That was very easy to change. But for several large retailers, that have big network of stores and they have their own built in management system, they're still struggling to make

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the changes on their system that could read Pix. So I think Pix is still picking up, because it's not available on the large retailers where there is a huge amount of transactions. And we'll see you know, the volumes continue to grow over the next couple of months.

Peter: Right, so do you make as much money from a Pix transaction as you would from a traditional debit card or credit card transaction? I mean, how do finances work there?

Augusto: The press started advertising and writing reports that credit cards would go away and the credit card business and payments provider we're going to disappear with Pix because Pix is for free. And for us the economics is very low.

However, what is important to do is Pix has helped digitize the society. So a lot of people that didn't have either a bank account for a credit card or a payments account have now signed up in order to be able to use Pix. And all of these credit card accounts, these banking accounts, these payments accounts, all of them have a companion card, sometimes a debit card, sometimes a credit card, sometimes a prepaid card.

So at the end of the day, what happened is you have increased the addressable market for electronic means of payment instead of increasing competition between means of payment. For many years, electronic means of payment was less than 25% of the payments market. The gross of the transactions in Brazil used to be performed with cash and checks. The volume of checks has been reduced significantly. So today it's credit cards mostly and cash. But still cash is around 50%, so it's a war against cash.

Peter: Right.

Augusto: But the press during many, many months, many years were advertising the POS war, the payments war, I mean, there's no war between payments companies. The war is against cash, is expensive to transport in Brazil. It's difficult to manage with COVID. You know, you have to touch it and you know, it's people are concerned about using each time more cash. So what we've seen is actually an increase in total average volume because of Pix. Because in order to use Pix you need your cell phone, and sometimes the cell phone battery goes down. But you still have your credit card and you can transact on a debit, or credit.

Peter: Right, right, gotcha. Okay, so then can you give us a sense, I know you said that you... like you said 12% of the market in Brazil. Can you give us a sense of the scale that you're at, as far as number of merchants, payment volume, number of employees, that sort of thing.

Augusto: When we started the company, the market had essentially two players, one with roughly 60% of the market and the other with roughly 40% of the market. So a very concentrated market. Actually, when we started the company, some friends said, Oh, are you crazy, I mean, there's two players, they're huge.

And if you think you have any chance in competing with these guys. And to be an entrepreneur, to a certain extent, you need to be a little bit crazy, otherwise, you won't take the risk. We decided that we would focus on the e-commerce space, the e-commerce at the time conversion rates were below 75%. So if I could increase if I would draw a better solution that will be able to

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increase that percentage of conversion, I would be helping merchants sell more, and therefore I had a chance. So that's how we decided to start a company.

The Brazilian Central Bank, decided to open up the market. So they changed regulation in order to make sure new players would come in. And it attracted investments, several American companies came to Brazil. Elavon, Global Payments, First Data and others. And some Brazilian startups, like ourselves also decided to enter the market.

Since then, the market has been changing significantly. And what we're seeing now is a higher adoption of electronic means of payment. And this is good for the society as a whole. It's good for merchants, because it's good for them to process, it's easier for them to process it's a more economic for them to process. And it's good for the consumers because it adds productivity, you don't need to go to an ATM to download cash for everybody it's quite nice. Our company started then operating in 2014.

In 2018, we were fortunate to be able to raise equity in the US market. We took our company public at NASDAQ, we raised \$1.5 billion to make investments in the company. Today, our company has over 1 million merchants that we serve. We are currently a team of roughly 14,000 people.

Peter: Wow.

Augusto: We do everything in house, you know both their customer service, we do sales, all the technology is internally built, we decided that our competitive advantage would be number one in terms of customer service. And today, our Net Promoter Score, which is the way we measure the quality of our service, is roughly two times the second contender. We made a commitment to our merchants that we would answer their call in less than five seconds. As a result of that we removed the URV system, the Electronic Answering System.

So whenever one calls us, you will be picked up by a human and a human would recognize you and call you by your name. That's a commitment that we have with our merchants. Which has become the theme the title of a book that I wrote. The title is 5 Seconds: Serving Clients the Stone Way' serving clients. So was written originally in Portuguese, but actually it's now available in the US market at Amazon. And the idea was to share a little bit about how we do things, why we do things and what we do. Very simple, small book friendly. It's not a book about about culture, it's not a book about our history but it's about our journey. And it talks about problems we ran into. It talks about our learnings, who we learned from and how, so an interesting book for any young entrepreneur.

Peter: Alright, I'll make sure I link to that in the show notes when we publish the show. So I want to ask about the fintech market in Brazil, and particularly like the rise of Nubank, which just seems to keep just rising with more customers, higher valuations, massive funding rounds. And it's not just them, there's...there's others as well, doing well in Brazil. You've been I mean, you've been doing this now for many years. And it's seems like the last year particularly, I'd say, since the start of COVID valuations of fintech companies in Latin America, and particularly in Brazil have just risen dramatically. What's your take on that?

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Augusto: The Brazilian market has been very active for more time, our company was created pretty much at the same time David and Cristina created Nubank. And we've been very, very close friends, particularly because they challenged the big banks, we challenged the big banks, we're trying to identify pains on the relationship that banks have with their customers and develop solutions for that. We exchange a lot of ideas and so forth, they have been more focused on the consumer side, we've been focused more on the merchant side.

And like us, many companies have also been created. The Brazilian central bank understood that because the market was very concentrated and very verticalized, there was no innovation in the market. And Brazil was falling behind its peers in terms of quality of service, efficiency and productivity.

So the idea of the Brazilian central bank was to open up the market to grant new licenses for not necessarily banking licenses, but payment accounts, payment licenses, and both Nubank and us started with this type of license. As a result, Brazil has good labor, Brazil has good technology, technology became easy access, accessible with the cloud services, more startups started to be created. I think at the same time, we had the phenomena of millennials and Gen Z coming up with not necessarily willing to engage in traditional careers at large companies.

So the entrepreneurial spirit that emerge strongly in Brazil, I personally believe that who changed Brazil are the young entrepreneurs, and we invest in them, we push them, we develop them. As a result, many new companies have been created. We have excellent universities, with excellent qualifications in their producing labor, which have, you know, technology component, a very strong economics component, managerial component.

And I think the country has been successful in creating this entrepreneurship environment, which is attracting capital. Which is attracting labor, which is generating jobs and making the economy turn. So, a very thrilling environment. Because interest rates, real interest rates are so low, the opportunity cost is very low. And several funds, fund managers are opening up new funds, and investors are pouring money on this. And they're full of money and they're buying and they're bidding against each other for these assets. And sometimes we can see astronomic valuations.

Peter: Right right, sure. One more question for you and that's um.. I want to talk about competitive threats obviously you're very well established in Brazil.

As you know, we can never rest on our laurels. Do you see those likes of you know, Square or Stripe or Shopify coming into Brazil? Because I don't believe those companies are there in Latin America yet. Or is a traditional banks, where do you see the competitive threat coming from?

Augusto: Yeah, several of the US companies have been looking at Brazil for a long time. I mentioned Elavon and Citigroup had a joint venture on a company called Elavon do Brasil, which was actually an asset that we bought out. You have Global Payments. Here you have First Data here. And for the American companies, which have, you know, huge processing machines and systems, it's very expensive to do all the tropicalization of the system. In order to operate in the Brazilian market.

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The Brazilian market has several particularities. The first one is the grace period, 30 days grace period, interest rates in Brazil were extremely high. And as a result, when you buy with credit card, you would have an equivalent to a 30 day grace period, and you need to embed that in the system. In addition to that, we have a very busy installment plans system. So anytime you go to an appliance store in your large retailer, you will buy your goods in installments.

Installments range from three to six to ten to twelve times. And these installments are actually financing. It's one of the largest consumer financing schemes available in Brazil. Any payments company willing to operate in Brazil needs to adapt its systems to make sure it can account for properly for the installments.

But not only to make the installments, we have a very active consumer protection agency here in Brazil. And its consumers go to the supermarket or the appliance market and tell us "listen, my TV's not working, I want my money back" you need to revert those 12 installments.

And you can do that both on the early days or later on when you've already paid several installments. So the system needs to handle this unwinding of installments. And that is very cumbersome to do. So there's a technological challenge one and two, there is the cultural challenge as well. I obviously see them as important players important competitors.

Stripe is already in Brazil. We actually did some processing for Stripe until a couple months ago. Mercado Libre which operates in Latin America is active here. Shopify and several others are players here. And all of them deserve respect. And we see the market in a different way. We see the market as a market evolving. And you can't be a provider of just one service. You need to be able to fulfill other needs of the merchant.

And we want to be the one stop shop provider for both managerial software for banking and financial service and for payment service for all of our SMEs.

Peter: Right. Augusto, we'll have to leave it there. Thank you very much for coming on. This was a lot of fun. We hope to do it again sometime.

Augusto: Great. Thank you very much Peter, and congratulations for your program.

Peter: Thank you, you too.

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Peter: Today's episode was brought to you by LendIt Fintech LatAm the region's leading fintech event. It's happening both online and in person in Miami on December 7th and 8th, Latin America is still the hottest region for fintech in the world, and LendIt Fintech, LatAm features the leading players in the region. So join the Latin Fintech community this year where you will meet the people who matter, learn from the experts and get business done. In person and virtual tickets are available at lendit.com/latam.