

3Q'23 Earnings Call Prepared Remarks

Operator:

Good morning, everyone. And welcome to Semantix's Third Quarter 2023 Earnings Conference Call. At this time, all participants are in a listen-only mode. After the speaker presentation, we will conduct a question-and-answer session. As a reminder, this call will be recorded. I would now like to turn the call over to Augusto Vilela, Semantix Head of Investor Relations and M&A. Please go ahead.

Augusto Vilela, Head of Investor Relations and M&A:

Thank you. Good morning, everyone, and thanks for joining our Third Quarter 2023 earnings conference call. Joining me on the call today is Leonardo Santos, our CEO, Founder and Chairman, and Adriano Alcalde, our CFO.

By now, everyone should have access to our earnings announcement. This announcement is also on our Investor Relations website. During this call, we will make forward-looking statements, including statements about our business outlook, strategies and long-term goals. These comments are based on our plans, predictions and expectations as of today, which may change over time. Our actual results could differ materially due to a number of risks and uncertainties, including the risk factors outlined in our 20-F filed with the SEC.

Also during this call, we will discuss certain non-GAAP financial measures. These non-GAAP measures are not intended to be a substitute for our GAAP results. Please refer to our earnings release on our Investor Relations website for a reconciliation of GAAP to non-GAAP financial measures, as well as additional context on our key operating metrics. And finally, this call is being webcast from our Investor Relations website at ir.semantix.ai. and an audio replay will be available on our website in a few hours.

With that, I would like to turn the call over to Leo. Leo, good morning.

Leonardo Santos, CEO, Co-Founder and Chairman:

Thank you, Augusto, and thank you all for joining us today. I'm excited to talk about the progress we made in the third quarter and continued innovation across our platform.

In Q3 we observed significant year-over-year growth in revenues from AI, particularly in our priority verticals, such as agro, finance and health. We remain optimistic about further growth opportunities. Notably, our Proprietary SaaS revenue saw an impressive 41% year-over-year growth, largely driven by the success of our AI applications. I am glad to announce that 53% of our total quarterly revenue came from Semantix's intellectual property, which means Proprietary Products and Consulting AI Services, up from 29% in the same period last year. This shift reflects our ability to execute our strategy, solving our client's challenges along the way.

This improved revenue mix towards higher quality income, combined with our strategic cost saving initiatives, is positively impacting our gross margin, driving it to an impressive record high of 62%, reaching a remarkable 14 percentage points increase from the same period last year. This gives us confidence in our strategy of pursuing sustainable growth on proprietary products and accelerating our path to operational cash break-even. In this context, as Adriano will elaborate on, I am pleased to announce our goal of achieving operational cash generation in the full year of 2024.

We are observing a growing traction and customer demand for AI-based business solutions, and for this reason, we have already identified new opportunities for launching AI applications.

In the current quarter, we unveiled an innovative retail application with a user-friendly, no code, touch-free interface, and a seamless integrated ready-to-use solution. These initial modules are available now, specially designed to elevate the customer's experience through seamless integration, data collecting and analyzing across both physical and digital customer touch points. This empowers retailers within valuable insights delivery from their data enable real time decision making and providing them with a competitive edge in understanding customer behavior and staying up to date to evolving market trends.

In the current quarter, we introduced ChatPharma, a cutting-edge application that serves as a GenAI layer within our Pharma Application. This revolutionary feature empowers pharmaceutical industry executives to seamlessly engage with Semantix's unique health data set using generative AI. As a result, it enables them to efficiently access valuable insights, complete with dynamically generated tables and charts, thanks to our Multi Generative AI technology. This advancement significantly enhances their capacity to expediently strategize and design effective go-to-market strategies.

We've seamlessly integrated four powerful AI algorithms into our health applications, and they are already making a positive impact within hospital operations, generating substantial value for our customers. I am especially proud of this because we can go beyond our purpose of impacting lives and actually contribute to the health system on saving people's lives. These algorithms were successfully implemented during the third quarter, resulting in a significant boost to the competitiveness of Semantix's products, all achieved with minimal cost implications.

Semantix has expanded its GenAI Hub with the addition of several specialized LLMs, reaffirming its position as a truly multi-generative AI platform. These LLM models are tailored for various tasks, ranging from source code generation to natural language understanding, among others. By combining these models, Semantix enables the creation of agents that leverage with unique abilities. In addition to the product appeal across all industries, this development not only benefits Semantix's customers but also accelerates the company's AI application development process. Semantix is actively engaged in multiple application development and testing projects in collaboration with its valued clients, with the aim of identifying opportunities to scale sustainably and efficiently while keeping costs under control.

Our multi-LLM management layer emphasizes security for businesses, ensuring data privacy and control. Customers don't need to worry about data leaks, as this concern is integrated within their own infrastructure, providing complete control, auditability, and maximum security. Our technology allows us to extract the best features from each LLM, whether they come from partners, open-source, or private sources.

I'd like to highlight a few key wins from the quarter. We secured new clients across various industries, with a strong presence in the financial, agribusiness, and health sectors. For instance, we're working in a use case for exporting companies, on a comprehensive solution that includes intelligent stock control, asset management, risk calculation modeling, and more. This specific application also simplifies stock exchange operations, enhancing efficiency and cost control.

In the financial market, similar to the Quasar model we reported on last quarter, we're creating a data architecture for a large Brazilian asset management company, enabling them to efficiently improve operational capabilities, eliminating weeks-long delays in some workflows.

In the pharmaceutical sector, we've structured platforms to support strategy, go-to-market planning, and monitoring of the market. Demonstrating how Semantix is well positioned in this market, we

recently signed a contract with a global laboratory to enhance the management of oncology patients in Brazil's public health system, with a focus on breast cancer.

In summary, our AI-focused strategy is yielding positive results. We're helping our clients extract intelligence through AI, all while maintaining cost-efficiency and accelerating our AI application development process.

With that, I'll pass the call to Semantix's CFO, Adriano Alcalde. Adriano?

Adriano Alcalde, CFO:

Thank you, Léo, and thank you all for being with us today. Let's jump into our third-quarter results and provide some insights into our 2023 outlook. But first, let's briefly review what we discussed in our previous call.

We emphasized our strong commitment to financial sustainability and our strategy to improve profit margins, especially with our larger third-party software contracts.

During the third quarter, we proactively obtained ways to further reduce our cash outflows and move closer to our goal of achieving operational cash break-even in 2024 as Léo just mentioned. In August and September, we reviewed our workforce and made strategic adjustments to prioritize our investments and strike a better balance between growth and profitability. As a result, we managed to reduce our annual total costs and expenses by a solid 30%, compared to the annualized numbers from June 2023, excluding costs related to third-party software.

Now, let's talk about the impact of these initiatives on our third-quarter results. We reported net revenue of R\$40 million, which, due to our strategic move of not renewing some low margin third-party contracts, is down 51% year-over-year and 17% compared to the previous quarter. Therefore, as expected, we saw a significant improvement in our revenue mix. Our proprietary SaaS revenues grew by 41% year-over-year, making up 37% of our total revenues in Q3 2023, up from 13% in the same quarter last year. On the other hand, revenues from third-party software decreased by 67% year-over-year and represented 47% of our total revenues, down from 71% in the same period in the prior year due to the context I just mentioned.

As predictable, these changes had a meaningful impact on our gross margin. The combination of a better revenue mix and improved third-party software revenue quality pushed our gross margin to a historic high of 62%, marking a 14-percentage point increase year-over-year.

Now, moving to operating expenses, we are still seeing material amounts associated with our restructuring efforts, mainly termination costs. We anticipate that the full benefits of our efficiency improvements will be noticeable in the coming quarters. Our non-GAAP SG&A expenses, which exclude merger-related costs and stock-based compensation, decreased by 5% year-over-year in the third quarter, mainly due to the restructuring efforts mentioned above.

Our adjusted EBITDA for the third quarter of 2023 showed a loss of R\$17 million, resulting in an adjusted margin of -43%. As of September 30, we had R\$111 million in cash and cash equivalents. It's important to note that during the third quarter, we paid a total of R\$9 million in bank loans.

As for the near-term business environment, we're still navigating the macroeconomic headwinds affecting IT spending. Customers and prospects are taking more time to make purchase decisions, often requiring additional layers of approval in their budgeting process. We're fully aware of these challenges and have factored them into our outlook for the rest of the year. Nonetheless, we're

committed to innovation and strategic investments while keeping a close eye on our expenses to improve profitability.

Looking ahead to 2023, we have been closely monitoring market conditions and have recalibrated our strategic priorities towards sustainable growth. In this context, we have decided not to provide specific revenue guidance for the rest of the year. Our focus remains on achieving a balance between growth and profitability and operational cash generation in 2024, emphasizing the importance of managing our finances wisely.

In conclusion, while we acknowledge the industry dynamics and the evolving landscape, we are enthusiastic about the opportunities ahead. We are dedicated to prudent financial management and delivering value to our shareholders. With that, I'd like to turn the call back to Leo for some closing remarks. Leo, the floor is yours. Thank you.

Leonardo Santos, CEO, Co-Founder and Chairman:

Thank you, Adriano. This quarter, we maintained a strong focus on our business strategy for AI, aligning it closely with our customers' needs while accelerating our AI application development process. As Adriano mentioned, we are also very mindful of balancing growth and profitability.

I am very proud of the collective support from customers, partners, Semantix's team and investors on this journey of shifting the company towards proprietary SaaS products.

Our product roadmap keeps advancing with a strong emphasis on developing AI together with our customers.

I would like to thank our team and our valued investors. Your support has been instrumental in our journey. To all those who have joined us, we extend our gratitude. Now, we can start our Q&A session.

Thank you.