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Bakkt Holdings, Inc. (BKKT)

Q2 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Bakkt's 2023 Earnings Conference Call. At this time, all participants are in listen-only mode. A question-and-answer session will follow the formal presentation. As a reminder, this conference call is being recorded.

I would now like to turn it over to Ann DeVries, Head of Investor Relations at Bakkt. Please go ahead.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

Good morning, and thank you for joining us for Bakkt second quarter earnings call. Today's presentation, including a separate earnings call presentation that can be found on our Investor Relations website at www.investor.bakkt.com, will contain certain forward-looking statements. These statements are based on management's current expectations and are subject to risks and uncertainties which may cause actual results to differ materially from those expressed or implied in such forward-looking statements. For a more complete discussion on forward-looking statements and the risks and uncertainties related to Bakkt business, please refer to its filing with the Securities and Exchange Commission.

During today's presentation, in addition to discussing results that are calculated in accordance with generally accepted accounting principles, we will refer to certain non-GAAP financial measures. For more information on this, the basis of the presentation for our financial results and our non-GAAP measures, please refer to our earnings release, which was filed this morning with the SEC.

Joining me on today's call are Gavin Michael, Chief Executive Officer; and Karen Alexander, Chief Financial Officer. After our prepared remarks, we will answer questions we will receive from our investors on the Say Technologies platform. After that, Gavin and Karen will be available to answer questions from the analyst community.

I'll now turn it over to Gavin.

Gavin Michael

President, Chief Executive Officer & Director, Bakkt Holdings, Inc.

Thank you, Ann. Good morning, everyone, and thanks for joining. We're making meaningful progress, executing on the key priorities we set out at the beginning of the year. We expanded our crypto platform through the acquisition and integration of Apex Crypto, while activating and broadening our client network. And we're being prudent with capital allocation.

We're winning new custody and crypto trading clients, and building strategic alliances with prominent players as our capabilities and best-in-class infrastructure resonates with the market. We're expanding into new international markets alongside our clients, with Latin America expected to launch in the fourth quarter, and other markets such as the UK, European Union, Hong Kong and Australia to follow on. We're focused on delivering solid results for our existing loyalty clients as we work together to grow transaction volume.

Lastly, we continue to prudently manage expenses, resulting in improved gross profit margin. We're also updating our full-year 2023 operating cash flow outlook, and expect to improve approximately 20% from our prior guidance. Our platform provides end-to-end crypto capabilities from advanced trading and secure custody to fiat onramps. We offer secure custody of assets founded in traditional finance and built to uphold the shifting regulatory standards. Regulated by the NYDFS as a limited purpose trust company, that custody has reliable infrastructure with multi-layered security for streamlined management and disaster recovery services to help ensure customer funds are safe and recoverable.

We offer curated, secure and regulated crypto trading with API and UI options to activate trading responsibly. This includes unparalleled liquidity and price quality with 100% uptime, and seamless integration and customer experience, which enables clients to integrate in less than 45 days with instant fund settlement and failover protection. Capabilities also include coin transfer and advanced order management system and multiple fee structures. As part of crypto trading, our clients are increasingly utilizing Bakkt fiat onramps via ACH, debit or wire transfer for a smoother end-to-end customer experience. And we continue to offer innovative ways for consumers to access crypto, including through rewards redemptions and by earning or getting paid in crypto.

Our loyalty redemption capabilities remain a strength and offer a full spectrum of content, including Apple products and other merchandise, travel and gift cards. We've introduced personalized offerings and additional Apple products, while maintaining a strong list of SKUs and modernizing our infrastructure and architecture with cloud capabilities.

Through our B2B2C approach, we have a broad client reach in high growth sectors that provide efficient scalability. This network is looking to expand their relationship with their millions of customers, and crypto presents an opportunity to differentiate their services, drive engagement and revenue growth. And for Bakkt, it enables us to reach millions of end customers across a variety of providers.

We've made progress in integrating Apex Crypto into our business, including employee onboarding, integrating our product and technology processes, and managing key functions like compliance and risk, all with minimal impact to our existing client base. We completed the rebrand of Apex Crypto to Bakkt Crypto and transitioned all necessary documentation and materials for clients. With the integration of this deal mostly done, we're now focused on leveraging the synergies and expanded capabilities from this transformational deal to continue growing and drive further efficiencies on a go-forward basis.

Through our client-led model we're always working with our key clients to grow their business. Our work with Webull is a prime example of our ability to successfully execute, bringing together the combined strength of legacy Bakkt and Apex Crypto. Webull approached us to develop a new innovative app with ACH funding rails for their crypto customers. Our teams mobilized quickly, bringing together Apex Crypto trading and Bakkt funding capabilities to launch Webull Pay in less than 40 days. In solving for this, we also built ACH funding functionality, which provides a competitive advantage and we're seeing significant interest from other clients and prospects in utilizing fiat onramps.

Additionally, I'm pleased to share that Bakkt will be one of Plaid's crypto solution partners for its customers who are interested in offering crypto solutions to their end user. This is particularly exciting since Plaid has an extensive network of over 8,000 fintechs using their platform today. Through the Plaid and Bakkt partnership, those fintechs will be able to easily and safely explore offering crypto solutions to their users. We're pleased to share that we've expanded our network of crypto trading clients, mostly in the fintech industry. We've recently signed on several new clients, and are engaged in late-stage negotiations with a number of additional prospects.

We're also making solid progress on our international expansion strategy, actively working with our client base to develop and execute our go-to-market strategy in markets where we see regulatory clarity. We will serve as Invstr's crypto provider in the US, a relationship sourced through our commercial agreement with Apex Fintech Solutions.

We're also working with Swan Bitcoin to provide end-to-end bitcoin trading, fiat onramps and qualified custody. We also signed Blockchain.com, one of the first and largest crypto wallet providers in the world, along with Zaden and CryptoMom to provide end-to-end crypto trading. On the international front, we signed an agreement with IBEX to offer crypto trading for Latin America. These recent wins are strong testament to the product market fit of our capabilities, and the continued focus on growing our core crypto solutions.

Recent market events have highlighted the difficulty in storing digital assets safely, and the need for multi-custodian access and self-custodial functionality. Our secure and compliant custody platform offers unparalleled protection and complete customer control over their assets. It utilizes multi-layered technology and the latest breakthroughs in MPC cryptography with hardware isolation, ensuring that customer funds are protected from the various threats, including cyber attacks, internal collusion and human error.

Given this backdrop, we continue to see an increase in new client activity. We successfully signed new clients, and are in late-stage negotiations with multiple prospects in mining, family offices, registered investment advisors and corporate treasury industries. Qualified sales opportunities are up 10 times in the first half of 2023 versus the second half of 2022. The custody platform generates stable recurring platform fees, as well as assets under custody based revenue, further diversifying our revenue.

Bakkt's institutional-grade custody platform offers the security and licensing clients are looking for, including qualified [ph] custody (00:10:07) status with the New York Department of Financial Services, comprehensive security controls, regulatory compliance and streamlined user management and consensus protocols. Given its prominence as a strong anchor product, we're continuing to invest in our custody offering to meet demand from new and existing clients. We're redesigning the application to enhance our offering and exceed client expectations and anticipate launching the upgrade throughout the remainder of this year.

In this enhanced offering, we'll maintain all of the elements that make Bakkt custody exceptional. It will continue to offer a compliance-first focused approach with multiple layers of security and outstanding operational

management. These upgrades will make it easy to launch additional products, such as the ability to add new blockchain networks and the assets on those networks, retail open loop and institutional staking, which adds yield generating opportunities for our institutional clients.

We have a new, multifaceted, strategic agreement with Fireblocks. As part of this agreement, Bakkt will provide disaster recovery services to Fireblocks' Off-Exchange customers, and we will join the Fireblocks Qualified Custodian Network. The Fireblock's Off-Exchange solution allows participants to maintain control of their private keys without sacrificing the convenience and speed of trading on centralized exchanges. This has become a high focus product for the market as recent misappropriation of customer funds by exchanges has led to the demand for safe trading solutions.

We're also integrating Fireblocks technology to fortify our custody offerings. For disaster recovery services, we will leverage our secure infrastructure to provide backup storage to ensure customer funds are safe and recoverable. Every Off-Exchange customer will require a disaster recovery package. So there's tremendous opportunity for Bakkt in safeguarding these assets.

By joining the Fireblocks Qualified Custodian Network, we'll be connected to the thousands of organizations across the crypto ecosystem who use the network every day, including exchanges, liquidity providers and custodians. There's only a select group of qualified custodians in this network, and we're proud that our differentiated, secure and compliance-first focused approach enabled us to be selected. The broad reach of this network will fuel our pipeline of prospects for our full suite of crypto solutions. We'll continue working with Fireblocks to jointly deliver additional use cases, and capabilities to the market through our strategic alliance.

With that, I'll turn it over to Karen to discuss our financial and operating results for this quarter.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

Thanks, Gavin. I'll now walk you through our second quarter financial results. A quick reminder that this quarter includes the results of Apex Crypto, which we acquired on April 1, 2023. Apex Crypto materially increases our crypto service revenue such that we now present crypto services revenue as a distinct component of our revenue. In accordance with GAAP, we are presenting crypto service revenue as well as crypto cost and execution clearing and brokerage fees on a gross basis, since we are a principal in the crypto services we provide to our customers. But in contrast, we are an agent in the loyalty redemption services we provide our loyalty customers. So, loyalty revenue is presented on a one-line net basis.

Crypto costs and execution, clearing and brokerage fees, which we will refer to as crypto costs and ECB for the remainder of this call, will drive crypto services revenue, and the difference between these two line items represents crypto trading's contribution to margin. Please see the notes section of our earnings presentation for additional detail on crypto services revenue and related costs.

Turning to slide 13, we have our second quarter 2023 financial results. We had total revenues of \$347.6 million, of which \$335.3 million was gross crypto services revenue, which increased significantly due to our acquisition of Apex Crypto. We had \$12.3 million of net loyalty services revenue.

Operating expenses were \$398.7 million in the period, which reflects a significant increase in crypto costs and ECB driven by the related crypto services activity. During the quarter, we had \$17.0 million of acquisition related expenses. \$10.4 million of this was a non-cash accrual related to the estimated fair value of the contingent stock earn-out associated with our acquisition of Apex Crypto through 2025. We will update the estimated fair value of

the contingent stock earn-out on a quarterly basis, based on the forecasted gross crypto revenue less crypto cost and ECB associated with the Apex Crypto relationships. As such, the accrued stock earn-out as of June 30 is subject to change as our revenue forecast changes. The 2023 and 2024 earn-outs will be finalized as part of our 2023-2024 year-end reporting.

Operating expenses, excluding crypto costs and ECB, were \$64.7 million. Excluding acquisition related expenses, operating expenses were \$47.7 million, which represents a decrease of 16% year-over year, primarily due to a reduction in total compensation and benefits, as we are starting to see the benefits from earlier expense actions.

The net loss for the quarter was \$50.5 million, which resulted in a diluted net loss of \$0.19 per share at an average diluted share base of 89.8 million shares. Net loss allocated to the non-controlling interest in the operating company was \$33.7 million, leaving a \$16.8 million loss attributable to Bakkt Holdings, Inc., for a net loss of \$0.19 per share on an average basic share count of 89.8 million shares.

Our total share count as of June 30 was 274.6 million shares. ICE remains our largest shareholder as they own 64% of our aggregate shares, which has remained relatively consistent with their shareholding in prior periods. Note that the percentage ownership is down slightly from prior periods, due to new Class A share issuances and not due to the sale of shares by ICE.

On slide 14, we have our EBITDA and adjusted EBITDA for the second quarter of 2023. Adjusted EBITDA reflects adjustments for non-cash and acquisition related items that impacted the period. EBITDA and adjusted EBITDA for the quarter were losses of \$47.2 million and \$24.5 million, respectively. Adjusted EBITDA loss improved versus the prior-year period, primarily due to lower compensation and benefit costs.

On slide 15, we show revenues for the company. Given the increase in crypto revenue resulting from our acquisition of Apex Crypto, we are now presenting revenue broken out between crypto and loyalty revenue in addition to the revenue detail for subscription and service revenue and transaction revenue. Total revenue in the second quarter of 2023 was \$347.6 million. As I noted earlier, crypto services revenue is reported on a gross basis. For the second quarter, gross crypto services revenue was \$335.3 million, which was the result of the increased crypto transaction volumes from our acquisition of Apex Crypto.

Net loyalty revenues of \$12.3 million were down 8% year-over-year. This was driven by a decline in subscription and service revenues, which were \$5 million for the quarter, down 23% year over year. The reduction we saw here was primarily due to lower volume-based service revenue. Service revenue has a variable component, and is driven by activity levels at our customer call centers and technology development work on behalf of our clients. Loyalty transaction revenue was \$7.3 million, increased 6% year over year, due to an increase in air travel volume. However, this was partially offset by lower hotel and car booking volumes, which have remained under pressure since the latter half of 2022.

Turning to slide 16, we have total operating expense. Total expense for the second quarter of \$398.7 million includes \$334.0 million of crypto costs and ECB. These costs are driven by crypto trading volume. SG&A expenses of \$7.6 million were down 23% year over year due to a reduction in marketing expenses. Total compensation expense of \$27.1 million declined 21% to the second quarter of 2022 due to lower head count and a decrease in non-cash compensation expense. Other expenses of \$30.1 million included \$17.0 million of acquisition related expenses, of which \$10.4 million is the non-cash accrual of Apex's stock contingent earn-out, as noted previously. We are pleased that we're starting to see the benefits in our gross margins from our prudent expense management actions. As a reminder, we expect the impact from earlier restructuring actions in 2023 to be \$29 million of expense savings and an incremental \$7 million of expense savings is expected in 2024.

Turning to slide 17, we have a new slide comparing gross crypto services revenue and crypto costs and ECB on a quarterly basis. You can see on this chart how crypto costs and ECB drive gross crypto services revenue. The gap in the two columns for a given time period depicts the net contribution to margin from crypto trading activities. Gross crypto services revenue of \$335.3 million was impacted by lower industry-wide activity levels in May, as you will see in our key performance indicators on the next slide. Crypto costs and ECB of \$334.0 million were in line with revenue levels.

On slide 18, we have our key performance indicators. We have made updates to our KPI disclosures to provide additional detail on volume activity for legacy Apex Crypto. Although our acquisition of Apex Crypto closed on April 1, 2023, we have included Apex Crypto in the historical KPI figures on the slide for comparison purposes. The KPIs we will now be disclosing are our crypto enabled accounts, transacting accounts, notional traded volume and assets under custody. For more information on how we define these metrics, please see the notes section of our earnings presentation.

We had 6.0 million crypto enabled accounts at the end of the second quarter, which reflects steady increase over time. Next, we have our transacting accounts, which we break out into crypto and loyalty accounts. There were 1.2 million transacting accounts in the second quarter, of which 740,000 were for a loyalty redemption and 441,000 for crypto trading.

Loyalty redemption and transacting accounts were up 9% year over year, due to higher air travel activity. Crypto transacting accounts were down 10% sequentially due to the industry-wide slowdown in the crypto market activity in May. Notional traded volume is also broken out between crypto and loyalty redemption. Total notional traded volume was \$531 million, of which \$334 million was from crypto and \$198 million was related to loyalty redemptions.

On this chart, we have also included crypto industry trading volumes, which is the orange line. As depicted here, our trading volumes were down 25% sequentially. Our business outperformed the overall crypto market industry, which was down over 40% during the same time period. Meanwhile, loyalty redemption volume was down 3% year over year, driven by lower hotel, rental car and merchandise redemption activity. Our assets under custody at \$660 million declined 8% sequentially, due to a reduction in certain client prices.

Turning to slide 19, we have our condensed balance sheet. We ended the second quarter with \$99.4 million of cash, cash equivalents and available-for-sale securities. In the second quarter, we had cash usage of \$18.2 million. Second quarter cash usage included \$5.0 million for acquisition-related expenses, a \$2.7 million in marketing partnership payment and \$1.8 million of insurance costs.

On slide 20, we have updated our full year 2023 outlook. Our updated guidance reflects the impact from the acquisition of Apex Crypto. Taking into consideration the disclosure of revenues on a gross basis and associate crypto trading costs as well as the current market environment, for the full year 2023, we expect revenues to be in the range of approximately \$2.132 billion to \$3.771 billion. This includes gross crypto revenues of approximately \$2.077 billion to \$3.716 billion, which includes the impact from Apex Crypto.

Our revised forecast also reflects the solid progress we have made signing up new clients and international expansion, as well as the recent industry-wide slowdown we have seen in crypto market volume. We expect full year 2023 crypto trading costs to be in the range of \$2.069 billion to \$3.702 billion. This is in line with our expectations for gross crypto revenues. Our full year 2023 outlook for loyalty net revenues is expected to be

around \$55 million. We expect loyalty transaction revenue to be relatively flat coming off a strong 2022, post COVID rebound.

This contrasts with our expectations for the loyalty business at the beginning of the year, when we expected continued growth in transaction volumes from 2022 levels. What we have seen so far this year is durability of the 2022 loyalty transaction volume, which effectively resets post-COVID. We've also updated our loyalty revenue outlook to reflect the lower loyalty service volumes we experienced in the recent quarters.

As a reminder, the guidance we gave earlier this year for net revenue was \$62 million to \$72 million. If you net out crypto costs against gross crypto services revenue and add back the net loyalty revenues, the expected contribution to margin is \$64 million to \$70 million.

For the full year 2023, we expect net cash used in operating activities to be \$78 million to \$84 million. You'll recall that the guidance we provided earlier in the year with operating cash usage at \$100 million to \$110 million. So, a significant improvement here due to our focused and disciplined expense management. Free cash flow usage is expected to be \$90 million to \$96 million. This compares to our prior guidance of free cash flow usage of \$105 million to \$115 million. This reflects a 70% to 80% reduction in free cash flow usage for the second half of the year versus the first half as we continue to focus on prudently managing our expense base.

I'll now pass it back to Gavin for his closing remarks.

Gavin Michael

President, Chief Executive Officer & Director, Bakkt Holdings, Inc.

Thanks, Karen. Just a few final thoughts. We've made substantial progress this past quarter and we're building momentum for future growth. We were at a pivotal moment at the beginning of the quarter, having just closed our acquisition of Apex Crypto on April 1. We've been off to the races since, integrating Apex Crypto, launching new capabilities, expanding internationally, signing new client relationships, and building new strategic alliances with leading brands such as Plaid and Fireblocks. I'm proud of our teams who have worked tirelessly to make this progress happen in such a short amount of time.

There's still so much more to come. We've built a platform that's really ready to take off and grow. We've made many of that big investments, and we're now leveraging the capabilities to scale our business. We will continue to work hard every day to deliver strong results to our clients, our partners and our shareholders. I'm optimistic about our future. I can't wait to share more as we continue to execute and win. Thank you for joining us today. I'll turn it over to Ann to manage Q&A.

QUESTION AND ANSWER SECTION

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. Let's move over to questions from the investor community. Leading into our Q&A session, we'll start by answering the top questions from Say, ranked by number of votes. After that, we'll turn to live questions from the analyst community. Our first question comes from [indiscernible] (00:28:30) who would like an update on the progress we've made on previously announced partnerships. They note that crypto market conditions have improved in the last quarter significantly, and wants to know what this means for our partnerships. Gavin, can you take the question?

Gavin Michael

President, Chief Executive Officer & Director, Bakkt Holdings, Inc.

A

Yes, sure. I'm happy to. Thanks for the question. We've discussed in detail during our prepared remarks the substantial progress you've seen us make recently, building out our client base and forging new collaboration with industry leaders such as Plaid and Fireblocks. And we're really pleased with the momentum that we're building, and it really is a proof point of how our acquisition of Apex Crypto could not have happened at a better time.

Our ability to expand into the rapidly growing fintech space and into international markets is even more compelling right now. Although we're seeing some more activity in the US around regulation for crypto, we're still not where we need to be. The lack of regulatory clarity for crypto has kept the activation of our TradFi partners on pause. We've long since completed most of the integration and go-to-market work with our TradFi partners. And we'll be ready to go when the time is right to enter the market.

We're making good progress with our non-TradFi clients. With Caesars, we're actively engaged and executing with them to launch crypto rewards. Our cross-functional teams, including engineering, sales, marketing and design, are collaborating closely to activate these capabilities. Stay tuned as we anticipate providing additional announcements on this before not too long.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. Next, we have another question from Working P., who would like to know why Bakkt was not selected to provide custody solutions for any of the recently announced Bitcoin spot ETFs despite our compliance-first approach. Karen, can you take this one?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Sure. Happy to take that question. Custody has always been a very important part of our business. Our secure and reliable platform is trusted by clients and it's the backbone of our company. That said, historically we have focused much of our sales and marketing efforts on the more scalable go-to-market opportunities through our B2B2C approach. While custody has always been an important part of the platform, given our focus on B2B2C, we're not always aggressively marketing our custody capabilities to win new business.

We've been fortunate that our clients are proactively reaching out to us with interest in our secure, trusted, institutional-grade custody platform. This influx of client interest has been even more pronounced following recent

disruptive events in the crypto markets, which have highlighted the difficulty in storing digital assets safely and the need for multi custodian access secure self-custodial functionality. We have been successfully signing up new clients for our custody product, and we are focused on building on this momentum to continue expanding our client base and custody capabilities.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Karen. Next, a few people have asked about international expansion and a status update around when we expect to launch. I think we answered this in the prepared remarks, but Gavin, please add any additional thoughts you might have here.

Gavin Michael

President, Chief Executive Officer & Director, Bakkt Holdings, Inc.

A

We mentioned earlier in the prepared remarks that we signed an agreement with IBEX to offer crypto trading for Latin America, which we expect to launch in the fourth quarter of this year. We're working closely with our existing clients to bring our capabilities into the United Kingdom, European Union, Hong Kong and Australia. While we're making solid progress on these efforts, and hope to be launched soon, as everything we do, we're being thorough and careful to ensure that we're following all of the rules and regulations in these markets. Our compliance-first focused approach is what differentiates it, and we do not make compromises with it. We think that we're getting close with expansion into additional markets, and I hope to share more with you soon.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks for that, Gavin. Our final question from the Say platform will be from Jonathan P. who asks, will Bakkt be a company that investors will look back on and be proud of having invested their hard earned money into. Karen, this one's for you.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Sure. Happy to take that one. Hopefully, you've gathered from our strategic highlights for the quarter the great amount of progress that we've made and the momentum that we're building. We're taking the top notch platform that we've worked tirelessly to build and leveraging it to scale and grow. We've done the heavy lifting already with the investments and the infrastructure build and the product development. Now, it's our time to scale and grow. I truly believe that Bakkt is well positioned to succeed and win. And our teams work day and night to make that happen. I'm extremely proud to be a part of this organization, and believe our shareholders will look back and be proud of all that we've accomplished. I know being an investor in our stock has not always been an easy journey, and I thank you for sticking with us.

While we can't control all of the market and economic factors that have negatively impacted our stock, we will continue to control what we can to drive positive shareholder value. That includes disciplined expense management, balanced with strategic capital allocation in areas where there is a clear path to profitability.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Karen. And with that, I would now like to turn the call back over to the operator to open up the phone lines to take questions from the analyst community.

Operator: Thank you, Ann. [Operator Instructions] Our first question today comes from Trevor Williams from Jefferies. Please go ahead.

Trevor Williams

Analyst, Jefferies LLC

Q

Great. Thanks. Good morning, guys. Maybe to start, Gavin, just would love your perspective on the regulatory environment, all the moving pieces. I know it's a very fluid month-to-month situation, but just maybe kind of the State of the Union of how you guys view the regulatory environment, what you're expecting to come out of Congress, if anything, over the next 6 to 12 months, how some of the recent SEC actions and court cases, how any of that affects you guys? So, I would just love kind of your broader perspective on it. Thanks so much.

Gavin Michael

President, Chief Executive Officer & Director, Bakkt Holdings, Inc.

A

Hey. Good morning, Trevor. Thanks for the question. I think when you look overall, I think it still is a tale of the US versus what's happening outside of the US. In the US, obviously, the repo decision has been a sort of a setback to the SEC with respect to some of the enforcement actions that we've seen against industry participants looking at unregistered securities. But, when you look at it as a whole, I think it will act as the catalyst for where we're going with Congress, and we'll start to see some movement. But when we think about it overall, I think the lack of clarity on how cryptos should be regulated is still apparent with where we are. While I'm hopeful that Congress is paying attention to this and I'm encouraged by the progress that we've seen, I think the market structure bill in the House is a good example.

As I said, there's a long way to go before it or any of the other bills come into law. We continue to make our voice heard on Capitol Hill to sort of encourage Congress to resolve the lack of clarity quickly. I think when we look outside of the US, I think we're seeing clarity come into some of the markets that we've spoken about in our prepared remarks. Ones that we're excited about and we see the entry. But I think here in the US, we're still seeing that ambiguity. And it's that lack of clarity that has moved, forcing some of the participants to still sit back and continue to watch what's happening with that landscape, because without the clarity, they're unsure about what their entry strategy should be.

Trevor Williams

Analyst, Jefferies LLC

Q

Got it. Thank you. That's helpful. And then, maybe for both you and Karen, it's nice to see the cash burn coming down just a little bit. Maybe give us a sense for kind of where some of the reallocated priorities have been just within kind of your investment spend framework, where maybe you've kind of de-emphasized or re-emphasized within the updated outlook for expenses. Thanks so much.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

I can take that one, Trevor. So, I am glad that you noticed that. I think we're making a lot of great progress in terms of reducing cash burn and really being prudent with expenses. So, the trend that you see for the second quarter, that's going to actually continue, where our free cash flow burn for the second half of the year is going to be 70% to 80% less than what we had at the beginning of the year. A lot of that came through some very tough decisions that we had to make earlier in the year in terms of head count reduction. But we're also at the point now where we've built a lot of the infrastructure and technology that we need to go to market. We are still investing in

the crypto business, but we're really being prudent in those additional investments, making sure that we're putting them where there's immediate product market fit.

So, one of the things that we talked about earlier in the presentation was custody. That's a great example of where the market is actually coming to us, recognizing what we can contribute to with our platform, with our compliance-first approach, with the fact that we're a [indiscernible] (00:38:39) custodian. So, custody is one of those areas where we're allocating capital, because we see the return there.

And then, we also continue to see the return and the opportunities on the crypto trading piece, not only with our international opportunities, but as Gavin mentioned, we do see demand increase for the [indiscernible] (00:39:01) rails that Bakkt historically has been able to provide. So, that's another area where you'll see us continue to add capital.

But at this point, I think with the actions that we took and as you've heard me talk about before, those actions reset the operating expenses by \$29 million in 2023 with an additional \$7 million reduction in 2024. So, we're really looking to have this reset expense base drive future growth.

Trevor Williams

Analyst, Jefferies LLC

Q

Thanks. Appreciate it.

Operator: The next question on the line is from Andrew Bond from Rosenblatt Securities. Please go ahead.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Hey. Thanks. Good morning. So, it looks like you guided up with starting to make some strong progress across the board here. With regards to custody, just thinking from a modeling perspective, when do you think new customer growth should begin to translate to meaningful revenue there?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. Hey, Andrew, it's Karen. So, in terms of what we've given as the outlook for 2023, we haven't broken that out between custody and trading. I can just give you a little bit of color in terms of how we price those services. So, typically, you're looking at a pricing model that has – that's based on assets under custody with a minimum. And then, you're also looking at incremental transactional revenue with draws and deposit activity. But as Gavin mentioned, we're offering more than just traditional custody. So, for instance, the backup key work that we're doing, that is something that is actually a platform-based, kind of almost like a subscription-based model. So, you're going to see a combination of both of those things as we ramp that up into 2024.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Got it. Okay. Karen, you mentioned kind of outperformance in trading relative to broader market. And there were some noted share shift during the quarter amongst some of your competitors. I mean, can you talk about how you guys are looking at market share dynamic and if anything stands out for Bakkt broadly, or particularly within some of the different Apex segments you guys have?

Karen Alexander*Chief Financial Officer, Bakkt Holdings, Inc.*

A

I think one of the things when we look at our trading activity, [indiscernible] (00:41:31) what we're seeing in the broader market, we have a customer base through the acquisition of Apex that is based in fintech. They are active equity traders, and we see a strong correlation there between investors, who are active equity traders and their propensity to trade more crypto as well. So, I think, compared to the broader market, I think we have an investor base that is probably more active as they see market volatility.

So, I think that's one of the reasons that we would see a little bit more durability. Our [indiscernible] (00:42:15) the market in general, and then we were able to rebound quickly. So, I think as you probably know, May was probably the worst month of the second quarter. I think everybody had a bad May, but our May was not nearly as bad as everybody else. And then importantly, our June rebounded faster than the market in general.

Andrew Bond*Analyst, Rosenblatt Securities, Inc.*

Q

Okay. And just lastly, in terms of the partnerships with rewards [indiscernible] (00:42:42) before, just thinking about actually the cross-sell opportunities to some of your – the legacy Apex clients and has that kind of been any progress there? And have you seen some interest from some of the clients that came over from Apex in your rewards solutions?

Gavin Michael*President, Chief Executive Officer & Director, Bakkt Holdings, Inc.*

A

Andrew, I'll take that one. Good morning. It is – we certainly see it in terms of the discussions that we're having. I mean, there's interest around the engagement that these platforms want to be able to create with their customers. Obviously, they're highly engaged platforms because of the trading activity. What they're looking to do is to look at other ways in which they can potentially diversify their revenue streams or bring people back in to their environments on a more frequent basis. And we think some of the rewards propositions, particularly on the crypto rewards side, have the ability to do that. So, there's definitely been strong discussions with some of those clients, and we're hoping to see it turn into opportunity, but right now, their focus is on addressing and ensuring that their trading businesses are working in the current macro.

Andrew Bond*Analyst, Rosenblatt Securities, Inc.*

Q

Okay, thanks, Gavin and Karen.

Karen Alexander*Chief Financial Officer, Bakkt Holdings, Inc.*

A

Thanks.

Gavin Michael*President, Chief Executive Officer & Director, Bakkt Holdings, Inc.*

A

Thanks, Andrew.

Operator: The next question on the line is from John Roy from Water Tower Research. Please go ahead.

John M.A. Roy*Analyst, Water Tower Research LLC*

Q

Great. Thank you. So, given that Apex just closed this quarter, how should we be thinking about the take rate on the crypto transactions there?

Karen Alexander*Chief Financial Officer, Bakkt Holdings, Inc.*

A

John, this is Karen. That's a great question, especially because with this material increase in crypto revenue, our income statement is now showing a lot of big numbers on a gross basis. So, maybe what's most helpful is if I take you through the statement of operations and so in how we think – what we're seeing as take rate, what drives it. So, when you think about the growth crypto services revenue that we have, the vast majority of that is from the gross trading volume that we have with our customers. But that is not the only thing that's in there. So, there are platform minimums of these that also come into play with that line item.

Crypto cost is really the cost of providing the crypto basically after the spread that we charge. And then we have execution, clearing and brokerage fees, which is really the – if you think about how we partner with our partners, they're really serving us introducing [indiscernible] (00:45:35) to us. And so, that's the rev share that we give them.

So, if you think about all those things together, as I mentioned in the call, the gross crypto services revenue less the crypto cost and execution, clearing and brokerage fees really represents the net contribution of crypto trading to our operations. And so, if you do the math, for instance, for the second quarter, you're seeing a take rate of about \$0.38. And so, again, that's really the – it's the spread in the minimums that we get on the trading, less what we share to our partners, which is really a byproduct of our B2B2C approach, which is – what we think is a very efficient way to get access to all these customers.

And so, as we go forward, I think we'll be talking about how that that take rate against – again, the difference between those three line items changes over time and the key drivers, because every partners are different in terms of how they want to set the spread. And then, we have different arrangements with different tiers of profit sharing. So, that is going to be somewhat dynamic over time. But we've been seeing it in the depths of the high 30s rate for some time.

John M.A. Roy*Analyst, Water Tower Research LLC*

Q

Great. Thanks. Now, obviously, there's been a lot of discussion on OpEx, so it seems to be if you adjust for acquisition expense and crypto cost, your OpEx seem to be coming down. So, what do we want to think about a run rate for OpEx going forward? And any kind of color you can give me on the non-cash accrual for acquisition stuff, that would be helpful as well.

Karen Alexander*Chief Financial Officer, Bakkt Holdings, Inc.*

A

Yes. Yes. In terms of OpEx, I think, obviously, one of the biggest component is our compensation and benefit expense. So, hopefully, the guidance that we provided earlier in terms of the impact of the decisions that we have made earlier in the year, it is coming down in the second half and then you'll see additional declines in OpEx expense in 2024 when you get the full year impact of those decisions of about \$7 million.

As it relates to the accrual that is in the acquisition expense, yeah, it is probably a little bit unusual, but you have to think back to the structure that we put in place when we bought Apex. So, there was, as you recall, a cash component of purchase price and then there were stock earn-outs that were dependent on revenue performance over certain periods.

And so, what you're seeing there in that \$10.4 million non-cash accrual is GAAP requires us every quarter to fair value that contingent consideration, that stock contingent consideration that will be paid out through 2024 and 2025, based on our expected outlook, the contribution that Apex Crypto's customer base has to our net revenue. So, yeah, the fact that we have an accrual, it's certainly not the whole \$100 million potential stock compensation that they could get over 2023 and 2024 performance yet. But we are seeing average – based on what we see now with the scenarios where some of that stock comp can get paid out. So, that's what we're accruing for. But that's going to change every quarter and it's really just have to wait until year-end 2023 and year-end 2024 where we actually fix those amounts. And again, I would remind you that that is not a cash expense. That is all stock earn-out.

John M.A. Roy

Analyst, Water Tower Research LLC



Great. Thanks, Karen.

Operator: [Operator Instructions] It appears we have no further questions. I'd like to hand back to Ann to conclude.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

Great. Thank you, everyone, for attending our earnings call this morning. We look forward to connecting with you again soon. Take care.

Operator: Ladies and gentlemen, this concludes our event. You may now disconnect. Goodbye.

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