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Bakkt Holdings, Inc. (BKKT)

Q1 2023 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the Bakkt First Quarter 2023 Earnings Conference Call. At this time, all participants are on listen-only mode. A question-and-answer session will follow the formal presentation. As a reminder, this conference call is being recorded. I would now like to turn the conference call over to our host, Ann DeVries, Head of Investor Relations at Bakkt. Please go ahead.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

Good morning and thank you for joining us for Bakkt's first quarter earnings call. Today's presentation, including the separate earnings call presentation that can be found at 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 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 we received 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. Our differentiated platform is positioned to win in this environment, through the combination of our premier secure custody solution and Apex Crypto's advanced trading capabilities. We are poised to be the crypto infrastructure provider of choice. In this current environment, clients are seeking a trusted partner. And our regulatory and compliance-first approach sets us apart.

We separate the entities facilitating crypto trading and custody functions, and we've built a broad network that provides scale, reaching millions of users across client verticals, including the fast growing fintech industry. Our priorities for this year further strengthen our competitive moat. We're investing in our crypto capabilities, including custody. We're building upon this core capability to enhance and expand flexibility. We're seeing significant inbound interest for our custody offering and our SOC1 and SOC2 certifications, along with our separate trust entity structure, and overall secure approach are really setting us apart in those conversations.

We're investing in our crypto trading capabilities to expand to new international markets alongside our existing clients while strategically investing to enhance our capabilities. We remain committed to activating and broadening our already robust network. This means continuing to collaborate with existing clients to drive trading volumes, partnering with these same clients to collectively bring new platform capabilities to market.

I also wanted to highlight our disciplined approach to strategically allocating capital. We are opportunistically deploying capital and remain highly focused on managing expenses. We apply rigorous analysis to inform capital allocation decisions across the organization. Intentionally investing in the areas that have the most growth potential for our organization and being prudent across other aspects. Leveraging the resources we already have in place.

Moving to our acquisition of Apex Crypto, which we're really pleased to close on the first day of the second quarter. As we've shared, Apex Crypto is transformational for our crypto capabilities. And with the powerful combination of our secure custody and Apex's advanced trading capabilities, Bakkt is holistically positioned to be the crypto infrastructure provider of choice for a broad spectrum of businesses.

The acquisition provides immediate scale to our platform, with more than 5.8 million crypto enabled accounts, along with significant expansion of distribution opportunities to new markets and new customer segments. It fast tracks our approach to bring new crypto capabilities to market and bolsters our path to profitability while adding a pool of extremely talented employees across product, engineering and operations to our team.

We're focused on executing on integration seamlessly, to ensure that we realize the full potential of the acquisition and capitalize on the new opportunities. This includes making thoughtful decisions about our offerings. Following the closing of our acquisition, we conducted a detailed analysis of the coins against our listing policy and made the decision to delist a number of coins on the platform.

Our clients' and their customers' best interests are our core commitment and our review process ensures that those interests are best served when we contemplate the most up to date regulatory environment. We are working to expand into international markets through our client base, many of which have operations

internationally today. The regions that we're most excited about and focused on in the near-term are the UK, EU, and Southeast Asia and we'll continue to make investments in capabilities that have near-term growth opportunity, as well as work with Apex FinTech Solutions as part of our commercial agreement to provide new services to their client base.

Our acquisition significantly broadens our client reach to include fintechs, neobanks, trading platforms and wealth managers. In addition to our clients in TradFi, travel and entertainment, and merchants. This group represents an attractive addressable market and it's noteworthy that we're now serving the rapidly growing fintech industry.

FinTech firms are much more agile. They have shorter activation timelines and serve attractive customer demographics, including younger, more tech savvy individuals who are more likely to understand and trade crypto. With the Apex Crypto acquisition closed, we also have a big opportunity to deepen relationships with the current roster of clients. And as you can see, on the right hand side of the slide, we're serving some amazing clients in Webull, Stash, Public.com, M1 Finance and many more. We're actively exploring how we can collaborate more closely to elevate crypto trading capabilities and increase platform volumes.

We know from our research that customers are looking to get their crypto from the companies that they already know and trust for ease and simplification. Our latest crypto research study is finding that consumers believe purchasing crypto through an investing or personal finance provider is more trustworthy than purchasing crypto through a traditional crypto exchange. Also, consumers who primarily purchase crypto through a fintech provider have less safety and regulation concerns than those who purchase crypto through a traditional exchange.

Further, we are seeing that clients we serve like fintechs are looking for new ways to increase the ways they serve their customers with more opportunities to drive engagement and power revenue growth through new offerings like crypto. The Apex platform is complementary to our offerings and accelerates our ability to offer advanced capabilities to our clients. Now let's look more deeply at what we're able to offer now that the acquisition is complete. By partnering with several top liquidity providers, we're able to provide unparalleled liquidity and price quality, customers receive deep, tight, and transparent pricing as well as redundant markets, which enable 100% uptime.

Clients integrate seamlessly with a rich set of APIs that enable them to be in production on the platform in around 45 days. We enable clients to offer investing in multiple asset classes from the same platform and a broad range of account types, along with instant funds settlement for customers with no pre-funding required. The ability for customers to seamlessly invest and settle between multiple asset classes is a significant competitive advantage and provides strong opportunity to deepen relationships and drive activity with these clients and their end users.

Additionally, [ph] failover (00:09:26) protection ensures customers can access our platform 24/7, just as the crypto markets operate all the time. A full spectrum of order types with broad execution capabilities, including quantity order denomination, block trading and allocations, multiple fee structures such as trade fees that can be customized per order, cost basis services, gifting and coin transfers for sending and receiving of Bitcoin, Litecoin, and Bitcoin Cash with more coming soon.

We remain committed to the US market, but we also recognize there are compelling growth opportunities internationally. We're already seeing demand from our clients to expand into new markets together. Based on those conversations, we see the greatest interest in the EU, the UK and Southeast Asia. Not only are these markets appealing to our clients, but we've seen enhanced regulatory clarity. For example, the European Parliament's progress with MiCA. The UK is introducing legislation to position itself as a hub for crypto. Hong Kong unveiled a proposed set of rules to regulate crypto activity, and South Korean lawmakers recently approved

an initial review of a comprehensive crypto regulation bill. These regions also boast positive consumer sentiment towards crypto, with really impressive levels of transaction volumes and progressing consumer adoption.

Now turning to Apex Crypto key performance indicators. This quarter, we're showing historical performance of the Apex Crypto platform, but going forward, we'll be reporting the company's combined key performance indicators. As you can see, the number of crypto-enabled accounts have continued to grow throughout the past several months, even when there was volatility across crypto markets, reinforcing the attractiveness of the market segment served by Apex Crypto.

When you look at the active accounts, we see the figures hold steady, but we expect to see these numbers increase as we see green shoots begin to emerge in crypto markets. Within the notional traded crypto volume, it's clear that this metric aligns with the pullback that we saw in the broader crypto market at the end of last year and the beginning of positive momentum in the first quarter.

You can also see a positive trend reflected in the first quarter assets under custody where a lift can be attributed to an increase in crypto prices, with a specific emphasis on Bitcoin. Following the fallout from last year and so many direct crypto exchanges going out of business, we benefit from the flight to quality in the industry with retail customers utilizing their existing relationships, like those with fintechs and trading apps to buy and trade crypto.

As the crypto winter turns to spring, we're seeing signs of life and while it takes time to translate into tangible revenue, Apex Crypto continues to win new business as clients seek to do more to drive engagement and drive growth with their customers. We are poised to capture increasing market share, both domestically and internationally as the market improves.

Now I'll hand it over to Karen to guide us through an expected outlook for Apex Crypto and the rest of our financial results.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

Thank you, Gavin and good morning, everyone. Let's now turn to Apex Crypto's recent financial performance in 2022 and a preliminary look at the expected outlook for 2023. In accordance with GAAP reporting, we show two line items here. Gross revenue, which captures all revenue associated with transactions, assets under management, and fees on a gross basis. The gross revenue presentation aligns with Apex Crypto's role as a principal in trades with customers. We also show crypto costs and execution, clearing and brokerage fees associated with the trading activity, which captures the cost of crypto, partner revenue share, and other fees. Crypto cost and fees will generally follow the same trend as gross revenue. Netting these two line items will provide the profit contribution from trading activity, which is a non-GAAP figure.

Let's move on to the numbers. You can see here that 2022 was a story of two halves. The first half of the year was very strong with customer transaction activity driving \$2.2 billion in gross revenue. Then the crypto market turmoil stalled activity levels for the overall industry and we saw second half gross revenue declined by over 50% to \$899 million, consistent with the broader total crypto market volume as illustrated on the prior slide.

We evaluated 2023 expected gross revenue performance in light of where the markets ended in the second half of 2022. We saw Q1 2023 volume start to rebound from Q4 2022 levels, consistent with industry trends. And we expect similar volumes in the second quarter. Accordingly, our outlook for the first half of 2023 is similar to what we saw in the second half of 2022. We expect crypto market activity levels to recover, as 2023 progresses and

our second half 2023 outlook reflects that. This outlook also reflects an estimate of the impact of the coin delisting actions Gavin described earlier.

Taking all of these factors into account, our gross revenue outlook for the full year is in the range of approximately \$1.9 billion to \$2.4 billion. We expect crypto cost [ph] going to be (00:15:28) proportionate with these revenue levels, which you can see on this slide. Apex Crypto provides a strong lift to our revenue base even in a year with a tough environment for the crypto market. We're excited about the positive impact it will have on our path to profitability as the environment continues to recover.

Moving to the next page, I will now walk you through the first quarter's financial results. A quick reminder that since our acquisition of Apex Crypto closed on April 1, 2023, their results are not reflected in the financials that I'm going to walk you through. Apex Crypto will be included in our financial results beginning with second quarter 2023 earnings.

Turning to slide 12, we have our first quarter 2023 financial results. We had net revenue for the quarter of \$13.0 million, which increased by \$500,000 or 4% compared to the first quarter of 2022, primarily driven by a transaction activity from loyalty redemption. Operating expenses were \$58.4 million in the period, which is down \$2.6 million or 4% year-over-year. The current quarter operating expense includes a non-recurring restructuring expense of \$4.3 million related to our actions earlier this year around head count reduction.

Excluding the non-recurring restructuring expense, expenses were down 11% year over year, driving strong improvement in our operating margin, as revenue growth coupled with efficiencies in our expense base, improved margins. The net loss for the quarter was \$44.9 million, which resulted in a diluted loss of \$0.17 per share and an average diluted share base of 81.9 million shares. Net loss allocated to the non-controlling interest in the operating company was \$30.9 million, leaving a \$14.0 million loss attributable to Bakkt Holdings, Inc., or a net loss of \$0.17 per share at an average basic share count of 81.9 million shares.

Our total share count as of March 31 was 265.9 million shares. ICE remains our largest shareholder, with ownership at 66% of aggregate shares, which have remained relatively consistent with their shareholding as of December 31, 2022.

On slide 13, we have our EBITDA and adjusted EBITDA for the first 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 \$43.4 million and \$28.9 million respectively. Adjusted EBITDA loss was unchanged 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 in the earlier part of the year, offset by lower marketing costs and professional service fees.

On slide 14, we show net revenue broken out between subscription and service revenue and transaction revenue. The total net revenue in the first quarter of 2023 was \$13.0 million, which is up 4% year-over-year. Transaction revenues of \$7.5 million increased 15% year-over-year. The first quarter is typically seasonally strong for travel bookings, which is reflected in the significant increase we saw in air travel volume.

However, this was partially offset by lower hotel and car booking volumes, which have remained under pressure since the latter half of 2022. Subscription and service revenues of \$5.5 million declined 8% year-over-year, primarily due to a reduction in volume-based service revenue. Service revenue has a variable component, and it's driven by activity levels at our customer call centers and technology development work on behalf of our clients. Subscription revenue increased slightly in the year-over-year period.

Turning to slide 15, we have total operating expense. Total expense for the first quarter of \$58.4 million, decreased 4% year-over-year. Excluding the \$4.3 million restructuring expense we took this quarter, operating expenses were down 11% year-over-year. The year-over-year decline in operating expenses was primarily driven by a decrease in depreciation and amortization and SG&A expenses, as marketing expenses declined.

Total compensation expense of \$34.1 million declined 3% compared to the first quarter of 2022, due to a decrease in non-cash compensation expense. Other expense of \$17.6 million increased 7% year-over-year and included the \$4.3 million restructuring expense related to our recent actions around head count reduction.

Looking ahead, we expect to recognize \$6 million to \$7 million acquisition related deal expenses in the second quarter of 2023. We expect our compensation expense to decline for the remaining quarters of this year, as the impact from our recent head count reductions become fully reflected in our financials starting in the second quarter. As a reminder, we expect the impact from the restructuring actions in 2023 to be \$29 million in expense savings and an incremental \$7 million of expense savings is expected in 2024.

On slide 16, 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 690,000. Digital asset conversions are a dollar weighted measure and were directly aligned to revenue growth. Volume of \$193 million was up 6% year-over-year. Activity levels reflect strong year-over-year growth in air travel volume, while hotel and car bookings were down. As a reminder, the first quarter is generally seasonally strong for travel volumes. While volumes reflected this to some degree, the year-over-year growth rates in the first quarter were more muted than what we experienced in 2022 when we had a very strong rebound coming out of the pandemic.

A quick reminder that our fourth quarter is seasonally strong due to the holiday season, which is why there is a quarter-on-quarter decline in these metrics. We continue to see strong interest in our platform from consumers with a 10% increase year-over-year in website visitors to our platform. Gavin shared with you earlier on the call the key performance indicators related to Apex Crypto that we expect to report going forward. As the results of our acquisition, starting next quarter the KPIs that we report will change to reflect the metrics for the combined company.

Turning to slide 17, we have our condensed balance sheet. We ended the first quarter with \$117.6 million of cash, cash equivalents and available for sale securities. In the first quarter, we had several significant non-recurring items which resulted in cash usage of \$121.8 million. These non-recurring uses of cash included the \$67.2 million of cash move into an escrow account for the closing of the Apex Crypto transaction. This was comprised of the \$55 million cash purchase price and \$12 million for Apex Crypto's cash.

First quarter cash usage also reflected \$13.6 million of seasonably high payable settlements, which included \$4.1 million of acquisition-related expenses. This is consistent with the fourth quarter being seasonably higher for redemption volume, which drives settlements with suppliers and purchasing facilities. First quarter cash usage also included \$4.3 million of cash severance costs related to the fourth quarter 2022 and first quarter 2023 restructurings and \$2.8 million of cash that was moved into restricted cash as collateral for surety bonds.

During the quarter, we also used \$1.4 million of cash to settle withholding taxes and vested stock awards. I wanted to highlight that although we don't have an official stock buyback program. By using cash to withhold to cover taxes, we're actually reducing shareholder dilution from the shares that otherwise would be released to the market. Excluding these items, our cash usage for the quarter was approximately \$33 million. With regards to

Apex Crypto, we will recognize the impact from their operations in our results starting in the second quarter. Excluding deal cost, we expect the inclusion of Apex Crypto's operations for the remainder of 2023 to be approximately free cash flow breakeven.

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 are really well positioned for improving crypto market conditions. We've brought together a winning combination of industry leading crypto custody solution and advanced trading capability. Coupled with our regulatory and compliance-first focused approach, our platform is truly differentiated in the current market and our company is built for sustainable growth.

Our key priorities for 2023 are highly focused on areas that will drive near-term results while building for a long-term future. This includes initiatives to significantly expand our network of clients, both in the US and internationally. We have a great opportunity to collaborate with our existing client base and meet their needs to expand internationally, especially in markets that are providing regulatory clarity. We're continuing to have active conversations with prospects across the board. Although there remains some ongoing caution regarding the regulatory environment in the US, we are seeing some pockets of green shoots.

We continue to strategically allocate capital to further strengthen our business and we'll continue to evaluate growth opportunities while driving efficiencies in expense management and being highly disciplined with our decisions around how we deploy capital. This is a pivotal moment for our growth. We are confident with how we are positioned, and as the environment improves, we are really ready to take off.

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

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

Thanks, Gavin. Let's move over to questions from the investor community.

QUESTION AND ANSWER SECTION

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

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 [ph] Rajeev S. (00:26:40), who asks, is it possible that Bakkt will get acquired by a larger company? Gavin, can you please take this question?

Gavin Michael

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

A

Yeah, sure. Look, happy to take the question. Well, we've built a great platform with a really strong value proposition that's attractive to a lot of companies. We're always monitoring the markets and making sure that we are evaluating opportunities that provide maximum value to our shareholders. We get approached about a lot of things leading to actions like our acquisition of Apex Crypto. That said, our team is really committed to building our business and we're excited about the path ahead with Apex Crypto in the fold.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. Next question is from [ph] Syed H. (00:27:21) who would like an update on our Mastercard partnership? Gavin, can you give an update here?

Gavin Michael

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

A

Yeah, sure. No trouble. Continuing to work with MasterCard on our crypto rewards offering, we remain highly committed to this and making it successful. Unfortunately, we've seen that the regulatory environment in the US around crypto slowed down the activation of many of our TradFi partners. Much of the integration and go to market work with our TradFi partners has been completed and many are now waiting for the right time to enter the market. Given these headwinds facing TradFi, the closing of our acquisition of Apex Crypto could not have happened at a better time. Our ability to expand into fintech verticals and internationally through our existing client base is even more compelling right now.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Gavin. Next question is from [ph] Samory F. (00:29:14), who asks when will XRP be a part of your platform and why aren't you listing it? Karen, can you answer this one?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yes. I can take the question. Bakkt has a rigorous listing policy that takes into account a number of factors to determine if a coin is suitable and safe for listing through our partners and to their users. One of the primary factors considered is regulatory status. Bakkt is committed to complying with the relevant laws and regulations in the markets we serve. And there's currently limited guidance as to the legal status of a number [indiscernible] (00:28:47)

Given these factors we are taking a prudent approach to the crypto tokens that we are offering on our platform at this time. We will continue to monitor the regulatory environment as it evolves and will make potential changes to the coins that we list if and when appropriate.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Thanks, Karen. Our next question is from [ph] Working P. (00:29:06) who wants to know what are your tangible plans to drive revenue – pay with crypto, bitcoin, custody – internationally while we await regulatory clarity in the US. Karen, can you jump in here?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yes. First, I want to reiterate that we are absolutely committed to staying in the US. That said, as [ph] Working P.'s (00:29:26) question alludes to there are jurisdictions around the world that have progressed a bit further than the US with regards to crypto regulation. It's the right time to pursue these markets given the clear regulatory environments and strong demand to offer our capabilities there from our existing clients.

There's an incredible opportunity to bring our secure crypto capabilities like crypto trading into these new markets. While I won't provide any specific timing on this right now. I will say that this is something that we are really focused on and actively engaged in trying to launch before July. Just like we did in the US when we first built our business, we are careful to ensure that everything that we do is secure, compliant, and well thought-out. Our regulatory and compliance-first approach is part of our DNA, and it's at the forefront of any decisions and actions that we're going to take as we look to expand.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

Great. Thanks, Karen. Our final question from the Say platform is from [ph] Working P. (00:30:27), who asks, are you considering the dilutive impact of issuing an additional 26 million shares to employees? While I understand the business needs to compensate adequately, are you enforcing accountability for delivering tangible business impact? Karen, can you take this one?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Sure, happy to. First, I want to clarify that the pool of 26 million shares would cover equity grants over a three-year period. Our firm's equity compensation program is absolutely tied to performance goals for both our overall company, as well as teams and individual employees. Our company's ability to execute against these concrete goals, determines the available pool of equity awards for our employees. We will not pay out these equity awards if we do not deliver on metrics that include revenue and cash expense targets among others. Our compensation program is subject to our rigorous process and is governed by the compensation committee of the board.

Ann DeVries

Head-Investor Relations, Bakkt Holdings, Inc.

A

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

Operator: Thank you. [Operator Instructions] So our first question comes from the line of Andrew Bond of Rosenblatt Securities. Your line is now open. Please go ahead.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Thanks. Hey, good morning, Gavin, Karen, and Ann. Just got couple on Apex. You've always discussed growth outside the US as an opportunity down the road for Apex, but this now seems to be a greater priority. And just understanding there is demand for costs from customers but to what extent has the regulatory environment in the US been a driver here as you're looking to grow in other countries? So in speaking with other industry participants, it seems that the regulators and current administration are doing their best to make it more difficult for brokers to allow crypto trading on their platform. So are you experiencing this post-acquisition and receiving more feedback like this from clients or potential clients to US?

Gavin Michael

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

A

Good morning, Andrew. It's Gavin. Let me take that one. I think when we talk about the change in posture with respect to accelerating that growth internationally, it's coming for a couple of reasons. I think firstly, we're getting strong demand from the existing client base to enter these markets. As we've seen, legislation in other markets start to favor crypto and it's a more conducive environment, many want to take advantage of that. And that provides us with an easy route into these markets. We've spoken about the UK, we've spoken about the EU and Southeast Asia. We're still very much committed here to the US and we see the potential for US market, we see the growth opportunities. But we're trying to maximize where we grow in the short term efficiently and effectively.

And so the near-term focus for us is really engaging actively with the client base to move as quickly as we can into these new markets while being thoughtful. And I think the change has been generated by the fact that post the Apex close, we now have a wrap into those markets that has a reasonably low barrier of entry, together with the fact that those markets are becoming more crypto-conducive and the fact that we're being led by this client base into those spaces.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Q

Okay, great. And just to follow-up on custody. You spoke to a significant increase in inbounds for your custody solutions. I mean, particularly following the banking crisis. So is this starting to translate to wins for the business, and what's the timeline look like to convert more of this pipeline and interest?

Gavin Michael

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

A

Yeah. We're certainly seeing a continued traction in those discussions. We're setting ourselves apart by the way we run our custody solution. Our SOC1, SOC2 certifications, a separate trust entity structure, the overall secure approach are really appealing to many crypto firms that have crypto that they want to be able to store with a custody provider like us. So there's very strong traction in those discussions. We expect to see momentum through the second half and as we've said, we continue to invest in our custody solution, to be able to broaden the basic structure and then also expand into other areas around our custody operates. We're very excited by the custody space. It's been a core competency of ours from our founding and we continue to use that as an advantage. It's a great anchor product when we're talking to many folks about starting down this pathway with us.

Andrew Bond

Analyst, Rosenblatt Securities, Inc.

Got it. All right. Thanks, Gavin.



Operator: Thank you. Our next question comes from the line of Trevor Williams of Jefferies. Your line is now open. Please go ahead.

Trevor Williams

Analyst, Jefferies LLC

Great. Thanks. Good morning, guys. Gavin, maybe just to start kind of higher level on the regulatory environment, I know you're mentioning, I think just may be a little bit of a change in tone just around kind of international markets that have been at least providing a bit more regulatory clarity. But maybe just to focus on the US, just kind of where you see the State of the Union from both on the legislative side, if there's anything that you guys are expecting to progress at all through the rest of this year, and then obviously there's just a bunch of noise with some of the enforcement actions that have been coming down. Maybe just kind of how you see the regulatory environment today versus three or six months ago here in the US would be helpful. Thanks.



Gavin Michael

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

Good morning, Trevor. Thanks for the question. Look, I think we're pleased to see that the congress and the federal regulators have certainly stepped up their attention to the crypto space. When you think about the high profile failures through last year, it's clear to us and logical that the federal regulatory framework is needed in order to restore confidence in the markets for everyone – for investors, for consumers and partners. We support the enforcement actions against bad actors in the space.



But when you think about it, a good regulatory framework or comprehensive regulatory framework shouldn't just define where the third rails are, it needs to clearly outline how good actors conduct their operations in a highly compliant way, but also allowing for innovation, and for us to be able to bring the benefits of these innovations to market in a very safe and transparent way.

So, we're getting more involved directly in the conversations both on Capitol Hill and with the relevant regulators as they consider these issues and we acknowledge that these issues are complex, but they're very important that we get it right. We see ourselves as a resource to them, as these discussions continue.

I'm still hopeful that through 2023, we'll see clarity in the space. We're seeing moves. The recent Stablecoins discussions have been very encouraging. But it's a space that we desperately need to protect the US consumers in. But it's also important that we ensure that innovation happens here in the US and it's not all driven offshore. Whilst we look at the other markets where we're seeing regulatory clarity evolve, that sets up a reasonable template for how these discussions can move forward and there's a lot of similar threads whether they would have [ph] micros (00:38:34) being put together, what Hong Kong has just come out with the UK comment paper from Treasury. All of these papers have common threads about using existing regulatory frameworks to be able to drive the way that this space should evolve.

So pleased to see that the attention that we're getting. Hopeful that through the course of this year we'll see the clarity and we need to move away from just defining where the third rail is and into something that is a comprehensive framework that allows us to operate the business and continue to innovate.

Trevor Williams

Analyst, Jefferies LLC

Q

Okay, that's helpful. Thank you. And then, Karen, I don't think we heard anything incrementally on the 2023 revenue outlook that you gave last quarters, I'm just wondering, we should still be assuming the \$62 million to \$72 million range on revenue is still the base expectation. And then as a part of that, the Apex contribution for this year, I just want to make sure – am I understanding the slides correctly? Is Apex contributing \$6 million to \$8 million to full year net revenue post-close, or is that the full year number? And you're only going to get a portion of that for the three quarters that you have it in the revenue base? Thanks.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. Trevor, happy to answer that. So in terms of the guidance that we gave last quarter, which was obviously excluding Apex Crypto, we did not provide an update on that. Typically what we do is as we do our mid-year update as part of the second quarter review, that's our time to look at whether we need to provide any updates to that guidance. And certainly we would do that on a combined company basis now that we have closed on Apex. So no updates to revenue guidance there.

In terms of the presentation, the numbers that you are seeing in terms of the \$6 million to \$8 million are full year numbers. So if you think about the fact that we will pick up those revenues starting in the second quarter, I can say that for the first quarter of 2023, that Apex net gross margin or net contribution was \$1.3 million. So you could basically get the rest of that in that range is what we'd expect now that they are part of our results.

Trevor Williams

Analyst, Jefferies LLC

Q

Okay, perfect. That makes a lot of sense. Thank you very much.

Operator: Thank you. Our next question comes from the line of Peter Christiansen of Citigroup. Your line is now open. Please go ahead.

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

Good morning. Thanks for the opportunity to ask a question. Just a couple on Apex. I mean, it looks like at least the net take rate was kind of like mid-to-high 20s last year. It's kind of been drifting higher now, kind of low-30s, like 33, 34 basis point somewhere around there. Can you talk about what's driving that? Is it underlying client mix or token mix activity-wise? And then I have a follow-up.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Hey, Pete. I'll be happy to take that one. So, similar how we've talked about how the organic Bakkt crypto offerings work, every Apex client has an agreed upon spread upon which we – that we add to crypto by themselves. And so that does differ client by client. And then from there, beyond just the cost of fulfilling the purchases of crypto, there is what has been termed the correspondence fee that's really a rev share with the clients. Again, that differs client by client. So if you are seeing mixes there, it tends to be driven by the relative trading volume by each client's underlying customer mix.

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

That's helpful. And then looking at the outlook for Apex to be free cash flow breakeven, I'm assuming that's at current crypto prices, if we were to test that like scenario analysis, maybe plus 10%, minus 10% for crypto values, I would imagine the free cash flow change would be kind of like single millions of dollars. Is that the right assumption and way to think about it as we stress-test our models? Thank you.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

I mean, obviously, the gross revenue is – as crypto prices go up, of course revenue goes up, but then also the cost of the crypto that we provide and the rev share goes up proportionately. So I mean, I would think about it in terms of that take rate being about the same. But certainly, it's based on growth volume that is being influenced by both crypto prices and the actual volume of coins that are being [ph] actively mothballed (00:43:47)

Peter Christiansen

Analyst, Citigroup Global Markets, Inc.

Q

Okay. I just wanted to understand the fixed cost relationship down to operating income. Okay. Thank you.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Sure.

Operator: Thank you. Our next question comes from the line of Jeff Cantwell of Wells Fargo. Your line is now open, please go ahead.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Q

Hey. Thank you and congrats on closing Apex Crypto. I wanted to ask you a couple on that. If we go to slide 10 of your presentation, can you walk us through your assumptions for the back half of this year for Apex Crypto gross revenue? What are sort of the underlying assumptions that would drive the gross revenue to improve sequentially versus the front half of the year? I'm just trying to think through some of the underlying drivers in terms of active accounts and assets under custody and crypto-enabled accounts and so forth.

So what are the assumptions that you're currently contemplating for the back half of this year?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Thanks, Jeff. I can certainly take that. So you think about how we make money on the crypto activity, obviously it starts with the access to the number of accounts we have now. We acquired over 5.5 million active accounts when we closed the deal. The percentage of those accounts actively trading in any period and at what notional and how frequently is really one of the behavioral drivers that we look at.

So, we look at that activity over time and the trends. So even for instance that we didn't pick up an additional client relationship for the end of the year, one of the things that we've ranged is based on the data we have over time, what do we expect that transaction behavior to look like?

And then on top of that, as we mentioned, Apex brought to us a great pipeline of additional client opportunities. So we are actively working on – some of them are signed and in the process of activating, [ph] others or some (00:46:00) of them are getting to the signed phase. So that range also reflects our analysis in terms of additional clients coming onto the platform and bringing their customers with that.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Q

Okay, great. And then to follow up on Trevor's question earlier about the prior guidance that you gave for the full year – it doesn't sound like you give numbers this quarter, but you will next quarter. But can you help us think through what your thinking is now about – there's so much happening with macro and so forth, but what is your thinking about the business now relative to three months ago, or any kind of color you can give us in terms of – just sort of providing us an update on how you're thinking about how the full year will play out? Thanks.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. So when we talked last quarter about the revenue guidance, obviously, one of the things we talked about – we've got a kind of a steady state, long history with our loyalty business that provides the range. And then we also talked about the crypto contribution pre-Apex coming from our traditional pipeline of traditional finance clients more at the end of the year.

So one of the things that we are constantly looking at is where do we see the momentum to start picking up activations on the TradFi space. And one of the things that as we think about now the fact that Apex is part of the combined company, depending on what we see in the environment, especially from a regulatory perspective, this now allows us the chance to pivot resources and focus [indiscernible] (00:47:52) for instance, we continue to see softness on traditional finance companies wanting to activate because of the uncertainty in the US regulatory environment.

We will very quickly pivot to focusing more of the efforts where we see more of the immediate opportunities for activation and expansion. So, I think all of those things come together as we think about and prepare for how we want to update our investors as part of second quarter earnings in terms of the combined potential of the company.

Jeff Cantwell

Analyst, Wells Fargo Securities LLC

Q

Okay. Very helpful. Thanks very much.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Thanks.

Operator Thank you. Our next question comes from the line of John Roy of Water Tower Research. Your line is now open. Please go ahead.

John M.A. Roy

Analyst, Water Tower Research LLC

Q

Thank you. So, Karen, obviously, there's been a lot of discussion about Apex. I was wondering, have you given any color or can you give us any color on what new metrics or line items we might be seeing when you start doing disclosures of the combined company? That would be helpful. Thank you.

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

Yeah. So great question, John. One of the things that I'm sure people have noticed when they looked at page 10 of our presentation, and we are talking in terms of gross revenue, and that is a different way of presenting compared to how we have talked about our legacy loyalty business, which is on a net revenue basis. Some of that is just based on the accounting rules around how we have to report that crypto activity relative to how we fulfill those clientele orders. So in accounting jargon, we are considered the principal in these transactions. So every gross dollar, crypto that we sell becomes gross revenue and then we separately have to identify the cost of fulfilling those orders, like cost of goods sold, as well as the correspondence fees, the business share or any brokerage fee to really get to the net contribution.

So, one of the things that you'll see in the second quarter is how we will come together now with two very different income statement presentations from the two sides of our business. Apex, yeah, the crypto activity which will be on a gross basis, and then our loyalty business that will continue to be on a net basis. We definitely intend, as Gavin mentioned, to complement that and expand that with the other KPIs that we were presenting historically. So if you think about things like number of active accounts and the dollar value of a transaction, per transaction. That has relevance on both the loyalty and crypto sides of our business.

So we look forward to seeing that – presenting that on a combined basis, so investors can really understand what is our reach in terms of customers and active customers on our platform every quarter and what type of gross activity in dollar terms is going through the platform. So investors can really see the impact – the contribution of all that activity to call it net revenue or gross profit.

The other things that you heard us mention on page 9, even looking at the total number of crypto enabled accounts we think will provide a very good measure of how we continue to sign new clients and then activate their underlying customers. And then the notional crypto volumes, again, is something that we will show and compare to what we are seeing in the industry. So far what we have seen is Apex Crypto prior to the acquisition performed very consistently with the broader market trends. So we think continuing to provide that data will be helpful for investors to understand the performance and the potential of the company.

John M.A. Roy

Analyst, Water Tower Research LLC

Q

Great. And on the expense management side, obviously, you've taken a fair number of actions this quarter. And previously I was – and you had a cash burn of, what \$33 million this quarter? Is that likely to continue to be that way in terms of the cash burn? Can you give us any color there?

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

A

That's going to go down. I mean, one of the things that you'll see go down most notably in the second quarter is when you think about our compensation expense, the tough decisions that we had to make around head count in March, those aren't going to really manifest themselves in the compensation expense until we get to the second quarter. So we certainly expect compensation expense to go down, as I mentioned, continue to be some one-timers in the second quarter as we pay deal costs associated with the Apex Crypto [ph] plans (00:52:57). But

generally speaking, I would say that Q1 is a high even on a normalized basis, is a probably the highest cash burn quarter that we're going to have and we certainly expect those expenses to continue to decline.

John M.A. Roy

Analyst, Water Tower Research LLC

Great. Thank you so much.

Q

Karen Alexander

Chief Financial Officer, Bakkt Holdings, Inc.

All right. Thanks, John.

A

Operator: Thank you. As there are no additional questions at this time, I'd like to hand the conference call back over to the management team for closing 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. Have a good day.

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

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