Sezzle

First Quarter Financial Results Conference Call

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CORPORATE PARTICIPANTS

Charlie Youakim - Executive Chairman, *Chief Executive Officer*

Paul Paradis - *Co-Founder, President*

Karen Hartje - *Chief Financial Officer*

Lee Brading - *Head of Corporate Development, Investor Relations*

PRESENTATION

Operator
Good evening, and welcome to the Sezzle First Quarter Financial Results Conference Call. All participants will be in listen-only mode. Should you need any assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone, to withdraw your question, please press "*" then "2." Please note, this event is being recorded.

I would now like to turn the conference over to Charlie Youakim. Please go ahead.

Charlie Youakim
Thank you. Good afternoon, everyone, and welcome to Sezzle's 2024 first quarter earnings call. My name is Charlie Youakim, I'm the CEO and Executive Chairman of Sezzle. I'm joined today by my Co-Founder and President, Paul Paradis, our Chief Financial Officer, Karen Hartje; and our Head of Corp Dev and IR, Lee Brading.

In conjunction with this conference call, we filed our earnings announcement with the SEC and have posted along with our earnings presentation on our investor website on sezzle.com. If you have not done so already, please go to the Investor Relations section of our website. There, you'll find the press release and earnings presentation under quarterly earnings within the financial section. Now that we're all sorted, let's get started.

We've had a number of extraordinary quarters in our short history, and I think you'll agree that this quarter could be among the best thus far. Now let's dive into the presentation starting with the left side of slide three.

Q1 turned out to be another strong quarter of top line growth as total income increased 35.5% compared to the prior year's quarter. Net income for the quarter came in at $8 million, which is larger than the $7.1 million in net income that we posted for all of 2023. Because that result puts us at nearly 50% of our guidance for the year, you might guess that we're raising 2024 guidance, and you're correct. I'll get to that in a moment. The $8 million in net income represented a 17% net income margin and resulted in a 31% return on equity for the quarter. To emphasize the return on equity is for the quarter. It is not annualized.

Our total subscriber count increased to 371,000 at the end of the quarter, which represents a net increase of 64,000 subscribers during the quarter. Further, we recorded $15 million in adjusted EBITDA compared to $8.3 million in the prior year at a margin of 31.9% for Q1. Consumer engagement remains high as evidenced by the top 10% of consumers transacting an average of 53 times per year. As alluded to earlier, we are raising our net income guidance for the first time and for the first-time providing EPS guidance. We are increasing our GAAP net income guidance for 2024 to $30 million from $20 million and providing GAAP EPS guidance of $5 for 2024.

On previous calls, we have discussed the rule of 40 and how companies may differently define profit margin and a range from adjusted EBITDA margin to net income margin. We're happy to say that we exceeded the rule of 40, however you'd like to slice it. If you take the hardest measure of the rule of 40 and use revenue growth and net income growth…net income margin, we're north of 50% for the quarter. If you take revenue and EBITDA margin, we're north of 67%.

We also discussed our own goal of 20/60/20, which equates to beating a 20% revenue growth target, a 60% gross margin goal and a 20% net income margin goal. In the first quarter, we're getting closer to attaining that overall, 20/60/20 goal with a 35.5% revenue growth, a 55% gross margin and a 17% net income margin.

Because of our recent run of successes, we often get the questions from bankers, analysts and investors, how have you all done such an amazing turnaround. What's the secret sauce? Our success did not happen overnight nor was it easy, but it occurred through creativity, dedication and hard work from each employee at Sezzle. But at our core, every decision we consider…we make, we consider our guiding principles as laid out on slide four, starting with positively affecting profitability. We used to chase growth for growth's sake. We no longer do that, which is obvious from our results.

A key part of profitability is increasing the lifetime value of our consumer. The launch of our Premium and Anywhere subscription products is a great example of us focusing on increasing LTV while we create products that our consumers truly love. While it may not be reflected in our absolute numbers, we are highly focused on acquiring new users. But first, we had to focus on profitability.

Over the next 6 to 18 months, we have several items focused on driving user acquisition from marketing campaigns to product offerings. Last but not least, from a stakeholder perspective, driving profit and bottom-line results are important, but we also recognize that we must be good stewards. We are proud to be the only buy now, pay later company that has a certified B Corp, which espouses being good stewards for the next generation that comes after us. We expect to renew our B Corp status this summer. As mentioned earlier, we have surpassed 371,000 subscribers across Premium and Anywhere.

As shown on slide five, the amount of engagement and positive feedback has been extraordinary. Consumers have really embraced the flexibility of Anywhere with about 32% of the orders being generated from virtual card taps at point-of-sale retailers. These are in-store transactions. Subscribers are also on average, making six more purchases a quarter than nonsubscribers, which is a key part of us increasing consumer lifetime value.

Further, our Anywhere members are shopping at a broader array of locations and are making everyday purchases at general merchandise retailers, grocery stores and restaurants to meet their discretionary needs. To borrow a quote from a recent article in PYMNTS, the data seems to suggest that buy now, pay later is simply a modern adaptation of credit in the evolving landscape of consumer finance.

Again, going back to our mission. Through these subscription services, we continue to financially empower the next generation on their journey through life and our NPS scores continue to track well for Anywhere and Premium. We do see customer NPS outperformance in Anywhere relative to Premium, and we attribute this simply to the greater flexibility of Anywhere as a consumer product.

We are excited about the path forward and aren't resting on our laurels. As shown on slide six, we recently launched Payment Streaks for consumers. We essentially gamified payments for consumers by rewarding good behavior, which marries well with our commitment to enhance the consumer experience and foster financial responsibility. It's too early to provide any color on the progress as we have just launched the product in the last couple of weeks, but we will surely be watching closely at the impact of Streaks.

We think that the new tiering system and the gamification and Streaks will enhance the consumer experience and help us with consumer retention as we'll start to have natural segmentation occur within our consumer base through the tiers attained via their payment performance.

We are also making great progress with our marketplace expansion into direct product listings. While it is still a work in progress, we are seeing it drive more engagement per square inch of mobile real estate through clicks and app sessions, which ultimately lead to better financial results and better retention of consumers. Similar to Payment Streaks, many of the improvements are very recent, so it's too early to share any quantifiable results.

Our bank partnership continues to progress, and we believe we're going to have a very good relationship with our future partner. We are fully engaged across the company on completing the final steps in our pre-launch engagement. The key initial benefit of the bank partnership will be the banking as a service relationship, which will allow us to unify our product construct behind a national standardization versus the state-by-state operations we work through today.

The state-by-state approach has proven to limit our profitability due to some states having very restrictive lending loss. As an example, some states don't allow any late payment fees and others restrict the amounts and timing of the fees. These numerous and diverse laws have made running our business a bit more complicated while also limiting our products profitability.

Through the bank partnership, we'll have a national banking charter behind our product that will help us pull back the restrictions, increasing the profitability of our core products. The secondary benefit of the banking partnership is that it will allow us to launch additional products that we believe will be a key to future user acquisition and customer lifetime value expansion.

The future benefits of this banking partnership are not included in our updated guidance, and we're not able to share the details of expected impact as we follow a conservative approach with projects like this. We like to actualize the benefits before we pass the results into internal budgets and guidance. We're also not guiding on the timing of this going live as half of the work is not in our hands.

Slide seven provides a sample of some of our marketing efforts. In case you're new to Sezzle, in the early stages, our marketing efforts were completely targeted towards the merchant. And while the majority of our spending is still targeted toward merchants, we are expanding our efforts to the consumer as shown on slide seven. Our marketing team is a creative bunch, and I'm looking forward to what they come up with next. By the way, all of these efforts are evaluated based on CAC to LTV ratios.

Our positive results and momentum are further reflected in some of the key non-financial metrics as shown on slide eight. It has been great to see us growing subscribers, increasing repeat usage, and improving consumer purchase activity in terms of frequency and total [indiscernible]. As further evidence of the success of Sezzle Anywhere, which was launched in June of 2023, shoppers have been using us everywhere.

In the first quarter, shoppers used us at over 149,000 merchants compared to just 22,000 in the prior year. It is great to see Sezzle become a part of people's daily lives. Year-over-year, we experienced a decline in active consumers, but sequentially, the number has been flat since

August. As noted last quarter, we believe it has bottomed out. We look forward to seeing active consumer count pick up in the second half of this year.

With that, I'm happy to turn the call over to our CFO, Karen Hartge, who will go over the quarterly financial results in greater detail. Karen…

Karen Hartge
Thank you, Charlie, and hello to all. On to slide nine. As referenced several times already, we had a very good start to 2024 as reflected in our year-over-year results.

Total income increased 35.5% year-over-year, led by a 33% increase in UMS. Net income came in at $8 million for the quarter compared to $1.7 million the previous year. The improvement was driven by a combination of driving top line growth through UMS growth and subscription signups, while also lowering operating expenses. Those actions are further reflected in our EBITDA margin of 31.9% and our non-transaction related costs declining to 34.5% of total income compared to 55.7% in the prior year.

As shown in slide 10, we typically see a drop off in UMS from fourth quarter to first quarter due to seasonality. The seasonal drop off in UMS was consistent with what we have experienced in the last couple of years. However, I would like to note that we did not see that same drop-off in total income, which only fell 3.9% from fourth quarter to first quarter as we had a pickup in subscriptions during the quarter. The combination of UMS and subscription growth drove total income higher year-over-year by 35.5%.

On slide 11, transaction expense, which is primarily payment processing costs, rose to 2.4% of UMS. Although we did see an increase partially attributable to our average order value declining during the quarter compared to the prior year, we believe we can lower this back to recent historical levels as a percentage of UMS.

Seasonally, first quarter is a healthier quarter for provision because of the tax refund season. We do expect the provision for credit losses as a percentage of UMS to rise over the remainder of the year as it did in 2023.

However, we expect it to remain within a reasonable level as we continue to evaluate the balance of growth versus losses. Led by the increase in provision year-over-year, our transaction-related costs, as shown on slide 12, rose to 44.7% of total income. Nonetheless, as reflected on slide 13, we were well above our 2024 guidance of total income, less transaction-related costs of 50%. In case you haven't figured it out by now, we are not all about growth at any cost.

On slide 14, you can also see that we are hyper-focused on expenses. Not only were we able to grow the top line by over 30%, but we were able to lower non-transaction-related operating costs on an absolute basis by $3.1 million, representing over a 15% decline year-over-year. The line graph on the right side of slide 14 reflects how the combination of our unit economics and expense management are driving strong bottom-line performance.

Speaking of bottom-line performance, turn to slide 15. The evident is in the results, $8 million of net income and $15 million of adjusted EBITDA.

In 2024, we've also improved our liquidity position and solidified our capacity for further growth as evidenced by our new credit facility, highlighted on slide 16.

Subsequent to quarter end, we closed on a new $150 million facility with Bastion, a long-time lending partner for Sezzle. The new facility increases the size of our credit facility and significantly lowers the interest rate cost from SOFR plus 11.5% to SOFR plus 6.75%. We expect a significantly reduced interest cost going forward as the facility has a lower borrowing rate and a lower minimum utilization requirement.

All paths lead us to continuing to improve and strengthen our balance sheet. Slide 17 reflects a positive impact our bottom-line performances had. As stockholders' equity stands at $29.6 million, and we've built an unrestricted cash position of almost $78 million compared to only $59 million at this time last year.

At this point, I imagine everyone is cheated unless they head to our outlook on slide 18. I know, I would've by now. We are happy to update previous guidance and provide some additional guidance as well. We now anticipate our total income growth rate for 2024 will be approximately 25% resulting in total income at $200 million compared with our previous guidance at 20%.

We still expect total income, less transaction related cost to come in around 50% for 2024. Meanwhile, we are upping our GAAP net income guidance to $30 million from $20 million. We expect our new GAAP net income guidance to result in GAAP EPS of approximately $5.

At the bottom of slide 18, we've added a valuation metrics based on the ratio of our market cap to our 2024 earnings guidance and compare to the same metric using the consensus for other popular indices. I am sure you get the point without us stating it. We are not happy with our valuation as we are trading at less than half of the valuation when compared to these indices.

As we were hyper focused on being profitable, we are hyper focused on enhancing shareholder value. In addition to the $5 million stock repurchase plan, we announced in December 2023, we will evaluate other capital return options for shareholders including but not limited to dividends, incremental share repurchases or a combination of both.

With that, I would like to turn the call over to the operator as we are happy to take your questions. Operator, will you please open the lines for Q&A?

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question-and-answer session. To ask a question, you may press "*" then "1" on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw your question, please press "*" then "2."

Your first question comes from Nico Sacchetti from RBC. Please go ahead.

Nico Sacchetti
Hi, everyone. How are you doing?

Charlie Youakim
Good. How are you doing?

Nico Sacchetti
Outstanding, reading through your earnings report here. I thought last report was good. This was…you guys knocked the cover off the ball, so just want to say congratulations and thank you for breaking out the earnings per share guidance. I think it really helps to clarify and expose how cheap your stock is here so that…and that's a great addition in that slide. Can you give us any information on the stock buyback as far as average price per share that was paid?

Charlie Youakim
Karen, do we have that detail outlined anywhere?

Karen Hartje
At this point, we have repurchased the $3.5 million worth of stock.

Nico Sacchetti
I was just curious. So out of the five, you bought back 3.50. I was just curious if you had and what you were paying for per share on average.

Charlie Youakim
I think you will see that in the 10Q, the detail being there.

Nico Sacchetti
Alright, very good. As far as…and I asked the question but maybe just to clarify for anybody else listening, you mentioned warrants on the call. I'm just curious, is there something outstanding that, if exercised would be significantly dilutive?

Karen Hartje
I'll take that one.

Charlie Youakim
Yes, go ahead.

Karen Hartje
Yes. We have about 54,000 in warrants. They're already reflected in the diluted share count, and that's less than 1%, so no, it's not significant.

Nico Sacchetti
Okay. A follow-up to that is I'm looking through the outstanding shares, and I see a jump almost of 10% in the dilutive number from the year-over-year reported, 5.5 to almost 6. Can you educate me on what happened with the increase in dilutive shares outstanding?

Charlie Youakim
Karen, you want to take that.

Karen Hartje
Well, it includes both warrants and employee options, and there are more options in the money compared to year-end at this point because of the increase in our share price.

Nico Sacchetti
So, your $5 a share earnings guidance is based off of, we'll call it roughly $30 million of net income divided by almost 6 million shares. Is that the math that you're doing?

Charlie Youakim
Exactly.

Karen Hartje
Yes.

Nico Sacchetti
Okay. Let's see, you kind of covered it, but I mean, you look at it, and it's almost shocking to see how profitable you are, especially when you get a real-life comparison with a firm coming out this morning and showing how much they're losing on operating income. You touched on it, but I mean, my question would be just how are you able to be so profitable when other players in the exact same space, and maybe it's not in apples-to-apples, they're doing different things, different revenue streams, and I wish there was a more eloquent way to ask, can you expand on just how you've been able to create so much net income off of this revenue base where others are struggling to turn a profitable penny?

Charlie Youakim
I think each company probably has a different strategy of how to approach things, depending on their cash balance, et cetera. Our view, though, was we always kind of talked on to the basics of the company, and I'm like, and our view is you've got to eliminate them let's make sure that we have a great lemonade, and we've got some great profitability on that lemonade before we start to sell it to the masses and really expand operations, and so we spent the last couple of years doing that, making sure that we've got a great lemonade, we've got some great profitability on it, and now we want to really hit the gas, where I think some other companies view it as let's just keep on hitting the gas and building the airplane while we go, and we just don't believe that's the right approach. We think the safer approach is making sure that you've got everything in order before you start to really expand it.

Nico Sacchetti
Is there an opportunity now for you to hit the gas without sacrificing the profitability metrics that you've built here?

Charlie Youakim
Yes, absolutely. I mean, our view is that we keep on working on lifetime value, increasing lifetime value of customer, and then what that does for us is we have this symbiotic relationship with helping them with their sales on their sites. We're also driving traffic to their sites, so we've got this fantastic symbiotic relationship with merchants, and what we can do, though, is be more aggressive with them as the consumer lifetime values of the federal customer continue to increase post that purchase. So, our belief is that we can continue to have strong growth while maintaining strong profitability goals as a company.

Nico Sacchetti
I mean, that's maybe a decent segue into what happened around with the Wal-Mart situation where it looks like they're trying to do this in-house, and the follow-up question would be, do you have a concentrated relationship that would be a material loss if this became commonplace? And then maybe is it…do you foresee this being something that large retailers at least will try to just do this themselves? And then a second follow-up would be, is that a potential acquisition down the road where someone would look at buying you to incorporate you into their existing business?

Charlie Youakim
Personally, I don't think so, I think that this Wal-Mart situation is quite unique, and we are not the…Sezzle is not highly concerned if you don't have direct relationship with Wal-Mart. I think it will be the few and far between. I mean…I always talk about internally in the company. I always talk about private label credit cards as like the precursors what we are doing with merchant relationships et cetera. And in that part of the world, you find that almost no retailers do their own private labels. They work through banking partnerships, and I think that Buy Now, Pay Later will kind of follow that same path. So, I think this will be unique.

Nico Sacchetti
Okay.

Charlie Youakim
And then on the M&A, you just never know on M&A. We basically built the business to build a great business and…don't believe folks on that.

Nico Sacchetti
Can you educate me on this Canadian opportunity, same competitors that are here? Is that something that…I mean it was definitely positive about a press release, can you give any additional information on the opportunity there?

Charlie Youakim
Yes, I mean I would actually recommend investors take a look at the app stores in Canada. And look at their accounts overdues for the competitors. First of all, not all the competitors in the United States are present in Canada and we tend to find that our competitors have degraded offerings in Canada due to a lack of focus in that market where we really fight for parity in our product offering there. We do it as an important part of our overall business. So, I think that we have a…I guess we index higher in Canada in terms of success and size versus the US.

Nico Sacchetti
Okay, very good. Last question is…it looks like you're sitting on a really solid balance sheet right now. It's…in terms of the cash, are there investments that can be made to help with the growth story? Is this an appropriate number to be sitting on? Seems like you have been generating and adding to the cash position. I am just curious what the end use is or what the end game is.

Charlie Youakim
We'll never make a hard rule about anything. I think our view is keep on piling on cash with possibility and then if we find an opportunity where the ROI makes sense, we'll take a deep look at it. Just look we do with our marking initiatives, always looking at CAC to LTV ratios, does this make sense? What we tend to find is that the merchant relationship is still by far and away the best relationship for us, and it makes sense because of the symbiosis of the relationship. So, we look at return and I think we would look at return with our cash, if we can find some return for us, we'll definitely take a look.

Nico Sacchetti
Okay. Well, yes, thanks for taking my questions. Congrats again on the quarter. And anyway, I look at this and try to work the numbers, I mean I am getting close to a billion-dollar valuation. You start overlaying even conservative metrics and so, really look forward to continue to own the company here and I'll jump back in the queue here.

Charlie Youakim
Thanks, Nico.

Nico Sacchetti
Yes.

Operator
Once again, if you wish to ask a question, please press "*" and "1" on the telephone keypad. We will now pause momentarily for any further questions to register. This concludes our question-and-answer session. I would now like to turn the conference back to Mr. Youakim for closing remarks.

CONCLUSION

Charlie Youakim
Thank you. In closing, I would like to thank the Sezzle team again. We continue to all row in the same direction which is leading to these great results. This quarter, I would also like to send a special shout out to the product measuring teams. As much of what we are seeing in these numbers is due to the amazing bit of work created by those teams over the last two or so years, great job, you all.

And in honor of the later Charles Munger, I'd also like to thank the true investors out there that follow his "Sit-on-your-ass-method" to investing with Sezzle and have invested and held our shares through it all because of their belief in what we are doing as a company. Please know that we keep you in mind as we continue to innovate and deliver. Thank you all and have a great rest of your day.

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