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Bakkt Holdings, Inc. (BKKT)

Q4 2022 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings and welcome to the Bakkt Fourth Quarter and Full Year 2022 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 it over to Ann DeVries, Head of Investor Relations at Bakkt. Please proceed.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

Good afternoon and thank you for joining us for Bakkt's fourth quarter earnings call.

Today's presentation, including the separate earnings call presentation that can be found on our Investor Relations website at www.investors.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 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.

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 afternoon with the SEC.

Joining me on today's call are Gavin Michael, Chief Executive Officer; Karen Alexander, Chief Financial Officer; and given the market's recent interest in the regulatory environment, Marc D'Annunzio, our General Counsel and Corporate Secretary, is also joining us today. After our prepared remarks, we will answer questions we received from our investors through the Say Technologies platform. After that, Gavin, Karen and Marc 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 afternoon, everyone, and thanks for joining.

Despite a challenging macro environment and a tumultuous crypto market, we're proud of our 2022 accomplishments. We delivered on our product roadmap for the year and we've made significant progress with our partner network and we signed a definitive agreement to acquire Apex Crypto, which we believe will enable us to break into new client verticals and tap into a universe of 5 million crypto-enabled accounts.

We have a differentiated approach and platform. We are built to endure. Our competitive moat comes from our regulatory and compliance-first approach, our culture of risk management, our embedded finance solution that meets customers where they are either through APIs or web-based experiences and our balance sheet strength. We focused on building responsibly since our founding as part of Intercontinental Exchange in 2018. Our extensive partner network is a potential gateway to rapid, efficient scale. These core strengths really position us to succeed, particularly as we see a flight to quality within the crypto space right now.

As we look to 2023, our priorities seek to appropriately balance growth and discipline. We expect the macro environment to remain challenging this year, but we see opportunity in the market for growth and that is where we're focused. We will continue to balance disciplined capital allocation decisions towards growth opportunities while prudently managing our overall firm-wide expenses.

In 2022, we made progress against our goals through a combination of organic and inorganic activity. We continued the expansion of our B2B partner network, adding leading brands such as Global Payments and Visa. We signed a definitive agreement to acquire Apex Crypto, which when closed, we expect will provide immediate access to a network of fintech partners and accelerate portions of our crypto product roadmap.

We delivered several core products such as Crypto Payouts and Rewards. We continue to test product market fit and we gained valuable insights on market demand and the biggest opportunities to scale, which is where we are investing as we look ahead.

Our platform is differentiated and our approach positions us to win amidst the current economic and crypto market dislocation. The regulatory landscape continues to evolve and we believe our regulatory and compliance first focus separates us from competitors. We see the prospects of crypto regulation as positive for the industry and for Bakkt and a key factor in support of widespread adoption.

We've always said that the crypto economy will mature much faster when there's regulatory clarity. We prioritize risk, compliance and security. We do not co-mingle customer funds. We do not lend or [indiscernible] (00:05:23) customer's crypto and we separate custody and trade execution functions to provide additional customer protection and to minimize potential for conflicts of interest.

Custody is managed through a separate entity regulated by the New York Department of Financial Services. The Bakkt Trust Company has a board of managers that is comprised of seven individuals with current or prior leadership experience at the New York Stock Exchange, ICE, CME, NYMEX, the CFTC among others.

Recently, the SEC proposed a new rule on safeguarding of advisory client assets and I wanted to quickly cover what this means for Bakkt custody. While this is still a proposed rule, it provides an avenue for state chartered trust companies like our custodian Bakkt Trust Company to maintain qualified custodian status. We've always placed a high premium on secure institutional-grade custody as a foundation of our platform. It's why we built that capability before anything else. We're pleased to see federal regulators stepping up their focus on this important function, and we continue to engage in dialogue as the legislative process continues.

We've intentionally stayed away from yield and lending products and continue to pursue a risk-focused culture and approach. That meant missing out on some big boom cycles, but we have conviction about the importance of a thoughtful and compliant structure, and that is why we've taken a more measured approach overall.

To move to some recent developments, we purchased Bumped Financial, LLC, a registered broker dealer, as part of our regulatory and compliance-first approach. This acquisition, which closed in early February, enables us to take over Bumped Financial's broker-dealer license. Given the evolving discussions in the crypto regulatory landscape, particularly around which crypto currencies may be deemed to be securities, we took a proactive approach and acquired this license. We view it as potentially helpful as these discussions evolve.

Lastly, we are intensifying lobbying efforts and increasing our presence in conversations with government officials, their staff and regulators. We are having active conversations and we'll share more in our perspectives as the legislation takes shape. We believe it is extremely important for responsible and trustworthy crypto market players to step up and play a role in the conversations to help the US continue to be a place where crypto innovation can flourish.

We've already seen the start of crypto legislation in the EU, the UK, Australia, Brazil and recently Hong Kong. Crypto has arrived on the world stage and as an industry, we must play a key role in supporting the development of a clear framework that protects consumers, while helping to avoid unintended consequences and promote innovation.

We have a strong balance sheet and robust liquidity of approximately \$239 million in available cash and cash equivalents and available-for-sale securities. This position, coupled with prudent expense management, provides capacity that enables us to be opportunistic around inorganic and organic growth, as well as adding stability in a challenging market condition. Our strong partner network is a key differentiator, both through the partners that we have on the backside and those that we will serve following the anticipated closing of the Apex Crypto acquisition.

We have built a broad network that provides scalable reach to millions of users across client verticals that can be easily turned on. Our B2B partners include fintechs, neobanks, RIAs, traditional finance, platform companies, brands and merchants. Lastly, we are differentiated through institutional grade security and compliance-focused technology that is built to embed into partner experiences.

So, now turning to our key priorities for this year, we're focused on three distinct areas of opportunity that balance growth and discipline. First, we are elevating and expanding our crypto platform. We're investing in our custody capabilities to expand the flexibility and features behind our offering and build upon our core approach, which is underpinned by infrastructure that is centered around safety and soundness.

Our pending acquisition of Apex Crypto further adds capability to our platform and accelerates the introduction of several roadmap features. For example, open loop wallet and additional coins. We're also planning to expand into international markets leveraging Apex Crypto's existing partner footprint. We believe crypto utility is a key part of driving value across the spectrum.

We're continuing to focus on enabling new ways to earn crypto, but we're building new ways to transact through the development of a Lightning service provider to provide partners with seamless access to Bitcoin and fiat to fiat, instant payments and remittances on the Bitcoin native rails. We are continuing to activate and expand our partner network to bring capabilities to market, expanding our network with new partners and our pipeline of potential prospects.

Lastly, we continue to prudently invest our capital and manage expenses closely. We have aligned our operating and investing expenses to focus on near-term market opportunities and product market fit while driving operating efficiencies and cost discipline.

Our key priorities focus on building value in 2023, and we believe these will propel us to be one of the best-positioned crypto companies when market conditions improve. The competitive landscape in crypto has completely changed in the last 12 months and given the hard work we've been doing since our inception, we're built for this time.

To provide more color on how we're working to enhance our crypto capabilities we wanted to outline our core solutions and the areas of investment. The narrative for crypto is moving towards utility, greatly expanding its total addressable market. We are building out our product suite to align to this utility and how crypto is appealing to customers and meeting business needs.

Access and storage remain top needs and we're providing this through custody and Crypto Connect. Crypto custody is a core proficiency about and we continue to invest to ensure we have best-in-class solutions that meet the regulatory and infrastructure needs of all institutions. Crypto as an investable asset continues to be extremely attractive and we've invested significantly in our Crypto Connect solution, which will be made stronger with the addition of Apex Crypto by accelerating our future roadmap. We'll be looking for ways that we can continue to enrich this offering for partners when our offerings are combined post-closing.

We're also focused on rolling out Crypto Payouts and Crypto Rewards to provide new ways to earn and interact with crypto in customers' everyday lives. And then, we have an eye for the future. Crypto utility doesn't stop here. We're preparing for additional opportunities as well. We see layer 2 protocols such as the Lightning Network and Stablecoins to have relevancy. And we're investing in these areas so we can benefit as their utility grows. For example, we see the Lightning Network helping with cross-border payments and offering settlement in seconds versus days at a fraction of the cost. We believe there are a lot of attractive and appealing applications of this technology.

Turning to Apex Crypto, we are collaborating closely and making strong progress on closing the acquisition in the first half of this year. As we've noted, the deal requires regulatory approval and we filed applications with all of the states that must approve the transaction and we've already received approvals from a majority of those states and we are engaged in active dialogue with regulators in the remaining states whose approval is outstanding. We continue to work with Apex Crypto in advance of regulatory approval. During this interim period, we're pleased to see continual sales activity on the Apex side with two new partners signed since the deal was announced in November of 2022 bringing the total number to 33 partners.

In spite of a challenging fourth quarter in 2022, Apex Crypto continued to deliver results. Their 4Q 2022 net revenue will result in an earnout of approximately \$9 million in Bakkt stock to be issued after the deal closes. We're really excited to be able to bring this deal to a close so that we can begin working closely together.

Moving to some recent news, we're excited to be expanding our partner network segments with the announcement of a strategic alliance with Caesars Entertainment. Starting later this year and subject to regulatory approvals, Caesars Rewards members will be able to have access to Bakkt Crypto Rewards, allowing them to redeem Caesars Rewards points for cryptocurrency.

We're also continuing to explore and innovate with Caesars around our existing suite of cryptocurrency solutions like Bakkt Crypto Payout. We're excited to bring these new options to millions of Caesars' online customers. This group is increasingly digitally savvy and providing more options, expands the ways Caesars can engage with their customers on an ongoing basis.

This announcement is testament to the continuing interest in cryptocurrency even amidst the crypto downturn. We're thrilled to be entering space with an industry leader like Caesars. We're looking forward to further solidifying our partnership with Caesars and looking for additional ways to partner in the future. We spoke earlier about how we're focusing our business.

As I've said, the external environment remains challenging and we're taking a number of specific and strategic actions to position Bakkt for the strength and durability amidst the broader market disruption. While in this type of uncertain market, there are some factors out of our control, but we see many factors that are within our control. Last year, we began eliminating capabilities that did not have strong product market fit. We're constantly assessing our capabilities and taking decisive actions. This critical review of what we're focused on and continual assessment of scalability is a key part of our overall approach going forward. We will remain disciplined in how we allocate our capital, and we're solely focusing on solutions with scalability and those that accelerate our path to profitability.

For crypto, we're continuing to invest in core capabilities that expand partner offerings, markets and further enable institutional participation. With the recent events in the market, we're experiencing demand from institutional players for certain capabilities and we'll invest in our platform to provide those offerings and features.

In loyalty, we're focused on serving and growing volume with our existing partners. This means maintaining existing offerings and relationships. We have a strong roster of clients in loyalty and we're focused on continuing to serve them while we always look for ways to innovate in the loyalty space. Going forward, we look to do so jointly with our partners, when there is a clear path to revenue.

We are focusing on the most scalable go-to market opportunities in our B2B approach. An example of this focus can be seen in sunseting our consumer app. The products where we're investing have broad applicability, and we believe they offer the best opportunity for expansive growth. With this overall simplification, we also implemented a corporate restructuring today. When it comes to our people, reducing team sizes is extremely difficult. We don't take lightly the impact reduction in force has on people's lives. We'll be approaching our work with leaner team sizes and looking to maximize our impact in core solutions. The continued uncertainty of the environment makes it clear that operating at a lower cost basis is the most prudent thing for us to do to ensure we are investing in the right places and being shrewd in our overall approach to fuel growth.

Expense management and discipline will continue to be an important theme for 2023. In a market that we expect to remain challenging this year, we can control expenses and ensure we're being prudent and nimble with our

investments with disciplined capital allocation decisions. Simplification initiatives include the recent corporate restructuring in December and today. We expect the actions to result in a 40% decline in the head count by year-end 2023 versus year-end 2022. This results in a \$29 million cash saving in 2023 and an additional \$7 million in cash savings in 2024 for a full-year impact of \$36 million.

We are mindful of the longer term goal we set for being adjusted EBITDA breakeven by the end of 2024 and we are making decisions that we believe will help us invest appropriately to meet that goal while being smart with each investment we make.

Now, I'll hand it over to Karen to guide us through the financial results.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

Thank you, Gavin, and good afternoon, everyone.

I will now walk you through the fourth quarter financial results. As a reminder, we used the term predecessor to represent the results of Bakkt Holdings, LLC prior to October 15, 2021. These results exclude any results from VPC Impact Acquisition Holdings. Successor represents the results of Bakkt Holdings, Inc., from October 15, 2021 forward, which is the post-merger period. Combined represents the combination of predecessor and successor for the applicable period. This is a non-GAAP figure.

Turning to slide 14, we have our fourth quarter 2022 financial results. We had net revenues for the quarter of \$15.6 million, which increased by \$1.9 million or 14% compared to the fourth quarter of 2021, primarily driven by transaction activity from loyalty redemptions. Similar to recent quarters, the key driver here is 2022 travel volume relative to 2021, which was impacted by the pandemic. This quarter included a \$271.9 million non-cash goodwill and intangible asset impairment charge. Similar to last quarter we took this charge in accordance with GAAP as a result of the revenue impact from the [ph] elongated (00:22:54) timing for expected crypto asset product activations, as well as the decline in our market capitalization compared to the end of the September, as well as our decision to sunset the consumer app.

Note that in accordance with GAAP, the financial impact from our pending acquisition of Apex Crypto is not factored into the valuations that resulted in the impairment charge given that the deal has not yet closed. The charge is noncash and does not have any impact on our future operations, or affects the liquidity or cash flow from operating activities. Excluding the noncash charge for goodwill and intangible asset impairment, our operating expenses were \$73.2 million in the period, which is down \$65.4 million, or 47% year-over-year, primarily due to a reduction in compensation and benefits.

Recall that in the fourth quarter of 2021 we had significant noncash compensation expenses as a result of the issuance of shares related to the close of our business combination, which did not repeat in the fourth quarter of 2022. The current quarter operating expense also includes a restructuring expense of \$2.3 million related to the head count actions we took in December.

Net loss for the quarter was \$323.9 million, which resulted in a diluted net loss of \$1.24 per share on an average diluted share base of 261.5 million shares. Net loss allocated to the noncontrolling interest in the operating company was \$227.4 million, leaving a \$96.5 million loss attributable to Bakkt Holdings, Inc., or a net loss of \$1.22 per share on an average basic share count of 79.4 million shares. Our total share count as of February 28th was 265.6 million shares. ICE remains our largest shareholder with ownership of 66% of aggregate shares, which has remained relatively consistent with their shareholding as of September 30, 2022.

On slide 15, we have our condensed results for the full year of 2022. Net revenue of \$54.6 million increased by \$15.1 million, or 38% year-over-year. This increase was due to higher transaction volumes from our loyalty business. Earlier in the year, we provided full year 2022 revenue guidance of \$57 million to \$62 million. There were a few market headwinds in the latter part of this year that caused revenue to come in lower than what we originally anticipated. This included continued pressure on travel redemption values due to high prices and supply constraints; and lower than expected merchandise redemption volume during the fourth quarter holiday season, consistent with the trends seen in the consumer retail industry.

Longer fulfillment cycles with merchandise suppliers and consumer sentiment about the economy resulted in a lower conversion rate than we initially anticipated when we communicated updated revenue guidance in our second quarter 2022 earnings release. Excluding the goodwill and intangible asset impairment charges in the third and fourth quarters that totaled \$1.8 billion, our operating expense for the full year was \$251.4 million, which was relatively flat from the prior year.

On slide 16, we have our EBITDA and adjusted EBITDA for the fourth quarter of 2022. Adjusted EBITDA reflects adjustments for noncash and acquisition-related items that impacted the period, including the goodwill and intangible asset impairment charge. EBITDA and adjusted EBITDA for the quarter were losses of \$328.4 million and \$30.5 million, respectively. An increase in the adjusted EBITDA loss versus the prior-year period, primarily due to higher non-share-based and unit-based compensation costs related to higher head count as we grew the company.

On slide 17 we show net revenue broken between subscription service revenue and transaction revenue. Total revenue in the fourth quarter and full year of 2022 increased 14% and 38%, respectively, compared to the comparable prior-year period. The year-over-year revenue growth was driven by higher margins and expansion of services with one of our loyalty partners and higher travel and merchandise volumes from prior-year period.

As mentioned earlier in the latter part of 2022, we saw a softening in travel and merchandise loyalty redemption volumes as a result of supply constraints, high prices, and consumer economic sentiment. The fourth quarter is typically a strong quarter due to merchandise redemption volumes related to the holiday season. In the fourth quarter of 2022, merchandise volumes were lower than anticipated, as longer fulfillment cycles with merchandise suppliers caused many consumers to abandon their redemption orders.

Turning to slide 18, we have total operating expense. Total expense for the fourth quarter excluding the noncash goodwill and intangible asset impairment charge was \$73.2 million, which was down 47% year-over-year. Total compensation expense of \$31.9 million declined 67% compared to the fourth quarter of 2021 due to a decrease in noncash compensation expense.

The fourth quarter also included a \$2.3 million restructuring expense related to our December 2022 head count actions. We expect to recognize an additional estimated restructuring charge of \$3.7 million to \$4.1 million in our first quarter 2023 results to reflect the reduction in force communicated today. This estimated charge includes approximately \$2.3 million to \$2.7 million of cash payments.

We've demonstrated through our disciplined actions, our strong focus on simplifying our business, we will limit future hiring and leverage the team that we've built, as well as the pending acquisition of Apex Crypto to further our road map in 2023. It's a really tough decision for us to reduce our employee base, but we know that these are necessary actions for us to take given the headwinds that we continue to see in the market. Our recent

restructurings, while unfortunate, help to ensure that we are right-sized for this environment and have the appropriate resources in place for various market cycles.

On slide 19, we have our key performance indicators. These KPIs reflect the full breadth of how our capabilities are accessed across both partner and Bakkt experiences and across crypto and loyalty experiences. Transacting accounts across the Bakkt platform were 958,000 in the fourth quarter of 2022, up 11% year-over-year. Transacting accounts were 3 million for the full year, up 16% year-over-year.

Digital asset conversions are a dollar-weighted measure and more directly aligned to revenue growth. Volume of \$263 million for the quarter was up 19% year-over-year. Full year volume was \$832.3 million, an increase of 51% year-over-year. These increases reflect the strong growth we saw in royalty redemptions, particularly travel relative to 2021, which was impacted by the pandemic. We expect these KPIs to increase in 2023 as we close the Apex Crypto acquisition, activate crypto partners that we have announced, as well as build new relationships.

Turning to slide 20, we have our condensed balance sheet. We ended the fourth quarter with \$239.4 million in available cash, cash equivalents, and available for sale securities. We believe our liquid assets, combined with the prudent expense management actions we are taking, provide us with significant liquidity to self-fund our road map and finance the cash component of the Apex Crypto acquisition. We are highly aware of the challenging market conditions around us and will remain keenly focused on maintaining a strong balance sheet and preserving liquidity to position us through the macroeconomic and industry cycle.

As a result of the noncash goodwill and intangible asset impairment charge we took this quarter and last quarter, our total balance sheet declined to \$458 million. I want to reiterate that these noncash impairment charges were due to Generally Accepted Accounting Principles, given the macro environment, current market capitalization for us and peers, and the sunset of our consumer app. They do not reflect any long-term deterioration of our underlying core business. We remain excited about future growth potential of our business, particularly with the pending acquisition of Apex Crypto. Given that the deal has not closed, the valuations that resulted in the impairment charge do not reflect any financial impact from Apex Crypto.

In the fourth quarter, we used \$34.3 million of cash, and for the full year, we used \$152 million of cash. Nonrecurring use of cash included \$1.2 million of severance and other onetime cash payments to employees in the fourth quarter, and a \$9.2 million cash payment in the third quarter related to our migration to a new purchasing card facility. Excluding these nonrecurring items, our cash usage for the year came in at \$141.6 million, which was slightly above the full year guidance of \$135 million to \$140 million that we provided earlier in the year due to lower than expected revenue results.

Turning to slide 21, we have our expectations around outlook for full year 2023. We expect net revenue for the year to be in the range of \$62 million to \$72 million, which is up 15% to 30% from 2022. Note that this represents revenue only from Bakkt since the Apex Crypto acquisition has yet to close. Our outlook for revenue incorporates our expectation that crypto activation timelines will continue to be impacted by market conditions.

Based on our conversations and market intel, we expect crypto activations to ramp up in the second half of 2023. While we hope the market takes a positive turn, too, we are being cautious given all the noise we've seen thus far. Our outlook assumes that loyalty redemption activity will continue to face some pressure from a challenging macroeconomic environment.

We expect our overall free cash flow utilization in 2023 to be \$105 million to \$115 million, which represents a 25% to 30% reduction from 2022 free cash flow utilization. Note that these numbers include \$13 million of acquisition

related deal expenses and \$2.3 million to \$2.7 million of cash payments related to the restructuring expense from the head count reductions that we announced today. We believe that free cash flow, which is a non-GAAP metric, is a helpful outlook metric because it reflects both our cash used in operations as well as our CapEx investments.

Free cash flow does not include other cash used for investing activities, which will most notably include the \$55 million cash purchase price that will be paid for Apex Crypto when the deal closes. Our free cash flow outlook reflects our expectation that the combined impact of increased revenue and expense reductions related to business simplification, including completion of recent restructurings, will reduce our free cash flow utilization for the year.

Our recent restructurings are expected to result in free cash flow savings of \$29 million in 2023. We expect to provide more color on the financial outlook for Apex Crypto once the transaction closes which we are targeting to occur in the first half of 2023. Following the close of the deal, we may look to update some of our financial disclosures, including our key performance indicators, to ensure that the information we are providing to our investor community best reflects the financial picture and operations of our combined company.

We expect to recognize quarterly losses this year as our business continues to scale. As Gavin mentioned earlier, we do have our longer-term goal of being breakeven on an adjusted EBITDA basis by the end of 2024.

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

Gavin Michael

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

Thanks, Karen. We've reviewed a lot during this call. So, just a few closing thoughts from me. We're really excited about our future. We know there are some near-term external headwinds that make the market challenging and that we can't control. So, we're focused on everything that we can control, like leveraging our core strengths that differentiate our platform to win. This includes our regulatory and compliance-first approach, strong balance sheet, and broad partner network. These help us stand out in this type of environment, and we'll use these strengths to our full advantage.

Although the near-term environment still faces some challenges, we're seeing green shoots and we believe 2023 will provide some pockets of growth. Our focus for this year will be on balancing strategic capital allocation with select investments in our crypto capabilities and our partner network, while maintaining a disciplined approach to our overall expenses. We are eager to invest in areas where we see growth opportunities and pull back our resources where we don't.

Thank you for joining us today. I'll now turn it over to Ann to manage our Q&A.

QUESTION AND ANSWER SECTION

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, guys. 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 Working P. who asks, what can Bakkt to 10x the revenue in the next three to four years? How is Bakkt thinking about generating revenue given the slowdown in crypto and delayed partnership activations? Karen, can you take this question?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Sure, I'm happy to. Thank you for the question. Our focus is on generating long-term value, and everything we are doing today is geared towards that. Our platform and B2B go to market strategy are based on robust, repeatable processes that are easy for partners to integrate and scalable. We've designed the entire business with the ability to ramp quickly and grow with our partners in the overall market.

We are confident that we have the right core infrastructure, platform capabilities, and strategy all in place; and we expect the acquisition of Apex Crypto to accelerate our growth by adding 33 signed partners and exciting cross-selling opportunity. This is still a relatively nascent market. As market conditions improve and the market has a bit more time to mature, we believe we will see our platform really take off and recognize its economic potential.

We're fortunate to have built a business with a diversified revenue base that could withstand a temporary slowdown in crypto. Our Q4 2022 revenues were up 14% year-over-year, even during an incredibly turbulent time in the market. Subscription and service revenues are about half of our current revenue base, and represent a steadier source of recurring revenue for us.

While this question was about revenue, I do want to point out that we have and will continue to manage our firmwide expenses as a general practice even more aggressively if our top line revenue growth is under pressure. Our prudent expense management is expected to enable us to improve free cash flow usage by 25% to 30% in 2022, while also achieving 15% to 30% revenue growth.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Karen. Our next question is on whether there is a risk of Bakkt or ICE pulling out of crypto investments, given the general slowdown in the market. Gavin, can you take this one?

Gavin Michael

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

A

Yeah. Look, happy to share thoughts on this. The short answer is no. There isn't a risk of us pulling out of crypto. We firmly believe crypto is clearly here to stay, and we see significant future growth potential for this space. Our most recent research is showing us that even post-FTX, the majority of consumers believe that crypto is the future of money. It has the potential to be a driving force in financial services innovation.

All of our conversations with partners, prospects, and other leading market participants affirm our belief that crypto is not going anywhere. Sure, some of our partners are extending their activation timelines to find the right time to enter the market given the volatility that we're seeing. Many are waiting for regulatory clarity, which we also welcome. But are they completely saying they're no longer interested in pursuing a crypto strategy? Definitely not.

Companies like ours are using this temporary lull in the market to be very opportunistic, to create value and build out the capabilities so that when the market rebounds, they're ready to take off. I mentioned earlier on this call that one of our key priorities in 2023 is to expand our crypto platform by investing in custody, integrating Apex Crypto onto our platform, and driving crypto to utility and to payments. Crypto is a core part of our long-term strategy. We're definitely not pulling back from this space.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. Our next question is from Working P. who asks, what is the market opportunity for Bakkt, given recent changes to the business model? For example, you decided recently to sunset your consumer-facing app. Gavin, can you take this question?

Gavin Michael

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

A

Okay. So, let's start off with our decision to sunset our consumer app. Our focus is on providing scalable B2B2C crypto and loyalty solution that enable businesses to offer their customers unique experiences. We decided to sunset the consumer app because it wasn't core to our approach. It also ensures that we're supporting the relationship our partners and clients have with their customers, rather than competing in any way, whether real or perceived.

Our market opportunity is not negatively impacted as a result of our decision to sunset the app. Now, that we've eliminated the app, we can focus our resources on B2B partners, who can provide much more scalability to our existing partner network and reaches well in excess of 100 million consumers. Our reach will continue to expand with our acquisition of Apex Crypto. We're confident that the decision to eliminate the app will ultimately drive positive value for the company.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. Next question is from Ibrahim G. who asks, what will you do to help shareholders gain confidence in holding the stock? Seems like there's no recovery and 99% of investors are underwater. Karen, can you opine on this?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Of course. I can appreciate the frustrations that our shareholders have felt. It hasn't been an easy journey, and I thank you for sticking with us. I want to remind folks that there's been a market-wide reset over the past year and valuations for many types of firms, including those who are high-growth tech or crypto focused, as a result of the macroeconomic environment. This isn't in a Bakkt-specific phenomenon, nor one that we could necessarily control.

That said, we are focused on driving positive shareholder value for the things we can control. This includes balancing strategic capital investments in areas where we see a path to profitability in the current environment, with disciplined expense management and cost cutting to align costs to revenue opportunities. We're continuing to build value so that when the market conditions improve, we are positioned to win, scale rapidly, and deliver the results we know we are capable of. That's ultimately what's going to drive recovery in our stock price.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Karen. A final question from the Say Technologies platform is from Michael G. who asks, when can we expect to see adoption of the Bakkt platform by larger financial institutions, and does Bakkt plan to use distributed ledger technology in the future? Gavin, can you take this one?

Gavin Michael

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

A

Yeah. Look, let's clarify that we already work closely with a number of large financial institutions today. Most of the major money center banks today are our clients. They leverage our platform's loyalty redemption capabilities. Our institutional-grade platform is already very capable of handling large scale transaction processing volumes for sizable institutions. On the crypto front, we've already signed up several large financial firms to our platform, both with Bakkt as well as with Apex Crypto.

On the Bakkt side, most of the institutions we signed up historically have been platform partners and traditional finance firms. The uncertainty in the regulatory environments caused some of these players to hit pause, temporarily delay activating their crypto strategies. But as we've discussed at length, in the past we've done much of the integration work with them already and we're really just waiting for the right time to enter the market. Meanwhile, Apex Crypto has 33 signed clients, with many of them active and sizable in nature.

Apex acquisition will provide immediate scale to our platform with their existing and pipeline client roster. Regarding the part of the question on distributed ledger, today we integrated with two public blockchains, Bitcoin and Ethereum. We have plans to support more protocols for both trading and custody over the course of this year. But we do not have plans to add distributed ledger technology beyond the support for public blockchains at this time.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. 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: We will now begin the Q&A session. [Operator Instructions] Thank you. The first question comes from the line of Andrew Bond with Rosenblatt. Please proceed.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Hey, good evening. Just a couple on the Apex acquisition, just in addition to the state regulatory approvals which appear to be moving along pretty well. Can you update us on any discussions with the SEC? And you guys are still guiding to the first half close, but could the timeline change at all moving forward, given the recent rhetoric and enforcement action we've seen from the SEC?

Marc D'Annunzio

Secretary & General Counsel, Bakkt Holdings, Inc.

A

Hey, Andrew. It's Marc D'Annunzio. I think that we remain very much on track to close that acquisition in the timeframe that we've previously told the market. Obviously, there is a lot of activity both at the federal and state level in terms of enforcement actions and additional guidance. But we feel good about where we sit right now.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Got it. Thanks. And I believe there is a \$45 million payout based on certain gross profit targets for Q4. In the presentation you mentioned a \$9 million stock earn-out. Is that the only payment due for Q4? And maybe if you can, what was the growth metric that triggered this payout?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. Andrew, it's Karen. Yeah. So the terms of the transaction had one potential additional stock payment related to Q4 performance of a value up to \$45 million. And, yeah, as everybody can realize, this has been a very tough quarter. Q4 has been in the crypto space. So I think looking at Apex's results and the fact that this earn-out was based on net revenue and they were able to achieve a approximately \$9 million earn-out, I think it's basically a testament to how they're performing in a tough cycle. But it is the only measurement we have as of Q4 to answer your question.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Okay. Great. And just lastly, could you update us on the status of some of the partnerships that have been announced over the past year or two? I think MasterCard and Fiserv are two of the larger ones. And perhaps our activations are trending with the legacy Crypto Connect business with some of the banks you announced partnerships with. Are many of these connected businesses still in wait and see mode given the current environment or do you expect an uptick in revenue contribution this year?

Gavin Michael

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

A

Andrew, why don't I start? In terms of where we are with the partners that we announced, most of the partners that we announced were obviously connected with the more traditional finance part of the sector. Many of those are definitely in a wait and see mode. We mentioned before the elongation that we see in the decision cycles about when the right time to enter the market is. With our platform-based partners you mentioned, MasterCard for example, work continues on the integration of our systems, on working to develop together with a strong focus on crypto rewards.

In that case both the ability to redeem and to look at potentially other applications of the rewards use case across what we do with MasterCard with Global Payments, for example, it's been somewhat similar. We ran a pilot towards the end of last year, which I think we've spoken about with respect to Netspend. And again, where we've used our APIs to integrate into the Global Payments systems. So I think what happens with the platform partners is we continue to integrate, we continue to work with them. When you think about where we are with some of the announced partnerships, many of those are in a wait and see mode as they look for regulatory clarity.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Okay. Thanks for taking the questions.

Q

Gavin Michael

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

Thanks, Andrew.

A

Operator: Thank you. The next question comes from the line of Jeff Cantwell with Wells Fargo. Please proceed.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Hey, thank you very much. I appreciate you taking these questions. So my first one is on the decision to transition from your consumer facing app to B2B2C. Can you talk a little more about the reasons why now and also kind of help us think about, understand what that means for the company going forward? I would like to get a good sense of why that positioning makes the most sense in this market from your perspective. Thank you.

Q

Gavin Michael

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

Yeah, sure. Jeff, it's Gavin. I'll take the question. Look, when we look at all of our offerings in the market, we continue to test product market fit, do we think that we can achieve rapid scale, efficient and effective scale. We've spoken from the onset of the company around the fact that what we have and what we take to market as a platform and our focus on driving B2B2C volume through that platform.

A

Through the course of 2022 we continued to add partners onto the platform and to build out those capabilities around crypto connect, crypto rewards and crypto payout. As we rounded the year, we started to look at how efficient and effective we've been in the marketplace with respect to all parts of our offerings. And it became apparent with the app that it really was detracting from the focus, what we had around being that platform, that scalable company that is really providing market level infrastructure without any channel conflict or brand conflict to our partners.

And it was through those discussions that we led to the decision to sunset the app. As I said at the outset, I think that this provides opportunity for us in terms of focus, obviously, in terms of simplification because we have a very clean and efficient go to market model now and it really is showing that the company's strength exists in its ability to generate growth through being a platform-based business.

I don't think that's a strong deviation from where we've been because we've always spoken about the platform and the app being a part of that. By retiring the app we're shifting our focus entirely to the platform.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Okay. I appreciate that. The second one I wanted to ask you is on Silvergate. I think it does make sense to discuss how that development impacts a company like Bakkt. Perhaps it makes sense to discuss Apex and whether the trading platform, as you guys are understanding it or thinking about it, can potentially capture share in this environment as we all are trying to factor in developments with SEN for example and so forth, and what that

Q

means for trading in this space? So I was hoping you kind of give us your thoughts, high level, if you don't mind, on Silvergate SEN and where you may potentially be seeing opportunity? Thank you.

Gavin Michael

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

A

Sure. So let's just start with Silvergate. Our exposure to Silvergate is limited to the consumer funds that we hold as part of the app and the use of their ACH services to sort of facilitate customer flows in and out. Obviously as many we've been anticipating issues with where Silvergate is for some time. We've been working with multiple other providers to minimize any sort of service disruption. We've accelerated that work with the recent news regarding liquidation. We're taking rapid action really to fully migrate off Silvergate entirely, ensure that any of the consumer funds are protected and minimal service disruptions to those will continue to be part of our app through a web-based experience as we've spoken about before.

With respect to Apex, I mean again that's a reinforcement of our B2B2C model. It's where we embed our services into those of others. Clearly, what we're seeing across the market is dislocation and through that dislocation we see opportunity and we'll continue to chase those market growth opportunities where we think we can be effective, efficient and scale and using the platform as a point of leverage.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Q

Got it. And if I could squeeze one last one in, I just want to make sure I am understanding your 2023 guidance and so what you're saying is that your revenue guidance, the range you're giving, does not include Apex and I'm also curious if there has been any moving of expectations in terms of the accretion from that deal over the past few months since you've last spoken with us. Thanks very much.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. And I could take that. You are correct in how you followed our guidance. So given that the deal has not yet closed, at the moment we're giving guidance on the organic performance of that. We would expect to update that guidance with a view on Apex after the Apex acquisition closes. I think in terms of – could you run me the other part of your question?

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Q

Yeah. I'm just trying to figure out. Sorry. Sorry to take up so much of your queue, but I wanted to figure out if your prior commentary on the accretion from the deal is still relevant. Or if there may be any change in how you guys are thinking about the deal. Thank you.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. We provided guidance last year or [ph] set our (00:56:53) expectation last year based on the underwriting that we did on the deal. So our plan at this point is to update that guidance once the acquisition closes.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Q

Got it. Thanks very much.

Operator: Thank you. The next question comes from the line of Trevor Williams with Jefferies. Please proceed.

Yvonne Jeng

Analyst, Jefferies LLC

Q

Hi, this is Yvonne Jeng on for Trevor. Thanks for taking my question. Just a quick one on expenses. Can you give us a sense for how the focus on expenses will translate into the pace of OpEx growth in 2023 and how we should think about the quarterly run rate for expenses? Thank you.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah, so clearly with the actions that we're taking and the focus on capital allocation decisions, our operating expenses will definitely decrease relative to where we were in 2022. So if you think about what we did in terms of guidance, we have a range of revenue guidance that then fills into where we think we'll be on a free cash flow basis. And then from there, you can see that basically the usage of cash from an operating expense perspective is going down, roughly from a cash operating expense perspective is going down roughly \$40 million from where we were in 2022 [ph] at the midpoint (00:58:19).

Yvonne Jeng

Analyst, Jefferies LLC

Q

Thank you.

Operator: Thank you. The next question comes from the line of Pete Christian (sic) [Christiansen] (00:58:32) with Citi. Please proceed.

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Good evening. Gavin, I was wondering if you could talk a little bit, dig a little bit more into, I guess, one of the priorities for investment this year is in custody. Just wanted to dig a little further into that. What areas are you investing within custody? And generally how are you seeing custody pricing kind of evolve? If there's a bit of a notion that you're seen some commoditization in the space and pricing that's kind of come down, just your thinking on how you could differentiate there on the positive side? And then I have a follow up.

Gavin Michael

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

A

Yeah. Sure. Look, I think when I look at custody, obviously we see it as a core offering to what we do. We're upgrading our work to be on a more modern architecture that will help increase our agility to meet both B2B2C partner needs and institutional needs. So think about things like automated wallets to enable consumer deposits and withdrawals, the ability for us to be able to support an increased range of tokens and protocols, including things like Stablecoins and yield generating offerings as well in consideration for things like staking. We see custody as a growth area. There are more and more of our partners are looking to work with custodial operations like ours. We've spoken before about the fact that we run the trust. We are a QC in that respect. The trust is run as an independent legal entity within our framework. It has its own board of managers as we spoke about during the presentation. In terms of pricing, we're still seeing the ability for us to be able to take an aggressive approach there just given the specialized features that we think we're able to offer as we move forward. And the fact that we're not just providing the technology that underpins it, it's the risk management practices, it's the compliance, the cyber, it's everything that goes around it to build that custody opportunity and operation out.

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. That's helpful. And then just curious, we've noticed other crypto players, the average crypto consumer [ph] has been (01:01:08) extremely passive in the last several months given the environment. And I was just curious if what you're seeing on demand for like things like crypto rewards and whether or not you're seeing focus groups and the appeal for that feature is stronger, is it holding up relative to what we're seeing in the broader market?

Gavin Michael

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

A

Look, I think it is holding up. I think the announcement we made today with Caesars is testament to that. I think the ability for Caesars Rewards customers to be able to use those rewards to purchase crypto and that gives us access to millions of customers is a good example of this passive acquisition, this new way to earn as something that is still showing relevance in the market.

We continue to work with a number of partners on what the rewards value proposition could look like. Many are interested in it because it allows them to build new engagement with their consumers in their everyday lives. And so we feel that the demand is still there and we think it's an offering that is somewhat unique by the way we're taking it to market and we think it's something that again continues to differentiate us with other players in the space.

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

Thank you. Last one for me, Karen, I was just curious, earn-out for Apex, is that still applicable for 1Q if the deal is not completed by then?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. So if you recall how we structured the purchase price, we had an earn-out of up to \$45 million related to Q4 2022 performance. And then there is an additional earn-out of up to another \$100 million of stock based on 2023, 2024 and a little bit into 2025 performance. So that will be measured over time. But the Q4 window where they earned relative to the \$45 million, that is just based on Q4 performance.

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

Okay. That's helpful. Thank you.

Operator: Thank you. The question comes from the line of John Roy with Water Tower Research. Please proceed.

John M.A. Roy

Analyst, Water Tower Research LLC

Q

Great. Thank you. So Gavin, maybe just mentioning Caesars there, maybe you could give us a little more color on how that came to happen? What you expect to see from it? And could we see others in the future?

Gavin Michael

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

A

Yeah. Thanks, John. This strategic alliance that we've announced today, I think, has a huge amount of potential, as I said earlier, just largely in the fact that we're offering the ability for Caesars rewards members to really have access to crypto rewards through our platform. They can redeem Caesars Rewards points for cryptocurrency. But it doesn't stop there. We're also looking for our ability to look around innovating further, using things like our crypto payout facility. I think what's so exciting about this is it's a new client vertical.

So we've gone into a different space in the entertainment sector and the space that we think with Caesars as an anchor client will actually start to lead to more demand generation as we move forward. So we're excited by the move into the new vertical. We're excited by the fact that we're taking rewards to scale, to market through a partner like Caesars. And we think that opens up additional opportunities as you start to think about the applicability of this in a broader entertainment context.

John M.A. Roy

Analyst, Water Tower Research LLC

Q

So maybe as a follow-on to that, from a regulatory approval standpoint, do you think it's significantly harder because of Caesar's gambling environment or is that not really that much of an impact on you?

Gavin Michael

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

A

For us, it's subject to regulatory approval across all of our regulators. Right now we see it as an exercise in briefing them on what it is that we're doing. I think the way in which we've structured the agreements and the way in which the transaction actually works, it looks like a crypto buy at the end of the day and a crypto sell. So we think it's reasonably straightforward, but it is subject to regulatory approval.

John M.A. Roy

Analyst, Water Tower Research LLC

Q

Great. Thank you.

Operator: Thank you. [Operator Instructions] There are no additional questions at this time. I will hand it back to the management team for closing remarks.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

Thank you, everyone, for attending our earnings call this evening and we look forward to connecting with you again soon. Have a good night.

Operator: That concludes today's conference call. Thank you. You may now disconnect your lines.

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