Katapult Holdings, Inc.

FQ1 2023 Earnings Call Transcript

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Call Participants

EXECUTIVES

Orlando J. Zayas
CEO, President & Director

Nancy A. Walsh
Chief Financial Officer

Derek Medlin
Chief Operating Officer

ANALYSTS

Anthony Chinonye Chukumba
Loop Capital Markets LLC, Research Division

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Presentation

Welcome to Katapult's First Quarter 2023 Conference Call.

On today's call are Orlando Zayas, Chief Executive Officer; Nancy Walsh, Chief Financial Officer; and Derek Medlin, Chief Operating Officer.

Materials from today's call can be found on the investor relations section of the Katapult website. I would like to remind everyone that this call will contain forward-looking statements regarding our financial performance, our business outlook and related assumptions that are 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 March 31, 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 measures is included with today's earnings release and is available on the investor relations section of the company's website.

I will now turn the call over to Orlando.

Orlando J. Zayas
CEO, President & Director

Good morning, everyone, and thank you for joining us. We are pleased to share our Q1 2023 results with you today.

Before we do that, I'd like to thank our team for their dedication to Katapult and for reinforcing our mission and values. I would also like to further recognize all of their hard work that drives our growth and profitability strategies. It is that dedication that has resulted in a record NPS score of 63.

Let me now begin by providing some key financial highlights from the first quarter. We had an outstanding Q1. Our gross originations increased 17.3% year-over-year to $54.7 million. Revenue decreased 7% year-over-year to $55.7 million, which continues to reflect sequential improvements due to strong collection efforts and underwriting performance. And we achieved adjusted EBITDA of $0.6 million, the first quarter of positive adjusted EBITDA since Q3 2021. Fixed cash operating expenses decreased by 17% compared to last year.

Overall, our first quarter 2023 results reflect continued strong demand for lease-to-own products and e-commerce channels that support underserved non-prime consumers who are unable to access traditional financing for the durable goods they need. With over 30% of American consumers overlooked by traditional financing options and 39% of Americans not being able to cover $400 of an emergency expense without assistance, Katapult's omnichannel and digitally native lease-to-own platform enables consumers to get what they need when they need it and connects merchants to a new market of engaged and loyal customers. Looking forward, we continue to execute on our 4 pillars of growth to drive increased revenue and improved profitability.

The first pillar is to expand our current relationships and grow our merchant base. And there are 3 distinct areas we are focused on: one, continue to deepen relationships with our existing directly integrated merchants by working closely together through special events, targeted advertising and new promotional strategies that are important to the merchant and drive their volume. During the first quarter, we saw strong results from the targeted marketing campaigns. For example, during Wayfair's Way Day event, 3 days of special discounted deals, Katapult participated in co-marketing efforts with Wayfair in advance of their announced Way Day to promote Wayfair using Katapult. We were encouraged by the results from the Way Day that took place April 26 through the 28, more than doubling Wayfair's average gross originations with Katapult during those 3 days. Another example results from a recent test marketing campaign for spring home and garden improvement showed significantly enhanced levels of effectiveness compared with traditional marketing methods. We look forward to sharing the results in future test marketing campaigns as new developments emerge. Additionally, while e-commerce remains our primary approach, we are working to expand our in-store presence with merchants so they're able to provide our offering to consumers both in person and online.

Two, continue to add new merchants to our direct integration pipeline. We are focusing on go-to-market efforts on larger enterprise merchants that offer a consistent funnel of new customers with minimal acquisition costs in order to provide customers with the opportunity to access Katapult from a more diverse offering of merchants. In the first quarter of 2023, our sales and marketing teams generated new leads and further built Katapult's sales pipeline. This included participating in retail industry conferences; and a new ongoing partnership with the Merchant Advisory Group, the leading payments industry association for enterprise merchants. We continue to have active discussions with several new enterprise-class prospects as well as build our active sales funnel in a variety of product categories. During the first quarter, we added 12 new direct merchants.

Three, expand merchants on Katapult Pay feature on our mobile app. Specifically, we are focused on accelerating the utilization of our mobile app featuring Katapult Pay, where customers who may be unable to access traditional financing can shop across multiple merchants on our platform. Leveraging the Katapult Pay feature, merchants can benefit from higher retail conversion, driving incremental sales and lower customer acquisition costs. During the first quarter of 2023, we continued down the path of adding new merchants to give our customers new places to shop, including IKEA.

The second pillar to drive increased revenue and improved profitability is to add more consumers to the network. We are focused on expanding the active consumer base through growth marketing efforts like partnerships with companies that serve the non-prime consumer, letting them know Katapult is available for purchasing durable goods. We are working with our current direct merchants on co-marketing initiatives to attract new consumers to try lease to own as a payment preference. We've also prioritized marketing efforts to expand the Katapult Pay feature on our mobile app, such as extending special offers to our current customer base.

The third pillar is higher customer repeat rates on our platform. During the quarter, approximately 47% of our customers were repeat customers. Repeat usage is a differentiator for Katapult and is powered by our focus on identifying consumer needs and driving high customer satisfaction. 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 way. We've also prioritized marketing efforts to expand the Katapult Pay feature on our mobile app, such as extending special offers to our current customer base.

Finally, the fourth pillar is to continue to use technology to innovate and develop new products. Since our inception, Katapult has always been fueled by innovation and tends to continue to bring new products to market for non-prime consumers. In addition to our recently launched Katapult Pay feature, we continue to work on product developments, with the goal of helping merchants increase conversion rates, repeat transaction rates and customer satisfaction. One example is we are currently beta testing risk-based pricing to offer better pricing to our best customers, and we look forward to providing more color as this rolls out.

Now I'd like to take a moment to further elaborate on our mission, how our unique solution addresses a growing industry problem and where Katapult fits into the market. Our mission at Katapult is to enable consumers to purchase the durable goods they need when they need them and connect retailers with a new market of engaged and loyal customers. With more individuals living paycheck to paycheck due to current macroeconomic conditions, there's a greater demand for flexible consumer financing solutions. In fact, more than 30% of American consumers are overlooked by traditional financing options. This leaves millions of consumers unable to access essential durable goods they need. Lease-to-own options help retailers reach a large and loyal consumer base. These consumers are browsing their stores and on their sites but are unable to purchase. We're able to bring a truly incremental customer to our merchants by giving these customers the power to shop.

According to a recent Katapult survey, 54% of Americans are more likely to shop with a merchant that offers flexible payment options, which is often the only way for non-prime consumers to obtain necessary durable goods, especially as many lenders tighten their lending criteria or increase interest rates. By offering financial solutions like lease to own, retailers can also cultivate strong customer loyalty and retention. At Katapult, we see approximately 40 -- 47% of our customers come back to make a repeat purchase.

46% of Gen Z lives paycheck to paycheck, with the cost of living cited as their top concern. They are only beginning to build credit as they enter adulthood and start to navigate financial independence. At the same time, they may be moving into their first apartment, meaning obtaining items like furniture and appliances which are essential. However, their lack of credit history can make it challenging to qualify for traditional credit products such as credit cards. Flexible payment options like lease to own appeal to Gen Z consumers, as they are less likely to have established credit and are worried of incurring credit card debt. They are also more likely to struggle with larger ticket purchases since they have yet to hit their prime earning years. This generation is familiar with alternative credit options which provide more accessible ways to pay for essential items. More and more retailers across key categories are discovering that lease to own can be cost-effective strategies for attracting younger buyers.

Our total addressable market is estimated between $40 billion and $50 billion, and yet we estimate we currently capture less than 1%. Combined with a countercyclical earnings model, minimal customer acquisition costs and a growing and loyal consumer base, we believe we are well positioned to continue to scale and drive profitability.

I'm extremely proud of our momentum, so far, in 2023, with our great first quarter under our belt reflected by the 17.3% year-over-year growth in gross originations. Unlike others in the industry, our business was developed around technology and innovation. It's this unique model that again differentiates us in the quarter, where strong gross originations growth outpaced the origination declines seen amongst our industry peers. Our 2023 story is just beginning. And we are excited to continue to serve a market that has been overlooked with fair, transparent and easy-to-use solutions that they deserve.

Now I'll turn the call over to Nancy so she can provide a detailed review of our financial results from the first quarter of 2023 and review our outlook.

Nancy?

Nancy A. Walsh
Chief Financial Officer

Thank you, Orlando.

I am excited to talk to you today about our strong first quarter 2023 results and provide an update on the second quarter. As Orlando mentioned, our operating priorities are centered around driving revenue growth while executing a path to profitability.

With that, for the first quarter of 2023, gross originations increased 17.3% year-over-year to $54.7 million. Increased originations were driven by higher wallet capture during tax season through our direct merchants and mobile app channels 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. During the quarter, our repeat customers accounted for approximately 47% of our customers. And the engagement of repeat customers through our mobile app continues to grow.

As a reminder: Gross origination trends are a leading indicator of future revenue streams. A percentage of revenue is realized in the quarter in which the gross origination occurred and increases cumulatively over the following quarters, reaching approximately 70% to 75% of revenue recognized within 2 quarters from when the originations occurred. We were also pleased to see write-offs as a percentage of lease revenue decline sequentially to 8.4% from 9.7% in Q4

2022. Q1 2022 write-offs as a percentage of lease revenue were 6.3%, reflecting the positive impact of COVID-related stimulus.

Revenue decreased 7% year-over-year to $55.7 million, which reflects sequential improvement due to strong collection efforts and underwriting performance during the quarter. We were pleased with our adjusted EBITDA results of $600,000, reporting the first quarter of positive adjusted EBITDA since Q3 of 2021. Growth in adjusted EBITDA was driven by more efficient lease costs and our ongoing expense reduction initiatives, which encompasses all areas of spending and continues to translate into improving operating leverage and profitability.

Overall operating expenses decreased by 4.9% as a result of our expense reductions initiated in the fourth quarter of 2022. Excluding underwriting fees and servicing costs, which are variable; noncash stock-based compensation expense; severance related to the head count reduction at the start of the year, and -- fixed operating expenses of $11.3 million decreased by 17% compared to last year.

As of March 31, 2023, we had repaid $25 million of our term loan, resulting in total cash and cash equivalents of $44.9 million. In connection with the repayment, we incurred a noncash loss of $2.4 million on the partial extinguishment of debt during the quarter.

The company continues to navigate macro uncertainty and expects further consumer spending headwinds to persist. However, lease-to-own solutions have historically benefited from periods of shrinking prime credit availability creating a countercyclical hedge against the challenging macro environment. Combined with our unique growth differentiators driving momentum within the industry, such as our mobile app featuring Katapult Pay, for Q2 2023, the company expects to see a 15% to 17% year-over-year increase in gross originations, building on our 17.3% year-over-year increase in Q1. This outlook reflects the benefits of new merchants, the expansion of the mobile app featuring Katapult Pay and marketing initiatives targeted to our loyal customers. The lag between gross originations and revenue is expected to result in roughly flat year-over-year revenue for the second quarter, generating revenue growth in future quarters. And lastly, solid improvement in year-over-year adjusted EBITDA, reflecting improved revenue and low double-digit fixed cash operating expense reduction.

In summary. We delivered strong originations, sequential revenue improvement and profitability growth in the first quarter. 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

Our first question is from the line of Josh Siegler from Cantor Fitzgerald.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Congrats on the adjusted EBITDA profitability this quarter. I'd love to dive a little deeper into Katapult Pay. So how much more opportunity is there to expand this direct-to-consumer product? And which marketing channels are you prioritizing to bring in new users?

Derek Medlin
Chief Operating Officer

Josh, this is Derek. And thanks for the question and for joining the call today. We're really excited that we're in the early innings of Katapult Pay and what it's meant for our business. It certainly has been a great new add for us in terms of us being able to manage our relationships with our consumers and drive more engagement. And that engagement has turned out to really drive faster transactions and more repeat purchases from this community, which in turn is driving a better LTV and a higher LTV for us for these consumers and these customers of ours. And that's done by basically being able to open up the funnel of other places where they can do transactions with new retailer partners and by having just a more engaged consumer, so what we are doing in terms of prioritizing things is we're looking at, one, ways for more engagement, more adoption of the Katapult Pay and the Katapult app; second of all, by having targeted retailers that open up new categories for our consumers to purchase. So just making them aware of all the different ways that they can use their partnership with Katapult in their everyday lives and to help them support transactions. And then lastly, we're looking at testing new marketing channels to attract consumers to this app. Some of that is done through our retail partners. And some of that is through new channels that we're exploring, so since it's the early innings, nothing to really report today, but I'm excited that these are going to open up new growth strategies for us today and in the future.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Yes, understood, looking forward to tracking that progress. And then you guys mentioned the benefit of prime credit tightening and acting as a countercyclical tailwind for the business. I'm curious if you've started to experience that credit tightening from the prime players. And how much of a tailwind do you expect it to provide in 2023?

Orlando J. Zayas
CEO, President & Director

Yes. Josh, it's Orlando. Thanks for the question. Yes, we've seen it. So I have a tracker that I look at that shows kind of the flow of credit, if you will, by credit band to us. And we started seeing it in October. And it doesn't happen -- it didn't happen as quickly as it did during the COVID days. On March 16, we saw a huge reversal, if you will, but we're seeing it's -- we're seeing it happening. I think, because, other than Katapult Pay, we're pretty reliant on the waterfall, that we can see it pretty easily when the credit bands start shifting, if you will. And we saw that shift in October and it continues today. I think it's going to continue through this year because -- you've heard some of the bank issues. As they tighten up and try to -- it becomes less available for prime lenders, obviously it flows down to us. And it's definitely, as you know, this business is very countercyclical.

Joshua Michael Siegler
Cantor Fitzgerald & Co., Research Division

Got it, all right. Congrats again.

Orlando J. Zayas
CEO, President & Director

Thanks.

Operator

Our next question is from the line of Anthony Chukumba from Loop Capital.

Anthony Chinonye Chukumba
Loop Capital Markets LLC, Research Division

Congrats on a strong quarter as well. And I promise I won't be too hard on you guys. So just a bit of a clarification: So you mentioned that you're -- with the Wayfair Way Day, you more than doubled your originations. Is that year-over-year compared to the Wayfair Way Day 2022? Or is that sort of like sequential relative to sort of like your typical originations with Wayfair?

Orlando J. Zayas
CEO, President & Director

Yes. It was the -- thanks, Anthony, for the question, and thanks for not being too hard on us. It was definitely an average. Like if we look at the -- it was Wednesday, Thursday, Friday. If we look at the averages for the last -- I think we looked at averages over the last 6 weeks. We more than doubled it during those 3 days, which was it was very promising. Their business is obviously very important to us and they continue to be a great partner. And we did a lot of co-marketing ahead of it and got a nice bump those 3 days.

Anthony Chinonye Chukumba
Loop Capital Markets LLC, Research Division

Got it. Okay, that's helpful. And then just one bit of clarification. So you mentioned that your write-offs declined 130 basis points sequentially. What was the -- what was that year-over-year?

Nancy A. Walsh
Chief Financial Officer

So year-over-year, we talked about that the 8.4% compares to 6.3% in 2022, but that really was more of the anomaly because it reflected the positive impacts of the COVID-related stimulus at that point in time, so we consider this to be more of a run rate for us. And expect -- as the vintages post COVID continue to mature, we are expecting to see this to continue to improve.

Operator

Thank you. That, this concludes our question-and-answer session. I would like to turn the conference back over to Orlando Zayas, CEO, for any closing remarks.

Orlando J. Zayas
CEO, President & Director

Thank you, operator. And thank you all for attending the call today.

In closing. We delivered first quarter 2023 results in a strong manner, and our momentum is encouraging. We're excited about the opportunity ahead of us and remain focused on executing our growth and financial strategies. I look forward to updating you on our mission to provide underserved non-prime consumers the flexibility they deserve to access the durable goods they need.

Thank you for attending the call today.

Operator

Thank you. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.