

## PagSeguro Digital Ltd

## It is not all about credit; feedback from meeting with CFO and IR

Reiterate Rating: BUY | PO: 18.00 USD | Price: 13.70 USD

## Robust earnings growth supported by core business

Today we hosted Artur Schunk (PagSeguro's CFO) and Eric Oliveira (Head of IR) on a meeting with local investors. They reinforced PAGS' focus on the acquiring product, which should benefit from i) lower funding costs, ii) strong TPV growth in '24 (supported by MSMBs) and iii) more rational competitive environment. Importantly, the company believes that banking features are important to lower funding costs, and not necessarily to boost revenues through credit origination in the short-term.

## Stronger volume growth, gross margin expansion

Mgmt. expects to gain market share in '24, supported by the expansion into SMEs (TPV growth guidance of 12-16%). TPV growth in the first months of the year is running close to 4Q's pace (21%), partially on easy comps. Take-rate should continue to decline, negatively impacted by mix (greater contribution of SMEs). Marketing expenses should grow above inflation in order to boost the TPV growth. Including benefits from lower Selic on funding costs, mgmt. expects gross margin expansion (in line with guidance).

## "Banking" is not only about credit origination

Mgmt. reinforced that the banking strategy is important to support a resilient deposits franchise, lowering funding costs for prepayment. While mgmt. remains conservative on credit origination of unsecured products, they expect to monetize digital account holders with other financial products (such as collateralized credit cards). Mgmt. sees room for both PAGS and NU to expand into payroll loans and sees its digital origination process as a key differentiator. The company does not see software as a key feature to PagSeguro.

## Raising estimates and PO

We raise our estimates to incorporate 4Q23 and '24 guidance into our model. We now expect R\$2.0/2.3bn GAAP net income in '24/'25, suggesting NI growth of 23%/14% (9%/10% vs old estimates). Our model incorporates revenue growth of +7%/+11% and GAAP net margin of 12.0%/12.3% in '24/'25 (vs 10.4% in 23). Our new PO of \$18 (from \$16), reflects our new EPS estimate (target P/E of 14x unchanged). Reiterate Buy.

Estimates (Dec) (BRL)	2021A	2022A	2023E	2024E	2025E
EPS	4.58	4.82	5.44	6.56	7.47
GAAP EPS	3.61	4.54	5.09	6.28	7.13
EPS Change (YoY)	5.3%	5.2%	12.9%	20.6%	13.9%
Consensus EPS (Bloomberg)			5.23	6.31	7.27
DPS	0	0	0	0	0
Valuation (Dec)					
P/E	16.7x	15.0x	12.2x	10.4x	9.1x
GAAP P/E	21.1x	15.9x	13.1x	10.9x	9.6x
EV / EBITDA*	5.2x	2.9x	2.8x	2.7x	2.5x
Free Cash Flow Yield*	-10.1%	-41.9%	-18.2%	-7.7%	-8.9%

\* For full definitions of *IQmethod*<sup>SM</sup> measures, see page 5.

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**Refer to important disclosures on page 6 to 8. Analyst Certification on page 4. Price Objective Basis/Risk on page 4.**

12669900

Timestamp: 12 March 2024 09:38PM EDT

12 March 2024

## Equity

## Key Changes

(BRL)	Previous	Current
Price Obj.	US\$16.00	US\$18.00
2023E Rev (m)	16,054.0	15,904.2
2024E Rev (m)	16,976.1	17,008.6
2025E Rev (m)	18,394.8	18,800.6
2023E EPS	5.41	5.44
2024E EPS	6.02	6.56
2025E EPS	6.75	7.47

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## Stock Data

Price	13.70 USD
Price Objective	18.00 USD
Date Established	12-Mar-2024
Investment Opinion	C-1-9
52-Week Range	6.93 USD - 14.98 USD
Mkt Val (mn) / Shares Out (mn)	4,436 USD / 323.8
Free Float	99.6%
Average Daily Value (mn)	38.03 USD
BofA Ticker / Exchange	PAGS / NYS
Bloomberg / Reuters	PAGS US / PAGS.N
ROE (2023E)	14.1%
Net Dbt to Eqty (Dec-2022A)	-15.4%
ESGMeter <sup>TM</sup>	Medium

**ESGMeter is not indicative of a company's future stock price performance and is not an investment recommendation or rating. ESGMeter is independent of BofA Global Research's equity investment rating, volatility risk rating, income rating, and price objective for that company. For full details, refer to "BofA ESGMeter Methodology".**

Acronyms on page 3.

# iQprofile<sup>SM</sup> PagSeguro Digital Ltd

## iQmethod<sup>SM</sup> – Bus Performance\*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Return on Capital Employed	22.2%	37.9%	28.1%	23.1%	21.9%
Return on Equity	15.3%	14.3%	14.1%	15.0%	14.8%
Operating Margin	32.5%	40.8%	39.7%	37.2%	37.1%
Free Cash Flow	(2,411)	(9,602)	(3,928)	(1,699)	(1,976)

## iQmethod<sup>SM</sup> – Quality of Earnings\*

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash Realization Ratio	-0.8x	-4.7x	-1.5x	0.3x	0.2x
Asset Replacement Ratio	1.6x	1.9x	1.0x	1.5x	1.3x
Tax Rate	24.9%	16.0%	19.3%	19.4%	21.0%
Net Debt-to-Equity Ratio	-17.1%	-15.4%	-21.9%	-21.1%	-20.1%
Interest Cover	4.3x	2.0x	1.9x	2.3x	2.5x

## Income Statement Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Sales	10,374	15,286	15,904	17,009	18,801
% Change	52.2%	47.3%	4.0%	6.9%	10.5%
Gross Profit	5,086	7,853	7,928	8,317	9,095
% Change	56.5%	54.4%	1.0%	4.9%	9.3%
EBITDA	4,140	7,373	7,675	7,899	8,745
% Change	68.8%	78.1%	4.1%	2.9%	10.7%
Net Interest & Other Income	(759)	(3,406)	(3,637)	(3,161)	(3,317)
<b>Net Income (Adjusted)</b>	<b>1,517</b>	<b>1,598</b>	<b>1,768</b>	<b>2,134</b>	<b>2,428</b>
<b>% Change</b>	<b>5.7%</b>	<b>5.3%</b>	<b>10.7%</b>	<b>20.7%</b>	<b>13.8%</b>

## Free Cash Flow Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Net Income from Cont Operations (GAAP)	1,196	1,504	1,654	2,042	2,319
Depreciation & Amortization	769	1,131	1,356	1,565	1,775
Change in Working Capital	(3,120)	(10,100)	(5,625)	(2,927)	(3,687)
Deferred Taxation Charge	NA	NA	NA	NA	NA
Other Adjustments, Net	0	0	0	0	0
Capital Expenditure	(1,255)	(2,136)	(1,313)	(2,379)	(2,383)
<b>Free Cash Flow</b>	<b>-2,411</b>	<b>-9,602</b>	<b>-3,928</b>	<b>-1,699</b>	<b>-1,976</b>
<b>% Change</b>	<b>-129.7%</b>	<b>-298.2%</b>	<b>59.1%</b>	<b>56.7%</b>	<b>-16.3%</b>
Share / Issue Repurchase	(21)	(164)	(255)	0	0
Cost of Dividends Paid	0	0	0	0	0
Change in Debt	0	0	0	0	0

## Balance Sheet Data (Dec)

(BRL Millions)	2021A	2022A	2023E	2024E	2025E
Cash & Equivalents	1,794	1,829	2,899	3,224	3,545
Trade Receivables	23,429	36,249	41,757	43,119	47,939
Other Current Assets	1,496	1,689	4,068	4,582	5,137
Property, Plant & Equipment	2,289	2,493	2,451	3,266	3,874
Other Non-Current Assets	2,067	3,069	3,928	5,233	7,101
<b>Total Assets</b>	<b>31,076</b>	<b>45,329</b>	<b>55,104</b>	<b>59,424</b>	<b>67,596</b>
Short-Term Debt	0	0	0	0	0
Other Current Liabilities	19,003	29,740	34,432	35,918	40,860
Long-Term Debt	0	0	0	0	0
Other Non-Current Liabilities	1,571	3,747	7,435	8,228	9,138
<b>Total Liabilities</b>	<b>20,574</b>	<b>33,487</b>	<b>41,867</b>	<b>44,146</b>	<b>49,998</b>
<b>Total Equity</b>	<b>10,502</b>	<b>11,842</b>	<b>13,241</b>	<b>15,283</b>	<b>17,603</b>
<b>Total Equity &amp; Liabilities</b>	<b>31,076</b>	<b>45,329</b>	<b>55,108</b>	<b>59,429</b>	<b>67,601</b>

\* For full definitions of iQmethod<sup>SM</sup> measures, see page 5.

## Company Sector

Computer Services

## Company Description

PagSeguro is a leading electronic payment processor in the micro merchant market, and has recently been gaining traction in the SMB segment in Brazil. In addition, the company has built one of the leading digital banks in the country, with c.20mn active clients, and provides a unique, fully integrated banking and payment solution to its clients.

## Investment Rationale

We find valuation attractive, as the stock does not seem to reflect the potential benefits to the bottom line from a lower rate environment (which should reduce financial expenses), recent efficiency efforts (headcount reduction and marketing optimization), and the value of the digital banking operations (which has 17mn active clients).

## Stock Data

Average Daily Volume

2,775,745

## Quarterly Earnings Estimates

	2022	2023
Q1	1.12A	1.20A
Q2	1.21A	1.28A
Q3	1.25A	1.36A
Q4	1.25A	1.61E

## New earnings model

We raise our estimates to incorporate 4Q23 and '24 guidance into our model. We now expect R\$2.0/2.3/2.6bn GAAP net income in '24/'25/'26, suggesting earnings growth of 23%/14%/10% (9%/10%/15% vs old estimates). Mgmt. guided for non-GAAP net income growth of 16-22% (we forecast 21%).

Our model incorporates TPV growth of 15%/12%/10% in '24/'25/'26, led by the SME segment – which should weigh negatively on take rate (we expect 28bp net take rate contraction in '24). Mgmt. guided for TPV growth of 12-16% in '24. All in, we expect revenue growth of +7%/+11%/+10%. Including funding costs, mgmt. expect gross margin higher than 38.5% (we forecast 39.0%), vs 37.4% in '23.

Opex should grow above inflation (+11%/+11%/+9% in '24/'25/'26), pressured by marketing costs, while financial expenses should grow below TPV, benefiting from lower rates and greater contribution of deposits (-17%/+4%/+12%).

All in, total costs and expenses should grow just below revenues, leading to GAAP net margin expansion to 12.0%/12.3% in '24/'25 (vs 10.4% in 23).

### Exhibit 1: Earnings model summary

We expect +23%/+14%/+10% earnings growth in '24/'25/'26

	2024E				2025E			2026E					
R\$mnn	New	Old	New	Change	Old	New	Change	Old	New	Change	24/23	25/24	26/25
Net revenue	15,904	16,976	17,009	0%	18,395	18,801	2%	20,095	20,619	3%	7%	11%	10%
Cost of Services	7,976	8,828	8,691	-2%	9,711	9,706	0%	10,682	10,677	0%	9%	12%	10%
Administrative Expenses	715	713	776	9%	754	884	17%	824	928	13%	9%	14%	5%
Selling Expenses	1,430	1,782	1,775	0%	1,972	1,866	-5%	2,154	1,980	-8%	24%	5%	6%
Operating expenses	10,121	11,324	11,242	-1%	12,437	12,456	0%	13,660	13,584	-1%	11%	11%	9%
EBITDA	7,675	7,238	7,899	9%	7,804	8,745	12%	8,601	9,597	12%	3%	11%	10%
Financial expenses	3,270	2,742	2,721	-1%	2,630	2,837	8%	2,946	3,177	8%	-17%	4%	12%
Total costs and expenses	13,713	14,466	14,362	-1%	15,547	15,727	1%	17,086	17,190	1%	5%	10%	9%
Earnings before taxes	2,192	2,510	2,647	5%	2,848	3,074	8%	3,009	3,429	14%	21%	16%	12%
Net income - reported	1,654	1,876	2,042	9%	2,103	2,319	10%	2,218	2,557	15%	23%	14%	10%
Net income - non-GAAP	1,768	1,958	2,134	9%	2,193	2,428	11%	2,317	2,674	15%	21%	14%	10%
EPS -- reported	5.09	5.77	6.28	9%	6.47	7.13	10%	6.82	7.86	15%	23%	14%	10%
EPS -- non-GAAP	5.44	6.02	6.56	9%	6.75	7.47	11%	7.13	8.22	15%	21%	14%	10%
Operating margin	40%	33%	37%	395 bp	32%	37%	469 bp	32%	37%	543 bp	-249 bp	-17 bp	38 bp
EBITDA margin	48.3%	42.6%	46.4%	381 bp	42.4%	46.5%	409 bp	42.8%	46.5%	375 bp	-181 bp	7 bp	3 bp
Effective tax rate	19.3%	22.0%	19.4%	-262 bp	23.0%	21.0%	-200 bp	23.0%	22.0%	-100 bp	6 bp	162 bp	100 bp
GAAP net margin	10.4%	11.1%	12.0%	96 bp	11.4%	12.3%	90 bp	11.0%	12.4%	136 bp	161 bp	33 bp	6 bp
Non-GAAP net margin	11.1%	11.5%	12.5%	101 bp	11.9%	12.9%	99 bp	11.5%	13.0%	144 bp	143 bp	37 bp	5 bp
TPV (R\$ billion)	394	441	453	3%	486	507	4%	534	558	4%	15%	12%	10%
Active clients (th)	6,500	6,580	6,460	-2%	6,830	6,710	-2%	7,080	6,960	-2%	-1%	4%	4%
Gross take rate	3.98%	3.80%	3.71%	-9 bp	3.74%	3.66%	-8 bp	3.72%	3.65%	-6 bp	-27 bp	-4 bp	-1 bp
Transaction cost/TPV	1.51%	1.51%	1.52%	1 bp	1.51%	1.52%	0 bp	1.51%	1.52%	0 bp	1 bp	-1 bp	0 bp
Net take rate	2.47%	2.28%	2.18%	-10 bp	2.23%	2.15%	-8 bp	2.20%	2.13%	-7 bp	-28 bp	-4 bp	-1 bp

Source: BofA Global Research estimates

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### Acronyms

MSMB: micro, small and medium businesses

SME: small and medium enterprises

TPV: total payment volume

NU: Nubank



## Price objective basis & risk

### PagSeguro Digital Ltd (PAGS)

Our PO of US\$18 is derived from a target P/E of 14x to our '24 GAAP EPS estimate. The target PE is one standard deviation below the historical average, challenging perspectives for the industry in the long-term.

Downside risks: 1) more intense competition from peers, which could lead to take-rate pressure, 2) regulatory changes that could pressure profitability, 3) weaker macro economic scenario in Brazil, which could negatively impact TPV growth, and 4) slower decline in interest rates, which would maintain financial expenses pressured.

## Analyst Certification

We, Mario Pierry, Antonio Ruelle and Flavio Yoshida, hereby certify that the views each of us has expressed in this research report accurately reflect each of our respective personal views about the subject securities and issuers. We also certify that no part of our respective compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

### Latin America - Financials Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
<b>BUY</b>				
	B3	XIMAF	B3SA3 BZ	Mario Pierry
	B3	BOLSY	BOLSY US	Mario Pierry
	Bajio	BBAJF	BBAJIO MM	Ernesto Gabilondo
	Banco do Brasil	XBBAF	BBAS3 BZ	Mario Pierry
	Banco do Brasil	BDORY	BDORY US	Mario Pierry
	Banco Santander Chile	BSAC	BSAC US	Ernesto Gabilondo
	Banco Santander Chile	XLDTF	BSAN CI	Ernesto Gabilondo
	Banorte	GBOOF	GFNORTEO MM	Mario Pierry
	Banorte	GBOOY	GBOOY US	Mario Pierry
	Bci	BZCIF	BCI CI	Ernesto Gabilondo
	BTG Pactual	XNXCF	BPAC11 BZ	Flavio Yoshida
	Caixa Seguridade	XDXUF	CXSE3 BZ	Mario Pierry
	Credicorp Ltd	BAP	BAP US	Ernesto Gabilondo
	Genera	CMPRF	GENERAT* MM	Ernesto Gabilondo
	Grupo BMV	BOMXF	BOLSAA MM	Ernesto Gabilondo
	IFS	IFS	IFS US	Ernesto Gabilondo
	Inter	XBZIF	INBR32 BZ	Mario Pierry
	Inter	INTR	INTR US	Mario Pierry
	Itau Unibanco	ITUBF	ITUB4 BZ	Mario Pierry
	Itau Unibanco	ITUB	ITUB US	Mario Pierry
	PagSeguro Digital Ltd	PAGS	PAGS US	Mario Pierry
	Regional	RGNLF	RA MM	Ernesto Gabilondo
	StoneCo	STNE	STNE US	Mario Pierry
	XP Inc.	XP	XP US	Mario Pierry
<b>NEUTRAL</b>				
	ABC Brasil	XBABF	ABCB4 BZ	Flavio Yoshida
	Banco Pan	XQSFF	BPAN4 BZ	Flavio Yoshida
	Banrisul	XGRBF	BRSR6 BZ	Flavio Yoshida
	BB Seguridade	XBDPF	BBSE3 BZ	Mario Pierry
	BB Seguridade	BBSEY	BBSEY US	Mario Pierry
	Bradesco	BRDPF	BBDC4 BZ	Mario Pierry
	Bradesco -A	BBD	BBD US	Mario Pierry
	Nubank	NU	NU US	Mario Pierry
	Porto Seguro	PSGUF	PSSA3 BZ	Mario Pierry
	Santander Brasil	XCBDP	SANB11 BZ	Mario Pierry
	Santander Brasil	BSBR	BSBR US	Mario Pierry
<b>UNDERPERFORM</b>				
	Banco Chile-ADR	BCH	BCH US	Ernesto Gabilondo

## Latin America - Financials Coverage Cluster

Investment rating	Company	BofA Ticker	Bloomberg symbol	Analyst
	Banco de Chile	XHNDF	CHILE CI	Ernesto Gabilondo
	Banco Macro	BMA	BMA US	Ernesto Gabilondo
	Banco Macro	BCVMF	BMA AR	Ernesto Gabilondo
	GFinbur	GPFOF	GFINBURO MM	Ernesto Gabilondo
	Grupo Financiero Galicia	GGAL	GGAL US	Ernesto Gabilondo
	Grupo Financiero Galicia	GGABF	GGAL AR	Ernesto Gabilondo
	Qualitas	QUCOF	Q* MM	Ernesto Gabilondo
	Supervielle	SUPV	SUPV US	Ernesto Gabilondo
	Supervielle	XAZFF	SUPV AR	Ernesto Gabilondo
<b>RSTR</b>				
	Bancolombia	CIB	CIB US	Ernesto Gabilondo
	Bancolombia	XAFFF	PFBCOLO CB	Ernesto Gabilondo
	Cielo	CIOXF	CIEL3 BZ	Mario Pierry
	Cielo	CIOXY	CIOXY US	Mario Pierry

**iQmethod<sup>SM</sup> Measures Definitions****Business Performance**

Return On Capital Employed

Return On Equity  
Operating Margin  
Earnings Growth  
Free Cash Flow

**Quality of Earnings**

Cash Realization Ratio  
Asset Replacement Ratio  
Tax Rate  
Net Debt-To-Equity Ratio  
Interest Cover

**Valuation Toolkit**

Price / Earnings Ratio  
Price / Book Value  
Dividend Yield  
Free Cash Flow Yield  
Enterprise Value / Sales

EV / EBITDA

**Numerator**

NOPAT = (EBIT + Interest Income) × (1 – Tax Rate) + Goodwill Amortization

Net Income  
Operating Profit  
Expected 5 Year CAGR From Latest Actual  
Cash Flow From Operations – Total Capex

**Numerator**

Cash Flow From Operations  
Capex  
Tax Charge  
Net Debt = Total Debt – Cash & Equivalents  
EBIT

**Numerator**

Current Share Price  
Current Share Price  
Annualised Declared Cash Dividend  
Cash Flow From Operations – Total Capex  
EV = Current Share Price × Current Shares + Minority Equity + Net Debt + Other LT Liabilities  
Enterprise Value

**Denominator**

Total Assets – Current Liabilities + ST Debt + Accumulated Goodwill  
Amortization  
Shareholders' Equity  
Sales  
N/A  
N/A

**Denominator**

Net Income  
Depreciation  
Pre-Tax Income  
Total Equity  
Interest Expense

**Denominator**

Diluted Earnings Per Share (Basis As Specified)  
Shareholders' Equity / Current Basic Shares  
Current Share Price  
Market Cap = Current Share Price × Current Basic Shares  
Sales

Basic EBIT + Depreciation + Amortization

**iQmethod<sup>SM</sup>** is the set of BofA Global Research standard measures that serve to maintain global consistency under three broad headings: Business Performance, Quality of Earnings, and valuations. The key features of iQmethod are: A consistently structured, detailed, and transparent methodology. Guidelines to maximize the effectiveness of the comparative valuation process, and to identify some common pitfalls.

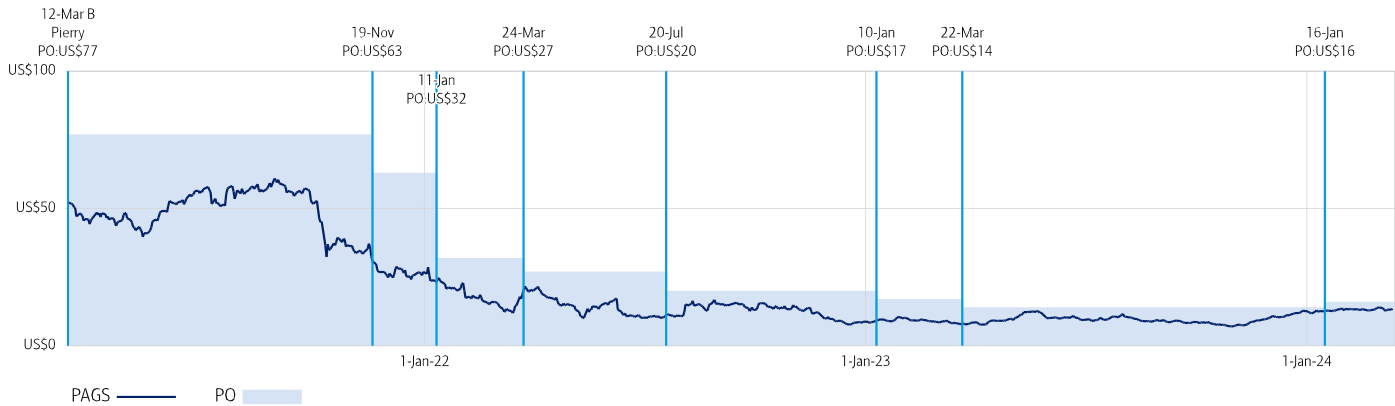
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# Disclosures

## Important Disclosures

### PagSeguro (PAGS) Price Chart



B: Buy, N: Neutral, U: Underperform, PO: Price Objective, NA: No longer valid, NR: No Rating

The Investment Opinion System is contained at the end of the report under the heading "Fundamental Equity Opinion Key". Dark grey shading indicates the security is restricted with the opinion suspended. Medium grey shading indicates the security is under review with the opinion withdrawn. Light grey shading indicates the security is not covered. Chart is current as of a date no more than one trading day prior to the date of the report.

### Equity Investment Rating Distribution: Technology Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	215	53.09%	Buy	111	51.63%
Hold	97	23.95%	Hold	45	46.39%
Sell	93	22.96%	Sell	24	25.81%

### Equity Investment Rating Distribution: Global Group (as of 31 Dec 2023)

Coverage Universe	Count	Percent	Inv. Banking Relationships <sup>R1</sup>	Count	Percent
Buy	1895	53.62%	Buy	1083	57.15%
Hold	832	23.54%	Hold	454	54.57%
Sell	807	22.84%	Sell	383	47.46%

<sup>R1</sup> Issuers that were investment banking clients of BofA Securities or one of its affiliates within the past 12 months. For purposes of this Investment Rating Distribution, the coverage universe includes only stocks. A stock rated Neutral is included as a Hold, and a stock rated Underperform is included as a Sell.

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Investment rating	Total return expectation (within 12-month period of date of initial rating)	Ratings dispersion guidelines for coverage cluster <sup>R2</sup>
Buy	≥ 10%	≤ 70%
Neutral	≥ 0%	≤ 30%
Underperform	N/A	≥ 20%

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