14-Nov-2023

Bakkt Holdings, Inc. (BKKT)

Q3 2023 Earnings Call

CORPORATE PARTICIPANTS

Ann DeVries
Head-Investor Relations, Bakkt Holdings, Inc.

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

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

OTHER PARTICIPANTS

Yvonne Jeng
Analyst, Jefferies LLC

Andrew Bond
Analyst, Rosenblatt Securities, Inc.

Peter Christiansen
Analyst, Citigroup Global Markets, Inc.

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

MANAGEMENT DISCUSSION SECTION

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

I will now turn it over to Ann DeVries, Head of Investor relations of Bakkt. Please go ahead.

Ann DeVries
Head-Investor Relations, Bakkt Holdings, Inc.

Good morning, and thank you for joining us for Bakkt's third quarter earnings call. Today's presentation including the separate earnings call presentation that can be found in 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 filings 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 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 that we receive from our investors through 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. Earlier this year, we communicated our plan to simplify our business and allocate our capital towards areas of the business with strong product market fit, scalability and a clear path to profitability. During the course of 2023, we've made substantial progress against this goal.

Our specific priorities for the year included expanding our crypto platform, expanding and activating our client network and strategically allocating capital. Our teams are being nimble and flexed to deliver on all of these priorities despite challenging market conditions. The US crypto market remains challenging. We still lack a clear regulatory framework and headwinds from bad actors in the space have muted trading volumes. However, we are seeing green shoots with institutional investors looking to participate in crypto ETFs and digital asset tokenization.

We've been flexible in adjusting our strategy as needed to meet these challenges. We've made international expansion a key priority, and we've demonstrated our ability to act quickly with our capabilities active in nine new markets by the end of this year. And there's more to come on the international front. This is just the beginning for us. This will generate strong revenue growth for us as we look to 2024. We continue our focus on custody and signing up new clients. With the recent flight to quality that we've experienced, as well as delivering enhancements to our offering, the custody product further diversifies our future revenue streams, given it's not as reliant on trading volumes. We've also reduced our reliance on market volumes and the related volatility in our revenue stream by signing on new clients with more of a subscription-based revenue model. Lastly, in light of the challenging market and slower revenue opportunities this year, we've been focused on controlling expenses. We've made a lot of hard decisions to make cuts and have been very prudent with our spend. It hasn't always been easy, but it's paid off with our core operating expenses, excluding crypto costs and impairment charges down 26% year-over-year. That's real progress and we'll continue to focus on that.

2023 has been a year of enhancing our industry leading platform across advanced trading capabilities and secure compliant custody that's built to evolve and adapt with the changing regulatory landscape. Our platform has reliable infrastructure that supports our trading and custody capabilities. Recent market events, including SBF's guilty verdict, all underscore how important it is to crypto responsibly and how critical it is to have a partner like Bakkt, who upholds the highest standards of transparency, security and compliance.

Our loyalty redemption capabilities also continue to be a strength as we provide our clients with a full spectrum of flexible and comprehensive solutions. While we remain committed to expanding in the US market, we've adjusted our strategy to quickly overcome the challenging US crypto trading environment. With that, we've capitalized on opportunities to expand with new and existing clients into attractive international markets with more regulatory clarity and sizable addressable markets. We're currently live with crypto trading in Spain and several Latin American regions, including Argentina, Brazil and Mexico. We plan to continue to further expand with our partners in LatAm, such as Hapi and IBEX.

As we shared last week, Bakkt plans to offer our crypto trading and custody services to 3.0verse in the UK, the EU, Australia and throughout Asia, including Singapore and Hong Kong. All anticipating activation by year-end. These examples are just the beginning stages of our international expansion efforts. As we enter into new markets we will follow a land and expand strategy, meaning following our initial launches, we will expand our network and reach with other clients. The hardest part of expanding into new markets is the initial landing. Once we've done that, further expansion is relatively painless as we've already taken steps to ensure we are compliant and regulatory first within these markets, we can confidently and quickly broaden our reach to millions of new customers going forward. In addition to the international clients, we continue to grow in the US as well, expanding our broad network and further emphasizing our product market fit.

On the trading front, Bakkt's secure platform is resonating with crypto native companies in the industry, such as OpenNode, which intends to use our advanced end to end solutions. Events of the past year have shown the value and need for qualified custodians, and in turn we've seen increased interest in our secure and highly regulated platform. We're expanding with institutionally backed companies like EDX Markets, a digital asset marketplace for crypto-native firms and large FIs. Bakkt as a qualified custodian, has preliminary agreed to join the clearing house and custodial network.

We've entered the family offices and high net worth space with our new live client LeboBTC Ledger Group, a firm that helps investors seamlessly access the most liquid digital asset markets for the acquisition and safe storage of cryptocurrencies. These customers have unique needs and Bakkt is well positioned to serve them as a qualified custodian. And finally, we've agreed to enter Unchained enterprise custody network. Unchained allows our clients to securely take control of their Bitcoin with their cold storage vaults. As part of the custody network Bakkt intends to serve as the institutional signatory also known as a key agent for customers collaborative custody multisig vaults.

We've made substantial strides this quarter, expanding our trading and custody network, and as this expanded network allows us to reach new industries and new international markets in our work together. These recent wins are a testament to the product market, fit of our capabilities and the continued focus on growing our core crypto solutions.

As our crypto business matures and we grow both internationally and domestically, we expect that our revenue mix will also evolve with an increasing share of our revenue coming from subscription-based annual recurring revenue, which will provide stability during uncertain crypto markets.

We're executing at a faster rate than ever before, moving quickly with newly signed clients in order to activate and go live efficiently. We offer seamless integration and customer experiences which enable clients to integrate in around 45 days adding active traders to our platform quickly. We're currently live with Blockchain.com, LeboBTC, Hapi and Finequities due to our smooth onboarding and activation experience.

We continue to expand our relationships with our current partners. Invstr recently appointed Bakkt as its US crypto provider with migration of the existing customer accounts expected by year-end. We're also expanding our crypto capabilities with Blockchain.com into new US regions, including Hawaii, Louisiana, Nevada and Virginia. We executed rapidly with Webull to facilitate a smooth Webull Pay app launch, and we're now enabling account signups. During this quarter Webull finished migrating customers to Webull Pay. Due to the migration during the quarter, we experienced a slowdown in client activity on our platform. We've been working closely with the Webull team to monitor customer activity and rollout enhancements to improve their customers' experience and drive deeper engagement levels. We're pleased to continue expanding our relationship with Webull Pay. As some other clients have decided to exit the crypto business, Webull Pay has created a model to transition crypto accounts and maintain them on the Bakkt platform. We're also working to expand our relationship with Webull on new and exciting use cases.

We have been working closely with the Caesars team to bring our crypto rewards capabilities to their members. Once live Caesars Rewards members will have the option to redeem their rewards credits for Bitcoin via Bakkt's user friendly experience. Our teams are excited to bring crypto capabilities to the more than 60 million members of the worldwide highly acclaimed Caesars Rewards platform early in Q1.

We are relaunching our custody platform with increased capabilities, including segregated wallet structure and a flexible policy engine.

Our platform offers a foundation for our clients to safeguard their crypto assets. In collaboration with our clients, we will offer off-exchange trading, settlement service and co-custodial service, illustrating the breadth of the platform. We'll be expanding the coins that can be custodied on our platform to include a total of eight coins: Bitcoin, Ethereum Bitcoin Cash, Dogecoin Ethereum Classic, Litecoin, Shiba Inu and USD Coin. Our redeveloped offering has already been awarded Best Digital Asset Custodian by the Digital Banker, and we've notably increased our marketing efforts to continue to spread awareness of our offering. We've gained significant interest in our upgraded platform from both existing clients and prospects, with many now operating in our sandbox.

While trading and custody will always be at Bakkt's core, we've spoken many times about the evolution of crypto and Bitcoin from a speculative asset to powering everyday utility. With this, we've been investing in the Lightning Network and we're looking forward to the near-term launch of our Lightning Service to select clients. This service will allow them to leverage for cross-border remittances, B2B settlement, instantaneous deposits and withdrawals for trading, and global interoperable P2P. We have partnered with two of the leading lightning service providers to collaboratively build out our global network of compliant on and off ramps.

Our multifaceted relationship with IBEX includes working together on Lightning, and we've recently shared the news that we'll be collaborating with Lightspark to support a new open standard for money transmission, universal money addresses or UMAs. UMA makes sending money as simple as sending an email. And the new service can be leveraged for a number of use case. We have a vision for Internet-native payments that is shared by Lightspark and IBEX. These partnerships are a natural fit for our business.

So with that, I'll turn it over to Karen to discuss our financial and operating results for the quarter.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

Thanks, Gavin. I'll now walk you through our third quarter financial results. A quick reminder that in accordance with GAAP, we present crypto services revenue in crypto costs and execution clearing and brokerage fees on a gross basis. Since we are a principal in the crypto services, we provide our customers. By 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 drive gross crypto services revenue. And the difference between these 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 third quarter 2023 financial results. We had total revenue of $204.8 million, of which $191.8 million was gross crypto services revenue. Total revenues increased significantly year-over-year due to our acquisition of Apex Crypto, which closed on April 1, 2023. We had $13.0 million of net loyalty services revenue. Operating expenses were $257.6 million, which reflects a significant year-over-year increase in crypto costs and ECB, driven by related crypto services activity.

During the third quarter in accordance with Generally Accepted Accounting Principles, we conducted our annual goodwill and intangible assets impairment testing. Earlier this year, we spoke about strategically allocating more of our capital towards the crypto business while maintaining existing offerings and relationships in the loyalty business. We made [ph] this decision (00:15:57), given our expectations for which products have a clear path to profitability. Given the pullback of significant investments in the loyalty business, we had lowered our long-term revenue growth expectations for this business. As a result, we've recognized a $23.3 million non-cash intangible assets impairment charge and our loyalty technology and customer relationship intangible assets and the Bakkt brand name intangible. The charge is non-cash and does not have any impact on our future operations or affect the liquidity or cash flow from operating activities.

Operating expenses, excluding crypto cost and ECB and non-cash goodwill and intangible asset impairment charges were $44.2 million. This represents a decrease of 26% year-over-year. This improvement is primarily due to a reduction in total compensation and benefits, as we are continuing to recognize the benefit from earlier expense actions.

The net loss for the quarter was $51.7 million, which resulted in a diluted net loss of $0.19 per share on an average diluted share base of 91.4 million shares. Net loss allocated to the non-controlling interest in the operating company was $34.4 million, leaving $17.3 million loss attributable to Bakkt Holdings, Inc. or a net loss of $0.19 per share on an average basic share count of 91.4 million shares. Our total share count as of September 30 was 274.7 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. We note that the percent ownership is down slightly year-over-year 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 third 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 $48.7 million and $21.6 million, respectively. Adjusted EBITDA loss improved during the prior year period, primarily due to lower compensation and benefit costs.

On slide 15, we show revenues for the company. Total revenue for the third quarter of 2023 was $204.8 million. Gross crypto services revenue for the quarter was $191.8 million. The quarter-over-quarter decline that we saw in the third quarter was due to a slowdown in overall industry wide activity levels, as well as lower customer activity during the migration of Webull accounts to Webull Pay, which Gavin mentioned earlier on this call. We've been working closely with the Webull team to monitor customer activity and roll out enhancements to improve their customers' experience and drive deeper engagement levels in the new app. As Gavin mentioned earlier, as our crypto business matures, we expect that our revenue mix will also evolve with an increasing share of our revenue coming from subscription-based annual recurring revenue. This should reduce our reliance on industry activity volumes and provide stability to our revenue stream during uncertain market activity levels.

Net royalty revenues of $13.0 million increased 2% year-over-year. This was driven by an increase in transaction revenue, which was $6.8 million for the quarter, up 5% year-over-year. This improvement was primarily due to higher air travel activity and royalty redemptions. Subscription and service revenues of $6.2 million were relatively flat year-over-year.

Turning to slide 16, we have total operating expense. Total expense for the third quarter of $257.6 million increased $190.1 million of crypto costs and ECB. These costs are driven by crypto trading volumes. SG&A expenses of $7.4 million were down 4% year-over-year due to a reduction in marketing expenses. Total compensation expense of $24.6 million declined 35% compared to the third quarter of 2022 due to lower head count and a decrease in non-cash compensation expense. Other expenses of $12.1 million were down 16% year-over-year due to lower depreciation and amortization and acquisition related expenses. We're pleased that our disciplined approach to expense management is paying off. We will remain prudent around our costs to ensure that we are strategic with where we spend and how we allocate our capital towards opportunities that provide the highest returns.

Turning to slide 17, we have a slide comparing gross crypto services revenue and crypto costs and ECB. Gross crypto services revenue of $191.8 million was impacted by lower industry wide volumes and lower activity levels from Webull Pay customers. Crypto costs and ECB were $190.1 million for the quarter. During the quarter, we adjusted our revenue share agreement with Webull Pay for the rest of the year to increase revenue retained by Bakkt while Webull Pay engagement stabilizes.s The benefit from this adjustment is reflected in the results for the quarter and acts as a partial offset to the declining gross revenue.

As a result, if you compare the two columns for Q3 2023 in the graph, you will see that the contribution to margin from crypto trading activities, also known as our take rate, was higher this quarter compared to historical periods. The Q3 2023 take rate of approximately 80 basis points of gross crypto services revenue is higher than the historical average of between 30 basis points and 40 basis points, which will continue into Q4 2023.

On slide 18, we have our key performance indicators. As a reminder, we have included Apex Crypto in the historical KPI figures on this slide for comparison purposes. We had 6.1 million crypto-enabled accounts at the end of the third quarter, which reflects a steady increase over time. Next, we have our transacting accounts which we breakout into crypto and loyalty accounts. There were 1.0 million transacting accounts in the third quarter, of which 592,000 were for loyalty, redemption, and 454,000 were for crypto trades. Loyalty redemption transacting accounts were down 13% year-over-year due to a decline in hotel, rental car and gift card activity. Crypto transacting accounts were up 3% sequentially due to increased activity related to the delisting of certain coins.

Notional traded volume is also broken out between crypto and loyalty redemption. Total notional traded volume was $366 million, of which $191 million was from crypto and $176 million was related to loyalty redemption. On this chart, we have also included the crypto industry trading volumes, which is the orange line. As depicted here our crypto trading volumes were down a substantial amount on a sequential basis.

During the quarter volumes were impacted by lower activity levels from Webull Pay customers and the delisting of certain coins. If you normalize for these factors, the quarter-over-quarter decline in our crypto trading volumes was right in line with the overall crypto market industry, which was down 23%. Meanwhile, loyalty, redemption volume was down 4% year-over-year. Our assets under custody of $506 million declined 23% sequentially due to the impact from delisting certain coins and a reduction in certain coin prices.

Turning to slide 19, we have our condensed balance sheet. We ended the third quarter with $90.9 million of cash, cash equivalents and available for sale securities. Our cash usage for the quarter was $8.5 million. During the quarter, we had a non-recurring addition of cash of $15.2 million, which was returned to us from ICE Clearing and is related to the delisting of futures and options contracts. Excluding the return of cash from ICE Clearing, our cash and usage from operating activities was $19.0 million, which was slightly higher than the second quarter cash usage of $18.2 million. Although we saw improvements in our operating expense base including lower acquisition related expenses, marketing and insurance expense, revenues were lower due to crypto trading volumes, which we discussed earlier, which led to the slight tick up in cash usage.

Recall that last quarter we updated our 2023 outlook for both revenue and free cash flow utilization with an expectation that net revenue contribution from loyalty and crypto revenue activities would be between $64 million and $70 million, and our free cash flow utilization would be between $90 million and $96 million. Since that update, we have seen continued softness in loyalty travel redemption levels as well as lower market retail crypto transaction activity. Additionally, our recently announced international retail crypto clients will begin to contribute to revenue in late Q4 2023, which is a bit later than the timing previously anticipated in last quarter's outlook update.

Accordingly, we are reducing our expectation of net loyalty and net crypto revenue activity contribution for 2023 to $57 million to $60 million comprised of gross crypto revenues of $697 million to $1,215 million and net loyalty revenues of $53 million less crypto costs of $693 million to $1,208 million. This directly impacts free cash flow utilization notwithstanding continued progress in reducing cash expenses and as such, we now expect free cash flow utilization for 2023 to be approximately $100 million. The progress we have highlighted in signing new retail and institutional crypto customers would drive strong backlog going into 2024. Our preliminary guidance for 2024 provides color on the timeline to revenue from these new customers.

We preliminarily expect gross crypto revenues of $3,406 million to $9,015 million. Net loyalty revenues of approximately $55 million in crypto costs of $3,386 million to $8,976 million. This translates into loyalty and crypto revenue activities, driving $75 million to $95 million of net revenue contribution in 2024. The increased revenue expectation is driven by new retail and institutional customers, with loyalty revenues expected to increase slightly.

As Gavin mentioned earlier, the 2024 revenue outlook includes an expectation of increased diversity of crypto revenue, both geographically, with the ramp up in international retail crypto and by customer segment with the growth in institutional custody revenue. It also includes an expectation of approximately 25% to 50% increased subscription revenue driven by subscription-based retail crypto revenue. 2024 free cash utilization is expected to be $43 million to $63 million, reflecting further reductions to our cash expenses. At the high end of our revenue range, we see a pathway to be approximately breakeven on an adjusted EBITDA basis by the end of 2024.

I will 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 and success. This was another consecutive quarter where we clearly demonstrated our ability to execute and leverage our industry leading platform made stronger from our acquisition of Apex Crypto, to win new clients and deliver results for our existing ones.

We're actively executing on our international growth strategy. Our crypto capabilities will be live in nine attractive international markets by year's end. This is a significant milestone for us and testament to how we push forward when faced with challenges in this case, a difficult environment in the US around crypto regulation. Our team is flexible, adaptable and quick to find other paths to success. We're still going strong with adding new clients to our roster. We're building an extensive network of clients in a diverse group of industries as the synergies of our expanded crypto capabilities and industry leading infrastructure resonates with market participants. We're pleased with the progress we're making, but what's even more important is that we're moving quickly to onboard all of these clients and activate our crypto capabilities expeditiously.

Lastly, we'll continue to be prudent on how we allocate capital and manage our expenses. Our results this quarter clearly demonstrate that our disciplined approach to managing expenses are yielding results. But we won't skimp on making investments in areas that make sense and have a clear path to profitability, such as the redevelopment of our custody foundation, to make it even stronger for our clients or the investments that we're making in the Lightning Network to increase crypto's utility. We're being smart with where we spend our hard earned money and look forward to sharing with you in the future how those investments are reaping rewards.

Thank you for joining us today. And with that, I'll turn 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. We've consolidated some of the questions that addressed similar themes. After that, we'll turn to live questions from the analyst community.

The first question we will address is about our stock price, which several investors, including [indiscernible] (00:31:10) submitted. They would like to know what our plan is to raise the stock price, whether we are at risk delisting and why we aren't using cash to do a stock repurchase. Karen, can you answer this question?

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

Of course. I know that the downward pressure on our stock price has been incredibly frustrating to all of our shareholders. As a fellow shareholder, I have certainly been disappointed by the stock price performance. We are closely monitoring our stock price and should we receive a delisting notice, we would take necessary action to remediate, such as a reverse stock split. We are committed to our shareholders and to remaining a public company. Ultimately, we believe the best way to allocate our capital to generate higher returns for our shareholders is to invest in the business, deliver on milestones and accelerate our path to profitability. That's what will drive our stock price higher. We always consider all options and while a stock repurchase sounds tempting, it ultimately will not provide sustainable growth and returns that investing in our business will.

Thank you to all of our shareholders for sticking with us. It hasn't been an easy journey, but I believe there are better days ahead for this company and our shareholders.

Ann DeVries
Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Karen. Our next question hits on a few themes from [indiscernible] (00:32:30) around the status of partnerships, including MasterCard and our plan to drive future success. Gavin, can you take this one?

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

A

Yes, sure. I think there was a comment from one of the investors mentioned that we haven't had any major partnerships since we announced the acquisition of Apex Crypto a year ago. No, I don't quite agree with that. We've signed up numerous new clients since April 1, which is when we closed our acquisition of Apex Crypto and have a number of other clients in late stage negotiations who we expect to announce before too long. Our new relationships span across new and diverse industries and also marks a foray into new international markets. This will enable us to land and expand and greatly broaden our reach across the world. We formed strategic alliances with industry leaders such as Plaid and Fireblocks, which provides an extensive network of prospective clients.

Also, prior to closing our acquisition, we signed up Caesars Entertainment as a new client, which as I mentioned, will launch early in Q1. This marks our entry into the gaming and entertainment industry, which should provide exciting opportunities to expand. I've said this before and I will reiterate that we greatly value our relationship with MasterCard and continue to work with them on being able to provide our crypto capabilities to their customers. Our respective teams have completed the development work and we're in the process of testing. We expect to be able to commence a collective sales effort soon. But that said, until the US regulatory environment for crypto gets fixed, I think many TradFi companies will remain on the sidelines and wait to activate their crypto strategies. We'll be here ready to resume our work with them when that happens, but I think that catalyst really does need to happen fast.

Ann DeVries
Head-Investor Relations, Bakkt Holdings, Inc.
A

Our last question from the Say platform is from [ph] Siad H (00:34:30), who asks if we are involved in any of the spot ETF applications? Gavin, can you give your thoughts on this one?

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

Yeah. Look, thanks for the question. The applications themselves have been a stamp of approval from traditional finance and SEC approval of spot bitcoin ETFs will be a positive step towards mainstream acceptance and legitimacy in the financial world. We're excited to see this happen and for the opportunities this will bring to the larger market. With custody being a core anchor, product for Bakkt, approval would open up the market for us and we're prepared to serve as a qualified custodian. We're looking forward to providing you with updates here when appropriate.

Ann DeVries
Head-Investor Relations, Bakkt Holdings, Inc.
A

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. [Operator Instructions] Our first question comes from Trevor Williams from Jefferies. Trevor, your line is open. Please go ahead.

Yvonne Jeng
Analyst, Jefferies LLC
Q

Hi, this is Yvonne Jeng on for Trevor Williams. Thanks for taking my question. My first one relates to the crypto services revenue and the increase in the take rate this quarter. Can you provide more color about the change in the revenue share agreement with Webull Pay and how we should expect the take rate to trend going forward? And my second question is, what do you see as a normalized pace of OpEx growth beyond 2023, excluding crypto costs and ECB fees? Thank you.

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

Hi there. It's Karen, and I'm happy to take the question. Yeah, starting with the take rate. As we mentioned earlier, we've worked and successfully completed a migration of the Webull crypto accounts over to Webull Pay during the third quarter. That migration required existing customers to activate new accounts that we've okayed to be – to continue to create crypto. So it wasn't surprising that we saw some disruption and decrease in trading engagement metrics from that group of customers as they were [ph] acclimating (00:36:41) themselves to the new Webull Pay experience. So we've been working actually very closely with Webull to monitor this customer activity and rollout enhancements.

And in the meantime, I think the adjustment that Webull made to our rev share agreement to allow us to retain more of that reduced gross volume of trading is really a testament to our collaborative relationship. So we expect that to continue through the end of the year. And then, the expectation at this point is as the Webull Pay customer experience continues to evolve, we'll see those trading levels return and we will revert back in 2024 to our more historical take rate, which is typically been if you look at the historical Apex history, it's typically been between 30 bps and 40 bps.

And then just in terms of the second question, can you just repeat it one more time just to make sure I have it?

Yvonne Jeng
Analyst, Jefferies LLC

Q

Yeah, I was just curious what you see as a more normalized pace of expense growth beyond this year, excluding crypto costs and ECB fees.

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah, so and expense growth. One of the things that we've highlighted is we've taken a lot of actions in 2023 to reset our expense footprint. And, we're seeing and continue to see a lot of opportunities to increase efficiencies through the integration of the Apex team and systems with the legacy Bakkt team. So we actually expect our cash expenses to continue to come down in 2024.

When you look at the guidance, the preliminary guidance that I gave for 2024 in terms of free cash flow utilization, that reflects again, when you compare that to the revenue guidance that we've provided, we are looking at continued reductions to our expense guiding – our expense rate in 2024 and probably expenses somewhere in the $130 million range on a cash basis.

Yvonne Jeng
Analyst, Jefferies LLC

Q

Thank you so much. That's super helpful.

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

No, problem.

Operator: The next question comes from Andrew Bond from Rosenblatt Securities. Andrew, your line is open. Please go ahead.

Andrew Bond
Analyst, Rosenblatt Securities, Inc.

Q

Thanks. Hey, good morning. Just want to start with guidance on the revenue side for 2024. You're expecting a pretty big ramp in gross and net revenue from the current run rate. So just wanted to get an idea if it's primarily from the international additions and kind of what are your assumptions on the broader volume environment given [indiscernible] (00:39:41) activity or growth? And additionally, how are volumes tracking quarter to-date with the stronger October for crypto?

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah, Andrew. Happy to take that question. In terms of the outlook for 2024, I guess, first off, we thought it was important and helpful to get a preliminary outlook in 2024, given the fact that we have made traction in signing new client relationships as we mentioned earlier in the call, a lot of these are set for activation towards the very end of 2023. So if you – while we don't see a lot of impact of these new relationships in 2023, we do see it as a strong backlog as we get into 2024. The range that I provided, when you breakdown that revenue and you put it on a net basis for crypto is somewhere between $20 million and $40 million. And that really is – that range reflects a kind of a variance in what we expect market engagement to be as well as timeline for activations. The international component is going to be a big component of that range. So if you look at under any scenario, we think that international retail crypto revenue can be almost half of that net crypto revenue coming into 2024.

And again, we look at that as not only the progress that we've made signing these relationships internationally, as Gavin mentioned, it really is a land and expand as we activate and gain footholds into these markets. That also a lot of these international relationships, they have signed up for a more of a subscription model and how we will generate revenue. And the fact that they will sign up for a tier of trading where they basically pay a flat amount for within a certain tier and if they go above that volume, then it will revert to more of a volume based model. So I think in terms of the composition of that, it would be that the ARR component of that also provides a good line of sight in terms of how we're guiding at least initially, 2024.

Andrew Bond
Analyst, Rosenblatt Securities, Inc.

Q

Okay. And just on that recurring subscription piece and the expected shift there, can you remind us what kind of what percentage of your revenue is currently recurring? And where do you expect that to get to over the next 12 months as you kind of onboard some of these international partners with this kind of subscription plan?

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. So right now, the subscription portion of our revenue stream is in the loyalty part of our business. So it's about – if you breakdown the loyalty revenue is about $10 million of the revenues are purely subscription-based revenues. And then looking into what the potential is for 2024, we can see that increasing anywhere from 25% to 50% on a dollar basis based on the contribution of crypto ARR contracts in particular from international, but we're certainly not limited to international for that type of model.

Andrew Bond
Analyst, Rosenblatt Securities, Inc.

Q

Okay. Just lastly from me, on the capital front, how are you guys feeling your position heading into next year, just given your current run rates and particularly the volume environment doesn't improve much from here. Any plans and then thoughts on the capital front?

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. So as I mentioned when we – I talked about the outlook for 2024, looking at the progress that we're making in reducing expenses and the potential revenue outlook, we continue to see a path to breakeven on an adjusted

EBITDA basis by the end of 2024. At the moment, we have sufficient cash to finance our operations. Yes, certainly as you think about the company's journey, the original fundraising that we did from the de-SPAC was intended to fund a three year roadmap. So I think as we get into 2024, we would be naturally looking at the next steps for the company in terms of a capital raise. But it's not something that we imminently need to execute on the plans that we outlined and the guidance that we gave.

Andrew Bond
Analyst, Rosenblatt Securities, Inc.

Q

Great. Thanks, Karen.

Operator: The next question comes from Peter Christiansen from Citi. Peter, your line is open. Please go ahead.

Peter Christiansen
Analyst, Citigroup Global Markets, Inc.

Q

Good morning. Thanks for the question. A quick one on the Webull disruption. Just curious, was that throughout the quarter or halfway or towards the end, just thoughts there. And then on the relaunch of the custody product, just curious if you're seeing incremental value, whether they're generating value based pricing. We continually hear that custody pricing has been under pressure. Just curious if the relaunch and some of the new capabilities is helping you drive pricing. Thank you.

Karen Alexander
Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. Hey Pete. I can certainly take the first part of the question on Webull Pay. So Webull started with our migration of customers over to the new Webull Pay experience at the beginning of Q3, so in July. So we started to see that impact on engagement levels at the beginning of the third quarter and the adjustment to the rev share agreement that we executed with them is retroactive to July 1.

In terms of the custody product and what we're seeing in terms of pricing, the most of the pricing that we're executing is a AUC fee model that is scaled to the amount of AUC that we bring on to the platform. There are some minimums, so it's not completely volatile, but there are other elements of custody [indiscernible] (00:46:13) services that have a more of a subscription component as well. So for instance, disaster recovery is something that we have talked about as a capability that we see the market coming to us for, that is more of a monthly subscription amount. So I would say mostly be an AUC with some opportunities for the additional subscription-based revenue. And certainly as we expand those capabilities, we see that opportunity for subscription or ARR type revenue to increase.

Peter Christiansen
Analyst, Citigroup Global Markets, Inc.

Q

Great. Thank you Karen. Appreciate it.

Operator: [Operator Instructions] The next question comes from John Roy from Water Tower Research. John, your line is open. Please go ahead.

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

Q

Sure. Great. And I got two questions. It was the Unchained Network. I'd love to get a little more color on that and anything on timing would be useful.

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

A

Hey, John, I'll take the Unchained one. Being part of this network is really an added dimension to what we're doing for custody. So if you think about, as Karen said earlier in responding to Pete's question, that we have the assets under custody model, but what we're seeing of these value-added services that are coming into the market and that the partnership with Unchained is one of those where we're holding part of the key, as I said, in the prepared remarks. And then where we're acting as one of the key signings in the transaction, we like this one a lot, hugely scalable. We anticipate being active in that network by year's end.

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

Q

Great. And then maybe transitioning a little bit to the international, I was curious, obviously, the US market needs some regulatory clarity, to say the least. Which markets do you see having the best set up or the least barriers for you outside the US?

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

A

John, I think it's the one belief we've spoken about this morning where we see strong regulatory clarity. We see a strong pathway for our entry. We've already demonstrated with markets like Spain, where we like today, together with some of the LatAm markets that we're working with regulators who have provided good guardrails for how the assets and the trading should operate. And we're working with partners who really want to take advantage of that shifting sentiment within the market. As we see regulatory clarity, we see that the consumer sentiment return to a very positive level. So the ones that we've spoken about this morning, those in LatAm, Hong Kong, Singapore, Australia are all markets that we like to work together with the UK and parts of Europe.

And as Karen also mentioned, the shift to an ARR model, to a subscription model as we are growing and evolving the business, I think provides good underpinnings to the forecast that an outlook that Karen gave as part of the presentation, I think us to be able to take advantage of that regulatory clarity, consumer sentiment together with strong backlog against a recurring revenue model, is really giving us great confidence as we move into 2024.

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

Q

Great. Thanks so much.

Operator: We have no further questions, so I hand the call back to the management team for any concluding remarks.

Ann DeVries
Head-Investor Relations, Bakkt Holdings, Inc.

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

Operator: This concludes today's call. Thank you very much for your attendance. You may now disconnect your lines.