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

Nikhil Dixit, Head of Investor Relations

Hi, everyone.

Thanks for joining our third 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 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 a preliminary estimate of performance for the month of October. This represents our current estimate for October performance as we have not yet finalized our financial statements for the month of October, and our monthly results are not subject to interim review by our auditors. As a result, actual October results may differ from this estimate and may not be reflective of performance for the full fourth 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 October or the fourth quarter.

Within these remarks, we will also discuss metrics related to our investment framework, including Rule of 40. With Rule of 40, we are evaluating the sum of our gross profit growth and Adjusted Operating Income margins.

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 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. We're going to do something a little bit different this quarter.

So we maximize time for questions, we're going to focus our opening remarks on Amrita providing more detail into what I wrote in my shareholder letter to you all. Most notably, reaching our Rule of 40 goal in 2026, and authorizing a repurchase of $1 billion of shares, to offset a portion of dilution from share based compensation. If you haven't yet, please read that letter for all details and what I'm focused on going forward.

With that, I'll turn it over to Amrita to share details on our quarter and talk about our guidance.

Amrita Ahuja, Chief Operating Officer and Chief Financial Officer

Thanks Jack.

There are four topics I'd like to cover.

First, our strong performance in the third quarter and increased profitability expectations for the remainder of the year.

Second, a preliminary view of 2024 and where we're demonstrating discipline on our investments to drive margin improvement.

Third, our path to achieving Rule of 40 in 2026.

And lastly, our capital allocation strategy to deliver value for shareholders.

In the third quarter, gross profit was $1.90 billion, up 21% year over year. We delivered our highest ever quarterly Adjusted EBITDA of $477 million, or 25% margin on gross profit. Adjusted Operating Income, which as a reminder includes expenses related to stock based compensation and depreciation, was $90 million and 5% margin on gross profit, compared to $32 million a year ago.

Our strong profitability during the quarter demonstrates our focus on efficiency in pursuit of our investment framework.

Cash flow generation has also been strong and improving. Adjusted Free Cash Flow was $427 million in the quarter compared to $88 million in the prior period. For the last twelve months, Adjusted Free Cash Flow was $945 million up from negative $99 million in the prior period.

Let’s get into Square and Cash App.

Square generated $899 million in gross profit, up 15% year over year. Square GPV grew 11% year over year, or 12% on a constant currency basis. We’re committed to serving sellers locally and through our banking products. In the third quarter, we experienced strong growth from our vertical point of sale products with gross profit up 29% year over year and our banking products up 20% year over year.

Cash App generated $984 million in gross profit, an increase of 27% year over year. Looking at the components of the inflows framework: As of September, there were 55 million monthly transacting actives, up 11% year over year with growth driven by our peer to peer network. Inflows per transacting active averaged $1,132 in the third quarter, up 8% year over year and relatively stable compared to the first half of the year. Monetization rate, which excludes gross profit contributions from our BNPL platform, was 1.43%, up 8 basis points year over year, driven primarily by pricing changes over the past year, and relatively flat quarter over quarter.

Turning to our BNPL platform, which contributed $94 million of gross profit to each of Square and Cash App in the third quarter. GMV from our BNPL platform was $6.7 billion in the third quarter, an increase of 24% year over year. Losses on consumer receivables were 0.84% of GMV, an improvement quarter over quarter and year over year.

As Jack noted in his letter, in the fourth quarter, we restructured our commerce efforts, moving our BNPL platform into Cash App as we believe combining the two ecosystems enables us to provide consumer experiences others can’t, especially for commerce. From a financial reporting perspective, moving forward, we will no longer split 50% of our BNPL platform into each of Cash App and Square. Instead, to reflect the recent organizational change, we’ll include 100% of our BNPL platform in Cash App’s results beginning in the fourth quarter.

During the quarter, we experienced an outage to our services across Block, which impacted both Square and Cash App systems. We know the reliability of our systems is crucial for our customers and are working hard to rebuild trust.

The outage lasted about 15 hours on certain products, and we estimate it impacted gross profit by less than 1% during the quarter. Our offline capabilities for Square and Cash App enabled our customers to continue to process some transactions during this time.

Looking ahead, we are accelerating our efforts to expand offline capabilities to all of our Square products, so sellers won't be worried about missing a sale, and are prioritizing building our technical infrastructure with greater redundancy and resilience.

Turning now to the fourth quarter of 2023. We are shifting away from monthly trend disclosures in favor of reinstating quarterly and annual gross profit and profit guidance. We expect to continue with this updated approach until we achieve and sustain Rule of 40.

We expect to deliver between $1.96 and $1.98 billion in gross profit, or 19% growth at the midpoint.

For Square, we expect gross profit growth to improve from the third quarter's 15% growth rate as we lap more favorable comparisons from the prior year and we get the first full quarter benefit from pricing changes on Square Invoices we implemented in the third quarter.

For the month of October, we estimate Square GPV was up 9% year over year. Our growth has moderated due to both GPV per seller, and lower contributions from new cohorts of sellers. We believe GPV per seller has been impacted by macro trends in discretionary verticals, which continued through October. Although we've achieved positive customer acquisition through the first three quarters of the year, gross profit from seller cohorts onboarded over the past two years are not contributing as much to growth as anticipated, and we're focused on evolving our go-to-market strategy to improve this.

For Cash App, we expect gross profit growth to moderate on a year-over-year basis from the third quarter's 27% as we lap stronger growth from the prior year. We continue to expect all three components of the inflows framework to grow on a year-over-year basis in 2023.

From a product perspective, we have seen particular strength in Cash App Card and Borrow as we drive continued growth in our financial services products, while we have experienced softness in growth from Cash for Business accounts and expect Cash App Business GPV to decline in the fourth quarter.

Compared to our prior expectations, growth in the fourth quarter was primarily impacted by expectations for our BNPL platform, and to a lesser extent, Cash App Business GPV and Square GPV.

Looking at profitability, we expect to deliver $430 to $450 million in Adjusted EBITDA and $40 to $60 million in Adjusted Operating Income in the fourth quarter.

And we are raising our full year 2023 profit guide. We expect Adjusted EBITDA of $1.66 to $1.68 billion and Adjusted Operating Income of $205 to $225 million. These are increases of $170 million and $190 million respectively at the midpoint, compared to our prior guide.

For the full-year 2023, the midpoint of our guidance implies gross profit growth of 24% and Adjusted Operating Income margins of 3%, leading to Rule of 27 this year.

This reflects meaningful margin expansion in 2023, with the midpoint of our guide reflecting 5 points of Adjusted Operating Income margin improvement, and 6 points of Adjusted EBITDA margin improvement compared to 2022.

Turning now to our path to achieving Rule of 40 in 2026. As a company, we remain focused on balancing growth and profitability. As we look longer-term, we are bringing a renewed focus to efficiency, exercising discipline with our expenses and thinking critically about how we operate to drive leverage. We're going to do all this while also focusing on how we can continue strong top-line growth to capture more of our addressable market.

We introduced our investment framework at the beginning of this year, and today, we want to provide more context on when and how we expect to reach our goal.

As Jack shared in his shareholder letter, we plan to reach Rule of 40 in 2026 with at least mid-teens gross profit growth and approximately mid-20% Adjusted Operating Income margin. This guidance is based on current trends in our business and does not factor in changes to the macro environment. As we learn more and trends change, our expected mix of growth and profitability may change over time as well. We will continue to monitor trends as we periodically update this view.

We see a long runway for continued growth ahead, and in our long-term planning, we have refined our priorities for each of our Square and Cash App ecosystems which are captured in Jack's shareholder letter. We believe we are still less than 5% penetrated against our $200 billion total addressable market, one which we will work to expand over time in a disciplined way with new products and audiences.

In balance with our growth priorities, what you're hearing from us today is a significant commitment to profitability and efficiency, across three key initiatives.

The first area is through the efficiency of our teams. As Jack outlined in his letter, we are implementing an absolute cap on the number of people we have at our company. We expect to be a smaller team by the end of 2024 compared to where we are today. Our cap of 12,000 people compares to our current size of just over 13,000 people as of the end of the third quarter. We believe constraining team size will enable us to be more effective in how we drive performance in service of our customers and accountability on our business strategies. We expect to reach this cap by the end of 2024, with steps towards this goal throughout the year, through a combination of performance management, centralizing teams and functions to reduce duplication, and strict prioritization of our scope aligned with the priorities outlined in Jack's letter. We expect to hold firm at 12,000 people until we feel the growth of the business has meaningfully outpaced the growth of the company.

With greater constraints on team size, we expect to drive meaningful leverage on stock based compensation as a percentage of gross profit in the years to come, starting in 2024.

Second, we are also in the midst of a broad-based effort to reduce our spend across corporate overhead areas. We've identified a number of areas where we expect to find savings such as real estate, process improvements using automation, discretionary spend areas like T&E, and certain vendor relationships across software, data, cloud, consultants and contractors.

Third, within our ecosystems, as we've shared in the past, we have been identifying opportunities to continue improving our cost structure as we optimize unit economics and partnerships by leveraging our scale.

Moving to our initial outlook for profitability in 2024, which we expect to be our strongest year of profitability yet**.** While we are still in the planning process for next year, we expect significant margin expansion as we implement these constraints.

We expect to achieve profitability on a GAAP Operating Income basis in 2024, and to deliver $875 million in Adjusted Operating Income, up approximately 4x compared to our 2023 guide.

We expect to deliver $2.4 billion in Adjusted EBITDA, an increase of more than 40% relative to our 2023 guide, and to deliver strong Adjusted Free Cash Flow growth next year as well.

We plan to share more about our gross profit growth expectations for 2024 during our fourth quarter earnings call in February.

Lastly, I wanted to touch on capital allocation and our focus on prioritizing shareholder return.

As we progress towards Rule of 40 in the coming years, we expect our margin profile and free cash flow generation to improve, which means we can return more to shareholders over time.

Today, we are announcing an initial share repurchase program of $1 billion, which will offset a portion of dilution from share based compensation and allow us to act opportunistically when we believe our shares are undervalued.

We consider share based compensation in our financial targets as we measure our progress towards Rule of 40, and we want to be responsible in managing the impact of dilution as our company grows.

What you hear from us today is an increased commitment to delivering value to our customers and to our shareholders, as we execute on the opportunity ahead of us.

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