Block, Inc. First Quarter 2023 Earnings Call - Prepared Remarks

Nikhil Dixit, Head of Investor Relations

Hi, everyone.

Thanks for joining our first quarter 2023 earnings call. We have Jack and Amrita with us today.

We will begin this call with some short remarks before opening the call directly to your questions. During Q&A, we will take questions from our customers in addition to questions from our customers and conference call participants.

We would also like to remind everyone that we will be making forward-looking statements on this call. All statements other than statements of historical fact could be deemed to be forward-looking. These forward-looking statements include discussions of our outlook and guidance as well as our long-term targets and goals, and we may decide to shift our priorities or move away from these targets and goals at any time. These statements are subject to risks and uncertainties. Actual results could differ materially from those contemplated by our forward-looking statements. Reported results should not be considered as an indication of future performance.

Please take a look at our filings with the SEC for a discussion of the factors that could cause our results to differ. Also, note that the forward-looking statements on this call are based on information available to us as of today's date. We disclaim any obligation to update any forward-looking statements, except as required by law.

During this call, we will provide preliminary estimates of gross profit growth and GMV performance for the month of April. These represent our current estimates for April performance as we have not yet finalized our financial statements for the month of April, and our monthly results are not subject to interim review by our auditors. As a result, actual April results may differ from these estimates and may not be reflective of performance for the full second quarter. Moreover, this financial information has been prepared solely on the basis of currently available information by, and is the responsibility of, management. This preliminary financial information has not been reviewed or audited by our independent public accounting firm. This preliminary financial information is not a comprehensive statement of our financial results for April or the second quarter.

We also will discuss combined company gross profit during this call. Block combined company gross profit assumes we acquired our BNPL platform on January 1, 2022 and includes a $51 million gross profit contribution from our BNPL platform for the month of January 2022. For purpose of comparison, fourth quarter combined company gross profit assumes a $185 million contribution to Block gross profit from our BNPL platform in the fourth quarter of 2021 as if we acquired our BNPL platform on October 1, 2021.

Also, we will discuss certain non-GAAP financial measures during this call. Reconciliations to the most directly comparable GAAP financial measures are provided in the Shareholder Letter, Historical Financial Information spreadsheet, and Investor Day materials on our Investor Relations website. These non-GAAP measures are not intended to be a substitute for our GAAP results.

Finally, this call in its entirety is being audio webcast on our Investor Relations website. An audio replay of this call and the transcript for Jack and Amrita's opening remarks will be available on our website shortly.

With that, I would like to turn it over to Jack.

Jack Dorsey, Block Head

Thank you all for joining us.

Last quarter we shared our investment framework going forward. As a reminder, our framework can be articulated in a single sentence:

Block and each ecosystem must show a believable path to Gross Profit Retention of over 100% and Rule of 40 on Adjusted Operating Income.

The principles that led us to this framework were:

1. Ensure our investments are focused on customer retention and growth.
2. Account for ongoing costs of the business, including stock based compensation.
3. Utilize industry standard conventions that are simple to communicate and understand.

We will not be distracted from living up to these principles and building our businesses according to this framework. Obviously, there are challenges ahead, including many out of our control. I wanted to spend a moment talking about those so you're aware of how we're thinking about meeting them, and then hand it over to Amrita to discuss our quarter. I'll start with the macro challenges and then the prevailing trends we can use to advantage our customers and us.

There are 3 macro challenges affecting all businesses now and over the long term:

1. Constant state of global crisis
2. Regulatory fragmentation
3. Global financial system shifts

The world seems to be moving from one global crisis to the next and suffering from an overwhelming amount of information, which is causing people and organizations of all sizes to be distracted and reactive to the moment. From COVID, to inflation, to the war in Ukraine, to bank failures, the number of things we all need to pay attention to grows unbounded. Throughout this time we want to remain focused and not reactive to any one particular moment in time. This is easier said than done, but it's something that underlies everything we do. Ensuring our long-term view guides all of our actions, especially those we take in the short term. At the same time, regulators around the world are coming up with slightly or entirely different answers to problems facing their citizens. Instead of having global standards, we end up with rules which are different for every market, effectively slowing the pace of development. While this might be a good thing for each market, it makes it very challenging to grow a global internet business, especially for smaller companies. Part of our job will be to help our customers navigate this complexity by taking it on ourselves.

Finally, there have been numerous challenges to the global financial system, and it's experiencing some significant shifts. From new global reserve currency candidates, centralization of banks through failure of smaller ones, to adoption of Central Bank Digital Currencies with entirely new capabilities.

These all affect our core businesses, and all are trends we need to navigate carefully. I'm confident we will, as we see and acknowledge them early. We want to be proactive in our approach, and not just react when it's too late. And there are a few technology trends that I believe will help us do just that.

There are 3 trends we're focused on:

1. Artificial Intelligence
2. Open protocols
3. Global South

Consider how many times you've heard the term AI or GPT in the earnings calls just this quarter versus all quarters in history prior. This trend seems to be moving faster than anyone can comprehend or get a handle on. Everyone feels like they are on their back foot and struggling to catch up. Utilizing machine learning is something we've always employed at Block, and the recent acceleration in availability of tools is something we're eager to implement across all of our products and services. We see this first as a way to create efficiencies, both internally and for our customers. And we see many opportunities to apply these technologies to create entirely new features for our customers. More and more effort in the world will shift to creative endeavors as AI continues to automate mechanical tasks away, and we believe we are well positioned for that shift with our strategy for artists on TIDAL.

Open protocols represent another fork in the road moment for people and companies. Bitcoin, nostr, Bluesky, web5 and others are all working to level the playing field for competition and give individuals and organizations entirely new capabilities. I believe this trend is growing as fast as AI, will have just as large an impact, and may even help address some of the harms AI presents. We are embracing this early so we can figure out how to best contribute to these protocols, and build valuable businesses on top of them. This isn't just about centralization versus decentralization. If these protocols are even remotely successful, they will present a customer base far larger than any one company can create alone. And there is good precedent for this happening again, look at the web, email, and the overall internet for proof. We have a number of efforts towards this trend, including our bitcoin wallet, miner, Bitcoin exchange, Spiral, and TBD.

If we consider where the internet population will grow the fastest, we must look at the so-called Global South, countries within Africa, Latin America, Asia, and Oceania, where most of humanity resides. This region is adopting open protocols faster than Western countries because the use cases they provide are increasingly becoming a necessity, such as money remittance. We are choosing to focus on these markets because we believe the total addressable market over time is bigger than anything we're currently in. The assumption you have to make here of course is that nearly everyone in these markets has access to the internet, which is a credible one to make over the next decade. We have already started this work in earnest, with our partnership between TBD and YellowCard to enable fiat on and off-ramps in 16 African countries. Open protocols and focused AI solutions will help us to move even faster, and in a way that's complementary to the businesses that already exist within these markets, and the ones starting up in the future.

I realize this is a lot to take in, but I wanted to make sure you all had context for how we will be driving our roadmaps and businesses in the future. With our investment framework, we will have the right accountability as we look to grow Block's many ecosystems together. Together is the key word here, as our real value comes from our multiple ecosystems working to positively reinforce one another, and provide resiliency through challenging times. I couldn't be more excited about what's ahead, and how we're positioned as a company to grow.

Over to Amrita.

Amrita Ahuja, Chief Operating Officer and Chief Financial Officer

Thanks Jack.

You've now heard three of the longer-term trends we are prioritizing in the coming years to expand our market opportunity and help advance our ecosystems. As we pursue these opportunities, we'll continue our day-to-day focus on serving our customers, operating with discipline, and driving long-term profitable growth at scale.

There are three topics related to our more recent performance that I'd like to cover today. First, an overview of our strong first quarter results. Second, trends we've seen across our business in April. And third, a look at our investments through the remainder of the year.

In the first quarter, we delivered strong growth across our ecosystems, with gross profit of $1.71 billion, up 32% year over year. On a combined company basis, gross profit grew 27% year over year in the first quarter, up from 21% in the prior quarter.

We delivered Adjusted EBITDA of $368 million during the quarter, an increase from $195 million in the prior year period. Adjusted Operating Income, which includes expenses related to stock based compensation and depreciation and amortization, was $51 million in the first quarter, up from a $42 million loss in the prior year period.

We also continued to diversify our monetization streams across our ecosystems. In the first quarter, we had 14 revenue streams across Square and Cash App that generated $100 million or more in annualized gross profit, up from 11 a year ago.

Let's get into each ecosystem. Cash App generated $931 million of gross profit in the first quarter, an increase of 49% year over year. On a combined company basis, Cash App gross profit grew 43% year over year, up from 39% in the prior quarter.

We delivered year-over-year growth across each component of our inflows framework: actives, inflows per active, and monetization rate. We reached 53 million monthly transacting actives in March, an increase of 17% year over year. Inflows per transacting active averaged $1,136 in the first quarter, up 8% year over year and quarter over quarter. And overall inflows into Cash App totaled $61 billion, up 27% year over year. We remain focused on driving growth in inflows per active by growing product adoption, diversifying the ways in which people can bring their money into Cash App, and investing in areas that strengthen trust in Cash App. Monetization rate was 1.41% excluding gross profit contributions from our BNPL platform, up from 1.19% in the first quarter of 2022, benefiting from growth in monetized products and pricing changes implemented in 2022. On a quarter over quarter basis, monetization rate was up slightly from 1.39% in the fourth quarter, including a modest benefit from interest income.

Our financial services products are a key driver of inflows into Cash App and help us build retentive relationships with our actives, particularly Cash App Card. In March, there were 20 million monthly Cash App Card actives, up 34% year over year, and average spend per active increased on a year over year and quarter over quarter basis.

In March, we had 2 million monthly direct deposit actives, one-tenth the scale of Cash App Card monthly actives. In particular, paycheck deposits continued to increase as a percentage of overall inflows, totaling $2.5 billion in March or $30 billion on an annualized basis. These paycheck deposits grew 69% year over year, two and a half times as fast as overall inflows into Cash App. We've driven adoption for direct deposit actives through unique Boosts, and more recently we've introduced free in-network ATM withdrawals for those receiving their paycheck in Cash App.

We also launched Savings on Cash App earlier this year, which was a top requested feature amongst our customers. This gives customers a simple and flexible way to manage money, and easily set aside funds as a separate savings balance. Since it launched in January, more than three million Savings actives added funds to their savings balance as of the end of April.

Square generated $770 million of gross profit in the first quarter, an increase of 16% year over year. On a combined company basis, Square gross profit was up 12% year over year, and further excluding gross profit from PPP loan forgiveness, Square combined company gross profit grew 21% year over year in the first quarter, up from 16% in the prior quarter.

Looking at the drivers of Square's first quarter performance. First, we continued to drive growth in software and integrated payments, with gross profit from these products up 19% year over year. Within this, we've seen strong momentum from our vertical point of sale offerings across Retail, Restaurants, and Appointments, where gross profit was up 42% year over year, in aggregate. By channel, gross profit from in-person channels grew faster than our online channels, as we've seen online growth rates normalize compared to pandemic levels.

Second, we continued to grow with larger sellers. Gross profit from mid-market sellers was also up 19% year over year. We remain focused on driving acquisition of larger sellers across our three key verticals of restaurants, retail, and beauty, and our software offerings for those verticals. We recently introduced vertical-specific homepages on our website that offer customized experiences to sellers. The updated website funnels demand to our sales teams, which we are also verticalizing in order to further support our go-to-market efforts.

Third, we continued to expand globally. Gross profit in our international markets outpaced overall Square gross profit, up 28% year over year excluding contributions from our BNPL platform. We remain focused on Square's top strategic priorities of omnichannel software, upmarket, and global, and have been orienting our roadmaps and investments towards these areas of meaningful growth in recent years.

These priorities have helped us proactively evolve our business mix from our roots in sidecar payments, or transactions where sellers enter an amount on the keypad and hit charge, towards software and integrated payments, which enable us to create more retentive, long-term relationships with sellers. As a result, Square's gross profit from sidecar payments grew 5% year over year, and represented 21% of Square gross profit during the first quarter, down from 30% two years prior. We intend for the mix of Square's business related to sidecar payments to continue to decline over time as sidecar use cases are now also well served by peer-to-peer solutions, such as Cash for Business within our Cash App ecosystem.

Finally, our BNPL platform generated $5.6 billion of GMV in the first quarter, an increase of 18% year over year, inclusive of January 2022 volumes. Losses on consumer receivables were 0.7% of GMV, an improvement year over year and quarter over quarter.

Next, an update on April trends. For the month of April, we expect total gross profit growth of 24% year over year, which we expect to remain relatively consistent for the second quarter.

Looking into the dynamics of each ecosystem. For the month of April, we expect Cash App gross profit to grow 35% year over year, a moderation compared to 43% combined company growth in the first quarter, as we have lapped the benefit of pricing changes made in the first quarter of 2022.

We expect Square gross profit to grow 14% year over year in April, compared to 12% combined company growth during the first quarter, as we lap the more meaningful PPP benefits from the first quarter of 2022. Excluding PPP, combined company gross profit for Square is expected to be up 16% year over year in April, consistent with the fourth quarter's 16% growth, and moderating compared to the first quarter's 21% growth. While first quarter growth benefited from lapping omicron in the prior year period, April trends were in-line with the fourth quarter which was when we started to see a moderation in processing volume growth, particularly in discretionary verticals.

For our BNPL platform, we expect year-over-year GMV growth of 20% in April, an improvement from 18% in the first quarter.

Turning to our expectations for the remainder of the year. Given the gross profit momentum in our business during the first quarter, we are increasing our expectations for profitability this year. We expect to deliver Adjusted EBITDA of $1.36 billion and Adjusted Operating Loss of $115 million for full-year 2023.

This primarily incorporates stronger top-line outperformance during the first quarter, as we intend on shifting some expenses that we had intended for the first quarter to later in the year. We remain focused on operating with efficiency in 2023, driving operating leverage across hiring, sales and marketing, and corporate overhead. For the full-year, we continue to expect margin improvement year over year on both an Adjusted EBITDA and Adjusted Operating Income basis.

Shifting to share-based compensation. Last year, in the second quarter, our share-based compensation expenses increased by $47 million quarter over quarter, when excluding a one-time SBC expense of $66 million related to the acquisition of Afterpay recognized in the first quarter of 2022. We expect a similar quarter-over-quarter increase in the second quarter of this year. This remains an area on which we are focused, and expect to drive greater leverage over time.

I'll now turn it back to the operator to start the Q&A portion of the call.