Bakkt Holdings, Inc. (NYSE: BKKT)
CFO Highlights Balancing Revenue Growth Opportunities with Prudent Expense Management in 2023

KEY POINTS

- On March 14, WTR held a fireside chat with Bakkt CFO Karen Alexander. The conversation can be accessed on demand.
- Alexander highlighted how, even in a challenging environment, Bakkt organic revenue guidance for 2023 is for 15-30% Y/Y growth. That excludes the impact from Apex Crypto, which is subject to regulatory approval and expected to close in the first half of 2023. The company expects to provide a financial outlook after the deal closes.
- The company has been taking action to simplify its business focus and prudently manage its expense base. Recent restructurings are expected to reduce headcount 40% by year-end 2023 and will result in $29 million of cash savings in 2023. These cash savings are reflected in its 2023 FCF utilization outlook, which is expected to be down 25-30% from 2022. If you take into account deal costs and the cash component of restructuring expenses, making it more like for like, it would actually be down ~35-40%. Furthermore, the company expects an additional $7 million of cash savings in 2024 from its recent restructuring actions, which should further improve FCF utilization. Bakkt clearly is focussed on balancing revenue growth, while reducing cash burn in a tough market, and appears to have a good strategy in place to do so. Bakkt reiterated on its recent earnings call that it expects to be adjusted EBITDA positive by the end of 2024.
- Regarding the Apex Crypto earn-out, Alexander mentioned that the $9 million 4Q22 earn-out was quite good in a very tough quarter for crypto. The full earning out would have required hitting much more aggressive targets, so assuming it missed the targets by 80% ($9 million out of $45 million) is not a fair assumption.

KEY STATISTICS

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<td>Fiscal Year-End</td>
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Source: YCharts, as of March 15, 2023

KEY POINTS

- The company continues to believe that the acquisition of Apex Crypto will be transformational for Bakkt, enabling it to add immediate scale to its platform. See our prior notes here and here.
- Alexander said the company has $240 million of cash in other liquid assets and it believes that its cash and liquid asset position, combined with its expense discipline, is “definitely able to self-fund our roadmap including the purchase price of Apex. We don’t expect to need to raise additional capital in the foreseeable feature.”
- View all our fireside chats and reports on Bakkt on our website.
COMPANY OVERVIEW

Bakkt was formed in 2018, with a vision to connect the digital economy. Its platform operates at the intersection of cryptocurrency ("crypto"), loyalty and rewards, and payments. It is uniquely positioned to enable consumers, brands, and financial institutions to better manage, transact with, and monetize those assets in exciting new ways.

Bakkt’s institutional-grade technology platform is at the core of everything it does. It has thoughtfully built a unique and powerful platform, melding together institutional-grade loyalty services to complement its crypto capabilities.

The Bakkt platform provides end-to-end services for its partners, which includes easily digestible technology services, 24/7 customer support, and marketing playbooks. Bakkt’s customers include consumers, businesses, and institutions.

Businesses leverage Bakkt’s crypto-related capabilities to facilitate new assets acquisition and rewards opportunities for their customers. Its loyalty-related capabilities help businesses deepen their relationships with their customers. Bakkt enables institutions to trade crypto using Bitcoin futures contracts that are traded and cleared on ICE and to store Bitcoin and Ether securely in its custody warehouse.
Karen Alexander has served as the Chief Financial Officer since August 2022. Ms. Alexander was previously the Interim Chief Financial Officer of Bakkt since May 2022. Ms. Alexander joined Bakkt in June 2021 as the Chief Accounting Officer. Prior to joining Bakkt, Ms. Alexander worked at GE Capital from October 2004 to April 2021 in finance and accounting roles of increasing responsibility, most recently serving as Global Technical Controller from January 2017 to April 2021. Ms. Alexander began her career as an external auditor with Arthur Andersen LLP and Ernst & Young LLP. She holds a bachelor’s degree in accounting from Miami University (Ohio).
EXECUTIVE DISCUSSION

John Roy: Welcome everyone. I’m John Roy, Managing Director at Water Tower Research. I’m very pleased today to have the Bakkt CFO Karen Alexander here.

For people who don’t know you that well, could you give an introduction of your background and what brought you to Bakkt?

Karen Alexander: I joined Bakkt almost two years ago originally as the Chief Accounting Officer and then I stepped into the CFO role about a year ago. I’ve always been in financial services, but I would say more of the traditional financial services. I spent 16 years at GE Capital. Before that, I was in public accounting, focused on a variety of financial services institutions.

It was interesting for me after spending 16 years at GE Capital, which involved very specific commercial finance activities, looking at the space and what was happening in financial services, both with the pace of technology, some of the innovations that were coming out of the use of crypto assets and digital assets, and disruptive trends.

It’s great for me to pivot to this role where I’m seeing an industry and a product that are still in a nascent stage, and then being able to take that and grow it through the life cycle.

John Roy: You just reported fourth-quarter and full-year 2022 results. Could you tell us about that and give us some color and highlights?

Karen Alexander: No doubt that 2022 was a challenging environment, certainly challenging from a macroeconomic perspective with a lot of turmoil in the crypto markets. With that said, we’re proud of what we were able to accomplish in 2022. We grew our full-year 2022 revenue to $55 million, which was up 38%. We spent a lot of time focusing on the product roadmap for crypto and we made significant progress with our partner network.

One of the things you probably saw on the news as we’ve signed a definitive agreement to acquire Apex Crypto. We are excited about that because it allows us to break into new client verticals. They’ve got a universe of 5 million crypto-enabled accounts, which excites us and complements what we have been building organically on our side.

The external market environment remains challenging. One of the things that we are trying to do is to take a number of specific and strategic actions to position us for strength and. We did initiate initiatives to focus on areas of the business where we think have scalability and a path to profitability. As a result and looking at that product market fit and where we want to invest capital, we did take some recent restructurings that will reduce our headcount by about 40% by year-end 2023.

This was a tough decision for us to choose our employee base, but we knew that it was necessary for us to take these actions given what we’re seeing with the headwinds in the market, and it helps us make sure that we are positioning the company to where it needs to be for the long term when the market conditions stabilize.

John Roy: You did give an outlook for 2023 and it’d be helpful if you could give us some color. I know you gave revenue and free cash flow, so maybe those two would be good to delve into?

Karen Alexander: I’ll start with the net revenue side. We gave a range of net revenue of $62 million to $72 million. That’s up 15% to 30% from 2022. Just one thing to note, I mentioned before the acquisition of Apex, which is still pending regulatory approval so that revenue growth is organic. It does not include the Apex acquisition because it is still subject to that approval to close.

When we thought about guidance for revenue, we do have an expectation that crypto activation timelines will continue to be affected by market conditions. Based on everything that we’ve seen, conversations we’ve had in the industry, and other market intelligence, the guidance is based on an expectation that we see activations ramp up in the second half of 2023.

Now we hope that the market takes a more positive turn, but we think that this cautious view about the market is appropriate given what we’re seeing right now. We also assume that loyalty redemption activity will continue to face some pressure given what’s happened in the macroeconomic environment.
I talked in last week’s earnings release about what we saw on the travel side where supply constraints are affecting consumers’ ability to redeem loyalty points as well as on the merchandise side, where I think we saw in the holiday season what the consumer retail space saw in terms of a softening in the demand for certain merchandise.

The other item that we gave in terms of guidance is free cash flow utilization. I think this is helpful because it’s not only how we use cash for operations, but it does also reflect capex and that’s an important part of how we manage the business in terms of making investments in our technology.

The guidance that we gave is for free cash flow utilization of between 105% and 115%. That’s a 25% to 30% reduction to what we had in 2022. You’re seeing two things. You’re seeing revenue increase in both the back half of 2023 from a crypto side, as well as a continued increase in revenue from the loyalty side. Then you’re also seeing the benefit from some of the prudent expense reduction actions that we talked about last week.

Just with the restructurings alone, that’ll save us $29 million of cash in 2023. On a full run-rate basis, it’ll be a $36 million savings given the fact that those are going to be coming in not on a full-year basis this year.

The other thing about that free cash outlook is that it has some one-timers in it. Obviously with the acquisition of Apex Crypto, there are deal costs in that utilization of about $13 million. Then we also have the cash utilization from the restructurings. I think we have an expectation for 2023 that reduces our cash utilization, while pursuing those opportunities for revenue growth.

John Roy: You were mentioning a fair amount about Apex Crypto. Maybe you could give us an update there and talk specifically about the earn-out that you announced for the fourth quarter? I think it was $9 million. Any color there would be great.

Karen Alexander: We are making a lot of progress in closing this acquisition. As you can imagine in this type of space, we need a number of regulatory approvals at the state level. We’re making great traction in getting those from a majority of the states. We’re in active dialogue with the remaining states where we need those approvals.

Even before getting all those approvals, we’re still talking to Apex on a regular basis about how to optimize the integration of our platforms and hearing about what Apex is seeing in their business. Since we announced the deal in November, they’ve signed two new partners. We’re excited about the fact that they had an increase in their signed partners.

Then when you look at their Q4 results, one of the things we talked about when we structured the deal is there’s a cash price component of $55 million and then there are various earn-outs based on how Apex Crypto performed on a net revenue basis in the fourth quarter of 2022 as well as additional earn-outs for 2023 and 2024. If you think about the fourth quarter of 2022, given everything that happened, all the headwinds with FTX and what that did with trading activity, they had a total potential earn-out of $45 million of our stock. They achieved a $9 million earn-out, which again, it’s not the full earn-out, but put it in the context in terms of what we all saw in the fourth quarter, it’s a great testament to the durability of their business during what everybody saw as a very tough quarter for crypto.

The other thing I would say with earn-outs is they are a negotiation between buyer and sellers, so the full earn-out potential is an aggressive target. I always tell people that if they are performing to the extent that we are paying the full amount of earn-out in stock I’m going to be thrilled because the growth that is reflected in those earn-out targets is significant.

I think what they did in the fourth quarter in this environment certainly was impressive and we will work toward closing the acquisition and we’ll provide more guidance after the acquisition closes about what the combined company looks like.

John Roy: Now earlier on, you were talking about business implication and focusing your resources on key elements. Could you give more color as to what that means. I know you’re sunsetting the consumer app so could you walk us through that?

Karen Alexander: We continue to focus on crypto and loyalty offerings. We’re looking at areas where we can provide those offerings in a way that have efficient scale and then strong product market fit. Crypto is going to remain a core part of our strategy. We are believers in the future growth potential in the space. 2022 was a big investment year for us.
We’ve invested in our core capabilities to expand offerings and we’ll continue to do that in 2023. We’re also going to do things that enable institutional participation in crypto. One of the things that came out of FTX that I think a lot of people have seen is effectively a flight to quality and a flight to reputational safety and players like us that have a regulatory-first and compliance-first approach.

We see opportunities there to continue to provide for institutional players, especially in the custody space. We’ve got a great roster of existing loyalty partners and we’re looking to serve and grow volume with these existing partners. We’re always looking for ways to innovate and we find that our loyalty partners are great with us where together see the ability to invest to basically innovate what they could then offer to their customers.

Turning to the app and we see some questions about why did we sunset the app? Why now? What does it do to your growth? The one thing I always remind people of is we’ve been talking for basically since the deSPAC about the fact that our platform is able to provide a crypto set of services through a variety of ways.

We have APIs and we have embedded partner web experiences. The app was a piece of it, but the app wasn’t the only way that we were going to market to deliver crypto services. When we think about what we saw in the past year and looking at product market fit and talking to potential customers, we saw that there is a way through our B2B2C strategy to be able to provide scalable crypto solutions to partners without having to use the app.

The decision to sunset the app was to allow us to focus on the go-to-market delivery model that we think is most efficient and works very well. Frankly, it’s always what we contemplated in terms of how we think about the growth opportunities in crypto.

John Roy: You recently announced a partnership with Caesars. I believe there’s a lot going on there. Can you give us some more color?

Karen Alexander: This strategic alliance has a huge amount of potential for us. We’re really excited about it. It’s a new client vertical for us; looking at how crypto can play a role in the entertainment sector. If you think about Caesars’ customer base, we now have access to millions of users through the Caesars partnership.

The first focus for the partnership is to offer Caesars reward members access to crypto rewards through our platform. That way, if you think of your Caesars customer right now, you have Caesars reward points, you can redeem those reward points for crypto services or cryptocurrencies and we will support that.

That really enables millions of Caesars reward members to access crypto through Bakkt. It doesn’t stop there though. There are other ways that we can innovate further with Caesars. Crypto payout functionality is another one that we see as an opportunity to work with Caesars.

We’re excited about the opportunity because of the access to the entertainment sector and the additional opportunities where you think about our Swiss Army knife of crypto capabilities and products. It’s really a multifaceted partnership where we can bring multiple solutions to the Caesars network.

John Roy: The capital markets have been interesting these days. Are you guys thinking of a stock repurchase? Do you think you need to raise capital this year?

Karen Alexander: The markets have definitely been volatile. No question about that. Yes, we’re always looking for market opportunities as to how to best deploy our capital. We’re in this to generate positive returns for our shareholders in the company.

We continue to think that the best use of our capital is investing it into the business. We’re focused on business opportunities that can scale revenue and the path to profitability. I understand the appeal of a stock repurchase program to certain investors, but I think the economic benefits of that are very short term relative to what we can do in terms of deploying that cash into longer-term opportunities that really support the revenue growth of the company.

One of the things we talked about last week with the earnings results is we’re really trying to balance discipline and capital allocation and making sure that we are investing in areas where we see the path to profitability, then also being very disciplined in expense management.
We’re fortunate that we have $240 million of cash in other liquid assets and we think that cash and liquid asset position combined with our expense discipline is definitely able to self-fund our roadmap including the purchase price of Apex. We don’t expect to need to raise additional capital in the foreseeable feature.

John Roy: As a final question, we will talk about the longer-term goals and what’s your timeline for profitability. Any kind of information there would be great.

Karen Alexander: We’ve always talked about the timeline for profitability, for instance, break-even on an adjusted EBITDA basis, as being about a three-year journey for us since the time of the de-SPAC. We still see that path to profitability on an adjusted EBITDA basis by the end of 2024. It’s been our goal for some time.

I think the acquisition of Apex Crypto is very important to us. We’re excited that it is really going to provide us a client base and the ability for synergies that will accelerate that path to profitability. A big piece of it as well is the continued discipline on expenses.

I think what we’ve shown through some very tough decisions, but very necessary decisions on the recent restructuring actions, that we can balance that expense discipline with a focus on executing the longer-term goals and really being there to take advantage of market conditions as they improve.

John Roy: This has been super helpful. Thank you much for spending the time with us. Investors, if you have any questions at all, just send them to me and I’ll get them to Karen and we can get them answered.
ABOUT THE ANALYST

In his role at Water Tower Research, Dr. Roy provides cutting-edge equity research coverage of companies building and using technology to drive the modern world. Technology is everywhere, and its impact is only growing. Whether it’s AI, Blockchain, FinTech, Quantum Computing, Autonomous Vehicles, Cryptocurrencies, or 5G, Dr. Roy has the expertise.

Prior to Water Tower Research, Dr. Roy worked as a lead analyst at UBS, covering IT Hardware, Communications Equipment, and IT Services. During his 20 years covering technology stocks on the sell-side, Dr. Roy was also a lead analyst covering IT Hardware and Nanotechnology at Merrill Lynch; and Alternative Energy, Advanced Materials and Nanotechnology at W.R. Hambrecht, and at Janney Montgomery Scott. Before his sell-side equity research career, Dr. Roy was a lead software architect at J.P. Morgan, an AI sales engineer at Neuron Data, and a systems engineer and AI researcher at Hughes Aircraft.

Dr. Roy holds a Ph.D. in Computer Science from the University of California, Irvine, a MSEE degree from the University of Southern California, and a BSEE degree from the University of California, San Diego where he was a Regents Scholar.
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