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Bakkt Holdings, Inc. (BKKT)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Bakkt Third Quarter 2024 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. As a reminder, this conference call is being recorded.

I will now turn the conference over to [indiscernible] (00:22), Investor Relations Advisor at Bakkt. Please go ahead.

Unverified Participant

Good morning and thank you for joining Bakkt's third quarter earnings call. Before we get started, I'd like to remind everyone that today's earnings call includes a separate supplemental presentation that can be found at our Investor Relations website at www.investors.bakkt.com. During today's call, we will make 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's business, please refer to its filings with the Securities and Exchange Commission. Further, in addition to discussing results that are calculated in accordance with generally accepted accounting principles, we also make reference to certain non-GAAP financial measures. For more detailed information on our non-GAAP financial disclosures, please refer to our earnings release, which can be found on our Investor Relations website.

Thank you. And I'll now turn the call over to Andy.

Andrew A. Main

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

Thank you, [ph] Cody (01:40). And good afternoon, everyone. Thanks for joining Bakkt's third quarter 2024 earnings call And it's great to connect with you all again. With me today is Karen Alexander, our Chief Financial Officer. Before I jump into our third quarter results, I'd like to begin today by discussing Bakkt's strategic direction and acknowledging the favorable market conditions and increased trading volumes we and the broader market have seen since the US presidential election on November 5.

As you will see on page 3 of our presentation an example of the prospects of our trading services correlated to the higher crypto prices. We saw a steady ramp-up in Bakkt's notional traded volume over the past three months.

Then in November, leading up to the election and especially following the election, our notional traded volumes dramatically increased. If you look at November's volumes by day, we saw this increase in reaction to the election results on November 5 and then traded volume went even higher days later along with the broader crypto prices and a new all-time high for Bitcoin. As of November 12, we've already treated \$279 million in notional volume, already exceeding October's total volume by \$114 million.

Compared to the broader market, we've achieved 169% of our total October volume in just the first 12 days of November while the market as a whole has only reached 78% of the October total, demonstrating our potential for strong performance. While we cannot predict future trading volumes, especially in the current environment, we believe the US presidential election results have provided a meaningful tailwind to the crypto industry, Bakkt not excluded.

Turning now to page 4, let's jump into the highlights of our Q3 financial performance, which Karen will give more detail later on. Q3 crypto and loyalty services revenue net of crypto costs and execution and clearing and brokerage fees was \$13.4 million, down approximately 8.8% from Q3 last year. This primarily happened as a result of the third and fourth quarter of 2023, benefiting from a onetime adjustment to a revenue share agreement with WeBull Pay that resulted in a temporary higher take rate which became normalized at the start of this year. Note that this dynamic will also impact our Q4 2024 year-over-year comps. Sequentially, our results were down 9.5% and reflected softer trading activities, which was seen across the broader market. But as previously noted, we have seen and expect to continue to see trading volumes improvement in Q4. Q3 operating expenditures, excluding crypto costs in execution and clearing and brokerage fees were \$40.7 million and was 39.7% lower year-over-year driven by our cost reduction initiatives. These actions helped reduce our Q3 operating loss by 48.2% compared to Q3 last year. In October, we completed another reduction in force as part of our continued cost improvement initiatives.

Moving on to our crypto business operations. Most of 2024 has been a challenging execution environment. That said, with the clarity from the recent election results, we are encouraged that the work we have done positions us well in the new environment. We achieved several milestones during the third quarter that broadened our client network and product offerings for the tailwinds we are seeing in the market.

Now, I'll introduce these accomplishments before diving deeper into our commercial operations starting with BakktX, our institutional electronic communication network. This past quarter, we successfully commenced trading on the BakktX platform with Bakkt Crypto Solutions, Bakkt's retail-facing crypto brokerage business, as one of the initial institutional trading clients. This represents the beginning of a broader rollout strategy to institutional clients. This rollout aims to combine the strengths of our strategic partners and the BakktX ecosystem, namely Bakkt security and compliance expertise, crossover markets, high-performance technology and sub-10 microsecond matching latency, Hidden Road's global credit network for institutions and real-time risk management and operational support. And our new partner, CoinRoutes, who will provide our clients with the best-in-class trading interface and algorithms. We remain confident BakktX will be a significant growth driver for the company and we look forward to sharing updates in the near future.

Further, we are excited to announce that we recently onboarded BlockWyre onto our brokerage infrastructure solution. BlockWyre is an AI-driven crypto fintech infrastructure platform offering banking custody and payment solutions for B2B and B2B2C customers. That will provide end-to-end crypto brokerage infrastructure for BlockWyre's spot crypto and stablecoin payments platform, including liquidity and execution, custody services, [indiscernible] (07:45) management and potential future joint product expansions. This new brokerage client is another demonstration of companies choosing Bakkt as their partner in growth using our preferred, trusted platform for buying and selling crypto.

As we stated in our Q2 earnings, we recalibrated our go-to-market approach to focus our resources on targeting companies already established in the US and international players coming into the US who may benefit from Bakkt's scalable trading capabilities. We are seeing very good results from this recalibration with an expanding sales opportunity pipeline for potential new clients with many such opportunities in advanced stages of the sales process. In August, we successfully introduced nine new coins to our Bakkt Crypto Solutions platform. The response from our clients has been very positive and many have begun integrating the new coins into their platforms. And in Q3, the new coins contributed a notable improvement in our trading volumes for the quarter. We also just launched six additional coins in November and we plan on bringing more coins to market in the future.

Furthermore, I'd like to give an update on our Bakkt Trust and custody operations. In October 2024, we began investigating a possible wind down and dissolution of Bakkt Trust due to its lack of market traction and high cost of capital due to regulatory requirements.

As this process has progressed, we have also worked to find strategic alternatives for Bakkt Trust. This decision was carefully considered and represents the next stage of our strategic initiative to focus on our brokerage and institutional trading services where we believe we have unique competitive advantages for sustainable, long-term growth. Our decision is timely. When you look at the macro environment, the custody space in general has seen significant margin compression particularly over the past several quarters, along with increased competition from new players and further regulatory reform. This move allows us to focus on our core strengths while also achieving an expected reduction in operating expenses. Additionally, we anticipate a lower regulatory capital requirement during this process, which would free up significant working capital and shows another example of our ultimate goal, maximizing shareholder value. A key point to make with this decision is that our brokerage clients will continue to benefit as they do today from our custody offering enabled by our Custody Solutions Partners. So it's business as usual, and there is no impact to our brokerage clients as we evaluate strategic alternatives to Bakkt Trust.

Finally, as you know, Bakkt operates across several complementary yet distinct business areas, both management and the board are continually exploring strategic alternatives to maximize shareholder value while advancing our 2024 priorities, Bakkt Trust being a prime example.

Turning to slide 5. Next, I'd like to review some key regulatory and macro developments that we believe are strong indications that crypto is maturing as an asset class and provides favorable tailwinds for Bakkt going forward. On the regulatory front, we've seen meaningful progress this year, notably [ph] Bakkt base (11:49) adoption of fair value accounting of crypto assets was a pivotal shift in reporting standards for public companies. As I mentioned on previous calls, the launch of Bitcoin and Ethereum spot ETFs has driven record adoption and capital flows in a very short amount of time and more recently, the SEC's approval of options trading for BlackRock's IBIT ETF and on the [indiscernible] (12:19) has further reinforced Crypto's growing presence in the US capital markets.

Meanwhile, we are now seeing that bipartisan support for crypto continues to improve. And with Donald Trump as the President-elect, we expect the narrative in crypto to improve even further as he has advocated for a more positive regulatory environment. On the monetary front, the Federal Reserve's 50 basis point rate cut in September following 11 consecutive hikes and the additional 25 basis point cut last Thursday signaled a significant shift in monetary policy. These reductions in the US federal interest rates have historically served as positive catalysts for risk assets such as crypto. Taken together, these policy shifts create a highly favorable environment for Bakkt, reinforcing our confidence in the company's strategic direction.

Turning to slide 6, our strategy of building a robust ecosystem of partners to address the institutional market has positioned us to capitalize on the growing opportunities that drive long-term growth. We have put together what we believe to be a unique combination of strengths to launch BakktX, namely Bakkt's advanced infrastructure with crossover markets, high-performance technology, CoinRoutes' trading interface and algorithms. And once we have a definitive agreement with them, Hidden Road's global credit network for institutions. This combination delivers the unique value proposition for institutions, giving them high-performance sub-10 microsecond matching latency, customizable liquidity streams and reduced trading costs. The strength of this ecosystem delivers solutions for institutions that are highly competitive against existing crypto trading venues.

To wrap up, we are executing and making significant progress on the three strategic priorities that we laid out at the start of the year. First, we are growing our client network and deepening our existing client relationships. On the brokerage side, we're thrilled to have BlockWyre as a new client in our brokerage infrastructure solution. Additionally, we continue to build momentum with Hidden Road's [ph] consumer (14:53) markets and our new partner, CoinRoutes, which demonstrates our commitment to growing our institutional client base while deepening relationships with existing partners. We believe these collaborations enhance our offerings and position Bakkt as a critical player in the broader digital asset ecosystem.

Secondly, we are expanding our product solutions and extending the Bakkt ecosystem. With the upcoming rollout of BakktX, we are finalizing our high-performance platform who caters the needs of institutional investors. This is demonstrated through our partnership with BlockWyre using our end-to-end infrastructure for the crypto payment processing and brokerage services. These milestones reflect our ongoing commitment to innovation and creating best-in-class solutions that meet market demands.

Lastly, we continue to improve our cost structure, ensuring that we operate efficiently of scaling our business. The integration of new strategic partnerships and our disciplined approach to cost management are already yielding improved results without compromising the high-level service and innovation we deliver for our clients. Thank you for your time. It's been a pleasure to update you on Bakkt from both a high-level financial and operational perspective.

I will now hand it over to our CFO, Karen, who will review our financial performance for the third quarter in more detail. Karen?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

Thank you, Andy. I will now walk you through our third quarter KPIs and financial results. As a reminder, in accordance with GAAP, we present crypto services revenue and crypto cost in execution, clearing and brokerage fees on a gross basis as we are a principal in the crypto services that we provide our customers. By contrast, we are an agent in the loyalty redemption services we provide our Loyalty customers. Therefore, loyalty revenue is presented on a one line net basis.

Starting on slide 9, we have our Q3 KPIs which provide a snapshot of the underlying trends driving our business. We ended the third quarter with 6.5 million crypto-enabled accounts, reflecting a steady increase over the past 12 months. This growth further underscores the increasing adoption and trust in our platform. Next, we have our transacting accounts broken down into crypto and loyalty accounts. There were 610,568 transacting accounts in the third quarter, of which 417,000 were related to loyalty redemptions and 193,000 were related to crypto trading. Total notional traded volume was \$476.5 million, with \$314.9 million attributed to crypto and \$161.6 million attributed to loyalty redemptions. Crypto notional traded volume was down 36.2% sequentially but up 64.9% year-over-year. As Andy mentioned, at the beginning of the call, we saw a 56.3% increase in notional volume month-

over-month from September to October this year, surpassing the market average by 40.8% and have already achieved 169% of our October volume in the first 12 days of November. We hope to see this trend continue as market sentiment for crypto becomes more positive.

As Andy also highlighted earlier, during the quarter, we enabled nine new tokens for trading at our brokerage platform for our clients. These new tokens demonstrated strong trading activity immediately and contributed approximately 10% to our September overall trading volume. We also added an additional six coins in November and believe our expanded listings that our clients' customers can trade, increases our user engagement, improves Liquidity and attracts more customers onto our clients' platforms. And lastly, assets under custody at our custodian partners for our brokerage business were \$938.7 million, down from the previous quarter of \$974.5 million driven by slightly lower coin prices.

On slide 10, we show our total revenue broken out between our crypto and loyalty products. Total revenue for the third quarter of 2024 was \$328.4 million. Gross crypto services revenue for the quarter was \$316.3 million, an increase of 65% from the same quarter last year. This growth trended with the overall market as overall crypto interest has increased since last year. Our crypto services revenue net of crypto cost and execution clearing and brokers' fees totaled \$1.3 million, reflecting a 20.9% decrease compared to the same period last year. As Andy mentioned earlier, this decline was primarily due to the second half of 2023, benefiting from a temporary onetime adjustment in our revenue share agreement with WeBull that resulted in a higher than normal take rate, which reverted back to normal rates at the beginning of 2024. Our net royalty revenues were \$12.1 million, down 7.2% year-over-year. Of this \$12.1 million loyalty transaction revenues were \$6.0 million and subscription and services revenues were \$6.1 million. The majority of the decline in net royalty revenue was driven by a decline in transaction revenue.

Moving on to slide 11. We have our total operating expenses. Total expenses for the quarter were \$355.8 million, including \$315.0 million of crypto cost in execution, clearing and brokerage fees driven by higher trading volumes. SG&A expenses were \$8.5 million, up 14% from Q3 2023 and 54.6% sequentially due to a \$1.1 million settlement payment made in July of 2024 to terminate a five-year strategic marketing agreement entered into in 2023. The settlement payment released us from future obligations under the agreement. Total compensation expense was \$21.1 million, down 14.3% from last year due to lower head count and incentive bonuses. We continue to prioritize cost-savings initiatives and have made significant strides in optimizing our expense structure.

On slide 12, we have our EBITDA and adjusted EBITDA for the third quarter of 2024. Adjusted EBITDA reflects adjustments for non-cash restructuring and acquisition-related items that impacted the period. EBITDA and adjusted EBITDA for Q3 2024 were losses of \$7.3 million and \$23.7 million respectively. Adjusted EBITDA loss for Q3 2024 increased by \$2.1 million or 9.8% compared to Q3 last year primarily as a result of the temporary higher take rate from WeBull in the second half of 2023 and lower royalty revenue.

Turning to slide 13. We present our condensed profit and loss statement. Net loss for the quarter was \$6.3 million, of which \$3.4 million was attributable to the non-controlling interest in the operating company and \$2.9 million was attributable to Bakkt Holdings, resulting in a diluted loss of \$0.45 per share on an average diluted share base of 6.4 million shares for both basic and diluted.

On slide 14, we have our condensed balance sheet as of September 30, 2024. We ended the quarter with \$35.7 million in cash, cash equivalents and available for sale securities and \$35.3 million in restricted cash. We utilized \$25.0 million of available cash in the third quarter of 2024. The third quarter included several annual and onetime payments including \$3.8 million for annual insurance premiums and a \$1.1 million settlement payment associated

with the termination of a strategic marketing agreement that I referred to earlier. Additionally, \$1 million was used to increase restricted cash driven by reserves needed to support higher trading ACH volumes.

Moving on to slide 15, we have an adjustment to our full year 2024 outlook from the previous quarter. We are seeing a lower forecasted royalty revenue range of \$49 million to \$50 million, missing the lower end of our range by \$4 million and the higher end of our range by \$7 million. We've seen a downward trend in the loyalty business this year, which is primarily driven by lower transaction volume. Also, we now expect the crypto net revenue contribution to be at the low end of the range of \$10 million to \$15 million we provided last quarter. This guidance does not include an expectation of material revenue from bad debts in 2024. Our cash utilization for the remainder of the year will be higher than previously guided due to the reduction of expected revenue and higher expenses. We expect to end the year with \$34 million to \$39 million of available cash, cash equivalents and available for sale securities. After consideration of the possible wind down and dissolution of Bakkt Trust and the lower regulatory capital requirements, we expect. Our end of year expectation for available cash, cash equivalents and available for sale securities considers our lower revenue expectations for 2024 as well as higher professional services expenses.

Thank you, everyone. That now concludes the prepared section of our Q3 2024 earnings call. I'll now pass it back to [ph] Cody (24:52) for the Q&A session.

QUESTION AND ANSWER SECTION

A

Thank you, Karen. Next, we will move over to a couple of questions from the investor community. Our first question from the investor community comes from [indiscernible] (25:02). What is Bakkt doing to bring its products to the market? There seems to be no enthusiasm from the company itself and nothing as far as announcements. So how can I be excited about you and your products? Andy, can you share your perspective here?

Andrew A. Main

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

A

Thank you, [indiscernible] (25:18), for your question and for being a valued stockholder. I appreciate the opportunity to address this. At Bakkt, our priority this year has been clear, delivering innovative, high-quality products that meet market demand. Specifically, we've concentrated on BakktX, positioning ourselves to capitalize on the growing institutional interest in crypto trading. We've been working diligently to refine our current offerings such as the recently announced coin listings, as well as introducing BakktX as an entirely new offering. While much of this work happens behind the scenes, it's all geared towards creating long-term value for our shareholders and establishing Bakkt as a leader in the evolving crypto ecosystem. We understand the desire for more frequent updates, but we are committed to only announcing developments when they're finalized. Rest assured, we are fully focused on building momentum and driving profitability, and we appreciate your continued confidence in our efforts.

A

Thank you, Andy. Our next question comes from [indiscernible] (26:31). What is the long-term vision for the company? What unique value can Bakkt offer its customers that the competitors can't match? Andy, could you also take this one?

Andrew A. Main

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

A

Thank you, Cody. And thank you, Jeffrey, for the question. At Bakkt, our long-term vision is clear, to establish ourselves as a leader in the rapidly evolving crypto ecosystem. We're laser focused on areas where we can deliver the most value, specifically through our best-in-class retail crypto trading platform and BakktX, our groundbreaking solution tailored for the institutional crypto trading market. We believe the future of crypto and tokenization is bright and our goal is to provide a seamless, secure entry point in crypto trading platform for brokerages and institutions venturing into the space. Our collaboration with industry leaders like Hidden Road, Crossover Markets, CoinRoutes and BlockWyre demonstrate a shared commitment to driving innovation and long-term value in this dynamic market. What sets Bakkt apart is our unmatched security and compliance expertise, our strong network of partnerships across the industry and our commitment to operational efficiency as we've discussed today. These pillars reinforce our mission to deliver sustained value to our shareholders in this burgeoning market.

Unverified Participant

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

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

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