Katapult Holdings, Inc.

FQ2 2023 Earnings Call Transcript

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Call Participants

EXECUTIVES

Orlando Zayas
CEO, President & Director

Nancy Walsh
Chief Financial Officer

Jennifer Kull
Vice President of Investor Relations

ANALYSTS

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Vincent Albert Caintic
Stephens Inc., Research Division

Presentation

Operator

Ladies and gentlemen, good morning and welcome to the Katapult Holdings Second Quarter 2023 Earnings Conference Call. As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Jennifer Kull, Head of Investor Relations at Katapult Holdings. Please go ahead.

Jennifer Kull

Welcome to Katapult's Second Quarter 2023 Conference Call. On the call with me today are Orlando Zayas, Chief Executive Officer; Nancy Walsh, Chief Financial Officer; and Derek Medlin, Chief Operating Officer. For your reference, we have posted materials from today's call on the Investor Relations section of the Katapult's website, which can be found at ir.katapultholdings.com. I would like to remind everyone that this call will contain forward-looking statements based on our current assumptions, expectations and beliefs regarding our future financial performance and results, which are all subject to significant risks and uncertainties. These forward-looking statements should be considered in conjunction with cautionary statements contained in the earnings release and on Form 10-Q for the quarter ended June 30, 2023, as well as the subsequent periodic and current reports the company files with the SEC.

These statements reflect management's current beliefs, assumptions and expectations and are subject to a number of factors that may cause actual results to differ materially from those statements. The information contained in this call is accurate only as of the date discussed. Except as required by law, the company undertakes no obligation to publicly update or revise any of these statements, whether as a result of any new information, future events or otherwise.

During today's discussion, the company will provide certain financial information that constitute non-GAAP financial measures under SEC rules. These non-GAAP financial measures should not be considered replacements for and should be read together with our GAAP results. A reconciliation of non-GAAP financial measures to the most directly comparable GAAP financial measure is included with today's earnings release and is available on the Investor Relations section of the company's website.

With that, I will turn the call over to Orlando.

Orlando J. Zayas
CEO, President & Director

Thank you, Jennifer and welcome to Katapult. We're happy to have you here to lead our Investor Relations program and I know you're looking forward to getting to know our shareholders. Thanks also to everyone joining us today. We're excited to share our progress and hear your feedback. So I'll jump right in.

During the second quarter, our team worked hard and continued to lay the foundation for profitable growth. This focus, coupled with ongoing demand for lease-to-own products for underserved non-prime consumers who are often left behind by traditional financing options led to another quarter of strong financial and operating results. In short, we had another good quarter. Year-over-year, gross originations were up 18% to $54.7 million and revenue grew 2.9% to $54.6 million. It's worth noting that gross originations have grown year-over-year for 3 consecutive quarters. And we are grateful for our team's hard work that is allowing us to deliver these strong results.

With the strength of our top line results and lower fixed cash operating expenses of $9.6 million, our adjusted EBITDA improved to a loss of $280,000. As I've mentioned before, more than 30% of American consumers do not have access to traditional financing options. Remarkably, approximately 37% of the adult U.S. population would not be able to cover a $400 emergency expense without assistance. And based on recent reports, we believe this number will continue to grow. With these dynamics, Katapult continues to have a compelling opportunity with our innovative lease-to-own platform to work for these consumers.

Our mission here at Katapult is to help this underserved community gain access to the durable goods they need when they need them, while simultaneously helping our merchant partners expand their reach to this growing base of engaged and loyal customers. It's a win-win for both our key stakeholders. Our dedication to doing the right thing for all of our stakeholders has not only led to an improving financial trajectory but also allows us to sustain industry-leading Net Promoter Scores from our customers. As of the end of the second quarter, our Net Promoter Score was a strong 64.

Before I get to the update on our progress against our strategic pillars, I want to reiterate our growth strategy. We have 2 basic goals, to grow our merchant base and to grow our customer base and to do both profitably and simultaneously. Let me explain how we're evolving our approach to achieve these goals. To date, we have been primarily focused on building our merchant base but we are also well positioned to expand our customer base. For example, we are growing consumer engagement with our mobile app featuring Katapult Pay, providing what we believe are undeniable benefits to our customers and enhancing and deploying our technology capabilities across the business.

This is creating more avenues for growth outside of just direct integrations with merchants. On side, we are growing our business by being a unique channel solution for our merchant partners that helps expand their businesses. This, in turn, has allowed us to expand the categories of durable goods that consumers can shop for. They can now use Katapult's lease-to-own products to shop for just about any durable goods, you can imagine. On the other side of our business, we're driving demand by building consumer awareness, consideration, engagement through our expanded mobile capabilities and features and targeted marketing efforts. We feel confident that we are creating a flywheel that unlocks both greater value for our merchant partners and enhanced experience for our loyal customers and that this will be the engine that powers our ability to achieve these 3 strategic pillars.

So now let me walk you through the progress we've made on each pillar during the second quarter. Our first pillar is all about our merchants. Quite frankly, we need to deepen our existing merchant relationships and enter into new ones with merchants and offer even more products consumers want. To do this, we are executing in 3 key areas: expanding current direct integration merchant relationships, adding new merchants to our direct integration pipeline and leveraging Katapult Pay to include more merchants.

Let's talk about expanding our relationships with merchants that are already directly integrated with Katapult first. At a high level, we are looking for more data-driven ways to drive business for our merchants. Some of the opportunities we are exploring include optimizing our offer pages and highlighting the lowest-cost payoff options to our consumers. As we continue to build an even better understanding of what consumers are interested in, we believe we are able to leverage special events, targeted advertising and new promotional strategies to drive volume. Although we are testing and learning with these opportunities, we are seeing them gain early traction with our largest merchant Wayfair. Take rates, conversion, customer flow and close rates remain healthy. And recently, Wayfair has begun to streamline their lending process and partners as Katapult has emerged as a preferred partner for this important merchant. We believe that this ongoing strong performance with Wayfair demonstrates the value that we can bring to merchant.

We are also working to add new merchants to our direct integration pipeline. With direct integrations, we have shifted our go-to-market efforts for larger enterprise merchants that have a robust installed base of customers where we can keep our customer acquisition cost low. In addition, we want to partner with large retailers that will help Katapult diversify products consumers can shop for using our unique lease-to-own model. We believe over time, a more diverse offering will be a driver of consumer engagement, turning our platform into a true shopping destination.

During the second quarter, we launched and signed contracts for new direct integrations with merchants spanning a variety of retail categories, including our newest, Casper, a leading omnichannel mattress company. The integration with Casper will be both online and in-store integration. It's important to note that while we certainly expect direct integrations to remain an important driver for us, it's not our only path of profitably scaling our business. We are also moving to diversify our revenue stream with other channel drivers.

Let's start with a quick update on one of our newer growth drivers, Katapult Pay. As a reminder, Katapult Pay is a feature in our app. It's a virtual onetime card that consumers can use for shopping and online stores in the U.S. Each time a customer uses Katapult Pay, we create a unique card number that can be used at the stores checkout. We believe our Katapult Pay feature will become a powerful tool for both merchants and consumers. For merchant, it helps expand their customer base with a new cohort of engaged and loyal shoppers who previously did not have the purchasing power to shop with them. This translates into incremental sales and lower customer acquisition costs for our merchants.

For consumers, it gives them the freedom to easily shop for durable goods with a variety of key retailers, putting purchasing power for the items they need within reach, at fair and transparent terms. We believe both the merchant and the customers will benefit from this easy-to-use technology. So far, we have a growing list of merchants on Katapult Pay, including Home Depot, Amazon, Wayfair, Best Buy, Nester, HP, IKEA and Lowe. We are pleased with the momentum we've been able to build for Katapult Pay, which was launched just last year.

We're also exploring opportunities to leverage our data, proprietary technology and industry know-how in new ways to drive growth and address the emerging needs of our merchants. Over the long term, we expect our offering to include a diverse set of products that can address specific merchant needs, meet customers wherever they are shopping and drive growth for Katapult. The second pillar is focused on consumers, bringing new consumers to our network and broadening our relationships with those who are -- already know Katapult.

Let's start with our efforts in marketing and consumer engagement. We are taking an increasingly data-driven approach to both and are laying the foundation for new and more targeted marketing programs that leverage data science. For example, we are adopting a new marketing platform that we believe will enhance our customer targeting efforts, allowing us to have more seamless and dynamic conversation with customers across e-mail, SMS and in-app push notification. We believe we'll be able to do a better job of putting the right content and target the right customer at the right time. This platform will allow us to be more responsive to consumer behavior and quickly take action based on how customers are engaging with Katapult.

We are currently launching Phase 1 of this program, e-mail but over the next 12 months, we expect to expand to a full suite of communication tools that will allow us to take our conversation with consumers to the next level. We believe these tools will allow us to better address the full spectrum of life cycle marketing opportunities from building awareness to consideration, to purchase and repeat purchase. These strategic marketing investments will, first, allow us to stimulate consumer demand with more targeted effort; second, use our interactions with consumers to inform our customer segmentation data, which will allow us to create a better platform experience and drive customer engagement.

And finally, leverage our engagement data, help drive on the value proposition we offer our merchants. These efforts will encourage those current direct merchants to engage in joint marketing campaign and for those merchants not yet on direct integration to see the value of a partnership with us.

Next, let's talk about how we're driving customer repeat rates. Repeat rate is defined as a percentage of originations with existing customers in any given quarter. With our mobile app featuring Katapult Pay, we have opened the door for our customers to access the products they need from high-quality merchants in a simple and easy way. This quarter, we continued to see strong repeat customer rate. In fact, approximately 51% of our customers are repeat customers. Repeat usage is a differentiator for Katapult and is powered by our focus on identifying consumer needs and driving high customer satisfaction.

We believe our AI-powered technology, which allows us to quickly determine what goods are leasable is a key ingredient in our customer experience and driver of repeat purchases. If you just think about Amazon and Home Depot, they offer a lot of goods that we can't lease. Because of our technology, customers are able to determine upfront, what is leasable and what is not. In addition, being transparent with consumers about pricing and all-in costs is critical part of our value proposition. These characteristics, coupled with the fact that we don't charge any hidden fees and we have quickly been able to add more durable goods categories by bringing on large retailers, creates a really great customer experience. We will continue to look at opportunities to enhance our offering for consumers and believe that in doing so, we can drive lifetime value of our loyal and engaged customers even higher over time.

Finally, our third pillar is really the foundation of which our business sits, our innovative technology. One of our core strengths is how adaptable and flexible our technology is. The ease of use and workflow simplicity allows us to quickly address key merchant and consumer needs. From our user experiences, which we believe are best-in-class, to the speed at which we can deliver underwriting decisions, to our integration flows that allow us to launch more quickly with merchants, we believe our technology sets us apart.

During the second quarter, we continue to see the benefits from the launch of Katapult Pay and our leading-edge AI capabilities allowed us to continue to add large retailers to our app. Both of these are a testament to the strength of our technology team here are at Katapult. Our tech strength is also accelerating our A/B testing capability. This will allow us to launch updates to our app and website's experience that we believe will resonate even more deeply with our consumers more quickly. For example, we are using A/B testing to test and learn our risk-based pricing model.

In addition, we are leveraging our agile technology platform to support our new targeted marketing programs and other B2C efforts. We've made a lot of progress during the first half of the year and we remain focused on delivering the value to all our stakeholders.

Now I'll turn the call over to Nancy, so she can provide a review of our financial performance during the second quarter of 2023. Nancy?

Nancy A. Walsh
Chief Financial Officer

Thank you, Orlando. I'm excited to talk to you today about our strong second quarter results, which exceeded our outlook and to provide you with an update on the third quarter. As Orlando has outlined to you, our operating priorities are centered around executing against our 3 pillars, which we believe will drive revenue growth and sustained profitability.

With that, let me provide you with some of the financial highlights for the second quarter of 2023. Gross originations increased 18% year-over-year to $54.7 million. Increased originations were driven by strong performance through our direct merchants and mobile app channel as well as the continued expansion of merchants on our mobile app marketplace featuring Katapult Pay. Katapult's portfolio of direct merchants provides a funnel of new customers to drive gross originations at minimal customer acquisition costs. As a reminder, gross origination trends are a leading indicator of future revenue stream. A percentage of revenue is realized in the quarter in which the gross origination occurs and increases cumulatively over the next 4 quarters.

During the quarter, approximately 51% of our originations came from existing customers. This is up from 47% in Q1 and demonstrates continued strong engagement through our mobile app. We are also seeing that customers who engage with our Katapult Pay feature tend to be higher quality customers. They repeat purchase faster, tend to cross shop across merchants and categories more frequently and ultimately, we expect them to have a higher lifetime value. While we are still in early days since Katapult Pay was just launched late last year, we are very excited about its potential with both consumers and merchants.

Revenue increased 2.9% year-over-year to $54.6 million and reflects the trends driving gross originations that I just mentioned, as well as the strong volume performance we saw in the first quarter. Write-offs as a percentage of lease revenue increased sequentially to 9.2% from 8.4% in Q1 2023. This sequential increase was due to seasonal patterns and trends. As a reminder, in 2022, we saw lower write-offs and impairment charges related to our 2021 gross originations due to COVID and other stimulus related repayment patterns that year. With this tailwind, Q2 2022 write-offs as a percentage of lease revenue was 6.4%. Our long-term target for write-off as a percentage of revenue is 8% to 10% and our results this quarter remain comfortably within this range.

We lowered our overall operating expenses by 13.3% compared with Q1 2023 and 16.5% year-over-year. These reductions were driven by the operating leverage benefits we are achieving as a result of the expense reduction initiatives we put in place in late 2022. Excluding underwriting fees and servicing costs, which are variable and depreciation and noncash stock-based compensation expense, our fixed cash operating expenses were $9.6 million, down 24.6% compared to last year. Based on our top line outperformance and the structural and sustainable benefits we are realizing from our focus on operating efficiencies, we were able to improve our adjusted EBITDA performance substantially. For the second quarter, we recorded an adjusted EBITDA loss of $280,000, which was a $5 million improvement compared with the $5.3 million loss we reported in the second quarter of last year.

As of June 30, 2023, we had cash and cash equivalents of $38.2 million and we feel comfortable that our cash position and our credit facility provide us with the resources we need to support our growth strategy. The company continues to navigate an evolving macro environment. While there are tailwinds such as better inflation data and a reduced likelihood of a recession in the U.S., interest rates remain elevated, lending standards are tight and the potential resumption of student loan repayment requirements may impact our core consumers' ability to take on new leases. This mixed bag of economic indicators has led to continued economic uncertainty. That said, lease-to-own solutions have historically benefited from periods of shrinking prime credit availability.

Based on this macro outlook and our operating plan for Q3 2023, we expect to deliver a 14% to 16% year-over-year increase in gross originations, which would be the fourth consecutive quarter of year-over-year growth. This outlook is driven by our expectation that macroeconomic conditions and our collections trajectory remain consistent with the first half of the year and that we see a positive impact from the new marketing initiatives we discussed today. We also expect revenue to grow 5% to 7% year-over-year compared with the second quarter of 2022.

Lastly, we expect our adjusted EBITDA performance to improve meaningfully compared with the third quarter of last year, reflecting our revenue growth expectation and further reduction of our fixed cash operating expenses. We expect fixed cash OpEx to be down approximately 25% year-over-year. In summary, we delivered strong gross originations, revenue growth and improved profitability in the second quarter and the first half of the year. We have a healthy balance sheet that provides us with the financial room we need to fund a growing pipeline of originations and to invest in our growth opportunities while enhancing our adjusted EBITDA. And we remain focused on continuing to execute our strategic initiatives to drive growth and profitability.
I would now like to turn the call over to the operator to open the line for Q&A. Operator?

Question and Answer

Operator

Ladies and gentlemen, we will now be conducting a question-and-answer session. Our first question comes from the line of Josh Siegler with Cantor Fitzgerald.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

So first of all, I'd like to talk about Wayfair. So in the quarter, Wayfair represented 56% of gross originations, which was the highest percentage since 2Q '22. Now as you expand Katapult Pay, do you expect further diversification away from Wayfair, as we head into 2024?

Orlando J. Zayas
CEO, President & Director

Josh, it's Orlando. Yes, we do. I mean Wayfair had a good quarter, a good half of the year, quite frankly, when they had their Way Day. And we've improved the partnership with them, where we're driving more repeat business back to them. They're on our app, on Katapult Pay as well. So we're really pleased that they continue to be a good part of our business. But yes, we believe that Katapult Pay and some of the other retailers that we added, will start diversifying the portfolio more.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Great. I appreciate that. And then you guys were just talking about how your EBITDA guide implies further reduction in cash OpEx. I was wondering if you could elaborate a little more on the leverage in this business and your ability to maintain these lower OpEx levels in the future?

Nancy A. Walsh
Chief Financial Officer

This is Nancy. It really comes down to optimizing our efficiencies and productivity. So I don't think of it as just cutting costs and then at some point in the future, we're going to have to build them back up again. As you remember, 2022 was an investment year that we've seen tremendous return on those investments that we made in terms of our app and Katapult Pay. This year, we've continued to focus on optimizing the expenses, which will be sustainable going forward.

Operator

Our next question comes from the line of Vincent Caintic with Stephens.

Vincent Albert Caintic
Stephens Inc., Research Division

First question is sort of a industry competitive landscape. I think it's impressive that you've grown this quarter and are calling for growth in the third quarter when the other lease-to-own players in the industry are still shrinking year-over-year. I was wondering if you are able to compare and contrast sort of what's driving Katapult's growth at double-digit year-over-year growth versus maybe what we're seeing in the industry. That would be helpful.

Orlando J. Zayas
CEO, President & Director

Vincent, nice to hear from you again. When we look at our business versus our competitors, it really is about the efficiency of our e-commerce. And I think that the merchants, the merchants on e-commerce didn't suffer for some of the store traffic. I think they all represented that store traffic was down across the board. And then if you add to that, working better with our merchants, Wayfair, for example, streamlined the number of players they have in their waterfall flow. We also continue to work with them to drive improved business, like I just mentioned with Josh.

And then Katapult Pay, obviously and adding some directly -- added Casper, which was a competitive win. And the retailers that we're talking to like the fact that the ease of use, the transparency, the way we treat our customers that matches their values and that's how we win and that's how we won Casper. And then if you look at Katapult Pay, we've got -- you can get about any durable goods that you can imagine. So we're, I think, in the early days on that one with getting our current customers to go back shop at multiple retailers, including Amazon and they can find stuff that maybe we didn't have a merchant before.

So we're pretty excited about that. And I think the next step is to really start growing our other partnerships where we can drive more customers in, not just from a merchant perspective but maybe a related industry where we can do that.

Vincent Albert Caintic
Stephens Inc., Research Division

Okay. And then I guess as part of -- so you see a lot of waterfall data. Are you seeing, I guess, maybe not competitors but like those who provide credit maybe at the higher levels tightening a bit. I'm just sort of wondering if there might be any volume opportunities from that.

Orlando J. Zayas
CEO, President & Director

Yes, we -- I actually mentioned that, I think, after our first quarter call that we started to see tightening back in October. And because we are pretty much 95% waterfall, we can see that almost directly when it starts to happen. And it seems like it's leveled out. It doesn't seem to be going deeper. I think the tightening has happened and we're just taking advantage of that and that's helping obviously drive our growth because we're seeing some better customers. But I don't see it tightening much more.

Vincent Albert Caintic
Stephens Inc., Research Division

Okay. Great. And last one for me. So with the growth you're generating over $50 million GMV and growing from here, just kind of looking at your balance sheet, looking at under $40 million of cash and thinking about kind of your balance sheet position. Anything that you need to do there to kind of fund your growth?

Nancy A. Walsh
Chief Financial Officer

We are well positioned between the cash that we have on the balance sheet as well as the revolving letter -- revolving credit facility that we have to sustain our growth going forward. We have options to accordion that facility and we're just very comfortable with the liquidity position and that, that can continue to foster the growth that we have.

Operator

As there are no further questions, I would now hand the conference over to Orlando Zayas for his closing comments.

Orlando J. Zayas
CEO, President & Director

Thank you and thanks so much for following our progress. We're very excited not only by our results and the opportunities but also by the positive impact that our business success can create for people in the United States. Many of us can't imagine not having access to credit to pay for durable goods that most of us take for granted. We're proud of the work to change this landscape and grateful that you as our shareholders are on this journey with us. I look forward to updating you in the next quarter on our continued progress. Thank you very much.

Operator

Thank you. The conference of Katapult Holdings has now concluded. Thank you for your participation. You may now disconnect your lines.