Riskified Second Quarter 2023 Earnings Transcript *Edited*

Corporate Participants

Chett Mandel, *Head of Investor Relations*

Eido Gal, *Chief Executive Officer*

Agi Dotcheva, *Chief Financial Officer*

Analyst Participants

Josh Beck – *KeyBanc Capital Markets*

Brent Bracelin – *Piper Sandler*

Timothy Chiodo – *Credit Suisse*

Will Nance – *Goldman Sachs*

Bob Napoli – *William Blair*

Terry Tillman – *Truist Securities*

Reggie Smith – *J.P. Morgan*

Chett Mandel
Head of Investor Relations

Good morning and thank you for joining us today. My name is Chett Mandel, Riskified's Head of Investor Relations. We are hosting today's call to discuss Riskified's financial results for the second quarter of 2023. Participating on today's call are Eido Gal, Riskified's Co-Founder and Chief Executive Officer, and Agi Dotcheva, Riskified's Chief Financial Officer.

We released our results for the second quarter of 2023 earlier today. Our earnings materials, including a replay of today's webcast, are available on our Investor Relations website at ir.riskified.com.

Certain statements made on the call today will be forward-looking statements related to our operating performance, financial goals and business outlook, which reflect management's best judgment based on currently available information and are not guarantees of future performance. We intend all forward-looking statements to be covered by the Safe Harbor provisions contained in the Private Securities Litigation Reform Act of 1995. Please note that these forward-looking statements reflect our expectations as of the date of this call and except as required by applicable law, we undertake no obligation to revise this information as a result of new developments that may occur after the time of this call. These forward-looking statements involve risks, uncertainties and other factors, some of which are beyond our control, that could cause actual results to differ materially from our expectations. You should not put undue reliance on any forward-looking statement. Please refer to our Annual Report on Form 20-F for the year ended December 31, 2022 and subsequent reports we file or furnish with the SEC for more information on the specific factors that could cause actual results to differ materially from our expectations.

Additionally, we will discuss certain non-GAAP financial measures and key performance indicators on the call. Reconciliations to the most directly comparable GAAP financial measures are available in our earnings release issued earlier today, and also furnished with the SEC on Form 6-K, and in the appendix of our Investor Relations Presentation, all of which are posted on our Investor Relations website.

I will now turn the call over to Eido.

Eido Gal
Co-Founder, CEO & Director

Thanks Chett and hello everyone.

We had a strong second quarter, highlighted by year-over-year revenue growth of 21%.

During the second quarter, our revenue growth was primarily driven by the successful execution of our "Go-to-Market" strategy. For the first half of 2023, our sales team was able to exceed their internal quotas while simultaneously building a rolling pipeline that is now stronger and more robust than it was at the beginning of the fiscal year.

We are fortunate to have strategic and deep-rooted relationships with some of the biggest and most sophisticated enterprise eCommerce merchants in the world. We aim to strengthen our position as one of the largest and most accurate eCommerce decisioning companies in the world by continuously finding ways to enhance our platform for our merchants.

To help accomplish this, we recently formed our Customer Advocacy Board or "CAB", made up of 10 senior executive decision makers, with C-level participation from some of Riskified's top accounts, which together represent a meaningful portion of our revenue base.

The mission of the CAB is to share insights, discuss eCommerce trends, and share ideas about product enhancements to strengthen our offering. This feedback is intended to help us to develop features and strategize our product roadmap to solve bigger and more complex use cases for our merchants, which we expect will ultimately land higher attach rates.

Based on the initial feedback from the group, we are even more excited about our technology stack, and our multi-product platform with "Dispute Resolve," and "Policy Protect."

"Dispute Resolve" fully automates elements of the dispute process for both fraud and non-fraud related chargebacks. During the second quarter we meaningfully improved our user dashboard experience, increased the number of gateway integrations, and utilized Artificial Intelligence to automatically create and gather Compelling Evidence on behalf of the merchant. As a result of this automation, we expect our merchants to experience an uplift in dispute win rates, which ultimately is intended to lead to recovering more revenue.

"Policy Protect" uses our innovative AI clustering technology, layered on top of the power of our global merchant network of billions of historical transactions, hundreds of billions of data attributes, and repeat interaction histories for hundreds of millions of consumers, to help detect fraudulent refund claims and block serial returners in real time. Our internal research indicates that approximately 5 cents out of every eCommerce revenue dollar is wasted as a result of bad behaviors like these - which means that the total addressable market for Policy Protect may be in the hundreds of billions of dollars.

A great example of how merchants want to utilize Riskified to help solve this massive problem is exemplified by our second quarter cross-sell to an existing Enterprise level merchant in our electronics category. This merchant tasked Riskified with helping them solve abusive returns by blocking bad customers upon checkout - addressing a seven figure return problem for the merchant, or more than 10% of their returns. Since going live, this merchant has indicated that we've been successful in blocking excessive returns at check-out with up to 99% precision, a testament to the performance of the product.

We also further strengthened our core "Chargeback Guarantee" product in the second quarter. We deployed our first autonomously trained model, researched and trained by our engine, but this time, without data science intervention. We expect this model to allow us to make faster and more accurate decisions for our merchants. This is just a sample of the features that we have added this quarter. Continuous investments into our machine learning platform like this one further differentiates our offering, which we believe ultimately makes our technology and ability to drive great outcomes for our merchants even stronger.

I am proud of all of the enhancements and features that we have rolled-out in our platform. Just as we pioneered the way that eCommerce fraud was managed 10 years ago with "Chargeback Guarantee", we aim to innovate the way merchants look at the overall eCommerce customer experience, from checkout to dispute, with our full tech stack.

And finally, we recently passed the two year anniversary of our IPO. Over that time we have continued working towards positioning our company to be more efficient and productive, while staying focused on delivering value for our shareholders.

We improved our year-over-year Adjusted EBITDA performance for the fourth consecutive quarter through consistent revenue growth and ongoing flattening of our expenses…flowing this leverage entirely through to the bottom line. As we anticipate approaching profitability on an Adjusted EBITDA basis in the fourth quarter of this year, and on a full year basis in 2024, we have determined that now would be the right time to allocate some of our capital towards share repurchases.

We have a strong balance sheet, a large and stable cash and deposits position of approximately $480 million, and zero debt. At this time, we believe that both the company, and our shareholders, would benefit from opportunistic share repurchases. As a result, today we've announced our Board's authorization of a share repurchase program of up to $75 million, subject to approval from the Israeli court, which is necessitated by law. This court approval process is expected to take several months.

We believe that our company is undervalued, with our cash balance currently comprising approximately 65% of our market capitalization. To us, this represents an attractive opportunity to repurchase shares, and ultimately increase the percentage owned by our current holders. In addition, we intend to continue managing the business with discipline to further reduce dilution and share-based compensation from current levels.

Additionally, even with this authorization, we believe that we have ample capital to pursue opportunities to continue to execute on our business objectives and strategically invest in the future of the company while pursuing profitable growth. We are laser focused on delivering for shareholders in the near and long-term.

Now, I will turn the call over to Agi

Aglika Dotcheva
Chief Financial Officer

Thank you Eido, team, and everyone for joining today's call.

Our GMV for the second quarter was $31.0 billion, reflecting a 22% increase year-over-year.

We achieved strong second quarter revenue of $72.8 million, up 21% year-over-year, which represents an acceleration from our first quarter growth of 17%.

Our growth in GMV and revenue during this quarter was primarily driven by the continued expansion of our platform across new merchants and upsells. We also experienced revenue growth across all geographies.

"Tickets and Travel" remained the largest category, and grew approximately 50% year-over-year. Going forward, as we now have fully lapped COVID related comparable periods, we expect a more normalized level of growth in this vertical for the remainder of the year.

Encouragingly, during the second quarter AND for the first time in several quarters, the overall business outside of "Tickets and Travel" has resumed contributing to our growth. And while too early to tell the ultimate trajectory, we are excited about the positive impact we have seen this quarter.

Similar to the first quarter, one of our largest categories, "Fashion & Luxury Goods," was close to flat year-over year in the second quarter, as compared to the growth that we saw in this category in 2022. For the second quarter in a row, we have seen softness in some of our same-cohort merchants within this category, in particular within our luxury brands and sneakers sub-segment.

Finally, from a geographic standpoint, the U.S, our largest region, grew by 18%, which was the highest level of growth seen in several quarters. EMEA grew 20%, and the Americas and APAC grew 35%, and 44%, respectively during the quarter. Our continued revenue growth from regions outside of the United States further demonstrates the positive returns from our previous investments, and market share gains.

Moving on to gross profit margin, our non-GAAP gross profit margin for the second quarter of 2023 was 52%, consistent with the second quarter of 2022.

Several weeks ago we became aware that one of our largest merchants was experiencing a significant fraud event.

Based on the information currently available to us, we anticipate an incremental impact of approximately negative $3.8 - $4.8 million dollars on our third quarter gross profit.

We have been working closely with this merchant to remediate the issue. Based on the information currently available to us, we believe that the impact on our gross margin is contained.

Outside of the impact of this merchant fraud event, we are encouraged by our gross margin performance, and have improved our fourth quarter gross margin outlook accordingly. However, as a result of this merchant fraud event, we now anticipate that our annual gross profit margin will be in the range of 50.0% to 51.5%. As a reminder, gross margin is best analyzed on an annual basis as gross margin may fluctuate on a quarterly basis.

Moving to expenses. Total non-GAAP operating expenses were $42.2 million for the second quarter of 2023, a 6% decrease year-over-year and relatively flat with the first quarter of 2023.

Our absolute dollar expenses have remained essentially flat over the past four quarters and, our non-GAAP operating expenses as a percentage of revenue declined year-over-year, from 75% to 58% reflecting leverage in the business model.

We plan to continue operating the business with discipline - we are modeling approximately $84 million in second half expenses, with our fourth quarter expenses to be lower than the third quarter.

Adjusted EBITDA for the second quarter was negative $4.6 million, a 67% year-over-year improvement. We have meaningfully improved our Adjusted EBITDA performance on a year-over-year basis for the fourth consecutive quarter since making the decision to accelerate our timeline to reach profitability. As previously mentioned, we currently anticipate being profitable on an Adjusted EBITDA basis in the fourth quarter of 2023, and on an annual basis in 2024.

Moving to the balance sheet.

We ended the second quarter with approximately $480 million of cash, deposits and accrued interest on the balance sheet, and we carry zero debt. This amount represents a slight sequential decrease in cash, deposits, and accrued interest.

We remain confident in the business's ability to generate positive cash flows over the long-term, and we continue to believe that our balance sheet and strong liquidity position are underappreciated assets.

In terms of our outlook, we are updating our 2023 guidance that we previously shared on our Q1 call.

Assuming no further material changes to the macro-environment, we now anticipate revenue between $298 million and $303 million for the full-year 2023, or $300.5 million at the midpoint.

We continue to believe that our full-year Adjusted EBITDA will be between negative $17 million and negative $12 million.

We continue to approach our guidance responsibly. We will continue to monitor the performance and health of our merchants, consumer spending, the broader eCommerce landscape, and the impact on our results.

Overall we are pleased with our strong first half of results amidst a continued challenging macro-economic landscape. We remain excited about how we are positioning our business, the continued prospects for long-term growth and our ability to deliver value to shareholders.

Operator, we're ready to take the first question please.

Question and Answer

Brent Bracelin
Piper Sandler

Great to see continued strength in tickets and travel. I guess I want to double-click into the base business. It sounds like base, particularly in travel return to growth. What are the factors that drove a return there? Are you just seeing a broader diversified base? Is it the top 3 merchants coming back? Any sort of additional color on the recovery you're seeing in the base to travel.

Aglika Dotcheva
CFO, Riskified

Of course, Brent, thank you for the question. So we're encouraged by what we see in travel and the overall continued strength in consumer spending and moving towards spend on experiences. Specifically about travel, what we're seeing is that international travel is growing very nicely. It's better than domestic. And lastly, it's really the number of transactions that have been increasing very positively, not so much like the price level. That's kind of the nuances, a lot of travel, outbound travel outside of the US, Europe and APAC in particular.

Brent Bracelin
Piper Sandler

Totally makes sense. And then what about the base business? If I exclude tickets and travel, what's driving the base business ex travel to return to growth?

Aglika Dotcheva
CFO, Riskified

Sorry, I didn't understand. So outside of travel, we've seen some of the continuation of the trends from Q1. We've seen some softness in high-end fashion and the segment of sneakers, but we're seeing some positive trends around food and specifically around home as well. So all in all, I see the higher not as high, but also the lower [declines]-- much better. So I would say, overall normalization. And for the first time, like this quarter, I'm very encouraged by seeing that we've been growing in aggregate in all the industries outside of travel.

Brent Bracelin
Piper Sandler

Helpful. And then maybe Eido, could you just spend a little time talking about the merchant Summit? I know it's a small summit, but I imagine some of your largest merchants were there. Walk us through what the pain points are out there, what's the feedback on the product? What's the feedback on policy Protect? Would love to get any sort of like real-world insights given that was a relatively recent event and you talked to your largest merchants.

Eido Gal
CEO, Riskified

Sure. Happy to provide more context there. So look, I think we are in a unique position that we work with some of the largest enterprises, and we've been fortunate that because of our relationship, we have a good relationship with some of the C-level executives, and they joined us for 3 days for the summit, and we were able both to present, let's call it, our immediate kind of 18-month road map to them to collect feedback and have them involved and say, "Hey, this would work for my business. This would not work for my business," but also really understand their pain points and strategic goals for the next 18- to 36-month road map.

And I think really across the board, the issue of policy, how do we make sure that we're selling to our best customers and give them the best experience while making sure that we're not spending too much money on shipping, logistics, reverse logistics, coupon codes on our low LTV or kind of bad customers was a consistent theme. And it's definitely something that strategically touches a lot of points in the organization. So having these senior leaders involved in crafting the solution and understanding their pain points, we think, is incredibly beneficial.

Will Nance
Goldman Sachs

I wanted to follow up on the merchant fraud event that you called out. I wonder if you could provide a little bit more color. Was this a different sort of event than you guys typically see in the business? How long did it take you guys to catch it, that sort of thing? And I guess, just like looking forward, you mentioned some innovation on the model front. Just one, is it something you can kind of learn from and factor into future models and roll out to the broader customer base?

Eido Gal
CEO, Riskified

Well, sure. It's an important question. So let me give a kind of a wide answer here. So really, what happened is, I would say, a confluence of 3 main things.

Number one, this was one of our largest merchants.

Number two, we had recently signed an agreement to target a higher approval rate for a higher fee.

And number three, as we started ramping up approval rates, there was a large fraud attack targeting this merchant.

Now when we increase approval rates, there is some anticipated risk within the account. Unfortunately, the mistake that we made is that we could not correctly categorize some of the new risks coming from the fraud attack. And that meant that we underrepresented the overall risk level of the account. So we actually did identify the fraud attack relatively quickly. But because we misunderstood the fraud level in the account, the mitigation strategy wasn't quick enough or severe enough to really stop the attack, and you can see the financial impact like Agi shared. Obviously, we're very frustrated and disappointed with the outcome. This is the single largest monetary event in the 10 years since risk has existed in the 5 years that we've kind of published audited financials. This is the first time that we've had to move down the annual gross margin guide. And I would say that some of the immediate steps we're taking to make sure that something -- that this or something like this doesn't happen again is:

Number one, just more on the operational side, which is a bit simpler, making sure we're not managing accounts that have multiple events happening at the same time, like a change in approval rates and a fraud events.

Number two is more around the modeling side to make sure that we're able to better differentiate the risk from different factors in the account like related to approval rates, related to the fraud attack.

And number three is just making sure we have a high reliance on quicker signals about the changing risk levels of the accounts so we can make changes even sooner than we are.

I do want to highlight that this is a contained event. We don't think that there's any additional impact to Q3 margins. There's no forward-looking impact, right? So it's not going to impact Q4 '24. And again, this is frustrating because outside of this, we do think that the business is performing very well. The new revenue, the platform side, the OpEx piece and flowing that through with full leverage. And it is frustrating because obviously, without this, we would have been able to improve the adjusted guide to not keep it as is like we did for now. But look, overall, we are encouraged with the modeling performance in the system overall. We have been able to increase our Q4 gross margin guide, and we think that's a better indication of the overall trajectory of the business.

Will Nance
Goldman Sachs

Got it. I appreciate all the color. And maybe just a follow up on the capital return announcement. It sounds like we've got a little time before that gets approved by local authorities. But just wondering if you could kind of talk through how you're thinking about the level of share repurchases into 2024 and how you're thinking about alternatives to share repurchases, such as M&A and how that might factor into the amount that ultimately gets done?

Aglika Dotcheva
CFO, Riskified

Yes, sure. So I'll start, and maybe Eido will add a little bit. So we've already got an approval by the Board, and we are in the process of submitting to the Israeli regulation and authority. Our request for approval is just something that we need to go through. I'd expect it will probably take like 2 months or so. And by the end of the year, we should be able to start the program. and execute throughout 2024.

Eido Gal
CEO, Riskified

Yes. I would say from our perspective, look, we have $480 million. We're approaching profitability. So we definitely feel that even with the $75 million share repurchases, it is not impacting in any way, shape or form or ability to strategically look for M&A opportunities. Obviously, internally, we feel that we're making a lot of smart investments, profitable investments to the growth of the company. So this isn't impacting that as well.

Ramsey El-Assal
Barclays

I wanted to ask a bit about your kind of Q2 take rate. I saw it come in slightly compared to last quarter in the previous year. Just wanted to get some color on that. I was wondering if you maybe kind of pass along a little bit more value to customers as you achieve scale? Or maybe there's some cyclicality in the quarter. Just anything to consider there would be helpful.

Aglika Dotcheva
CFO, Riskified

Thank you for the question. [So on the take rate] they are more of an outcome of the model than really kind of analytical inputs. There's a number of factors that can influence them in any given quarter. This is the amount of new revenue and upsell that we're adding in the different weights of different industries, the different mix and performance of different merchants. So all in all, I expect no considerable changes. It's always a little bit in and out, but I don't expect huge fluctuations based on that.

Ramsey El-Assal
Barclays

Understood. I appreciate that. And then I was wondering if I could follow up with some of the geographical expansion that you're kind of seeing, you called out APAC, Europe and Canada in this quarter. I was just wondering which one of those regions is sort of the largest opportunity from a geographical perspective that you're currently seeing?

Aglika Dotcheva
CFO, Riskified

I would say APAC is definitely a large opportunity for us, we've shown consistent growth in the last couple of quarters. But overall, I say that we have a lot of room for penetration in our geographies - proof of this was seen in some of the growth that we've currently seen. Also have [room] in the U.S., which is our largest geography as well.

Eido Gal
CEO, Riskified

Yes. Maybe just to expand on that. I mean, when we think just about the growth opportunities, it's a combination of some of the new products that we outlined, which are at a very early stage, so that has a lot of opportunity globally. But also just thinking about core charge-back even in the U.S. and Europe, we still think it's relatively low penetration, but obviously, outside of that APAC and LATAM, the growth is both faster and the penetration lower. So we think there's a lot of opportunity there.

Tim Chiodo
Credit Suisse

You recently announced a chargeback guarantee integration with commerce tools, which has some impressive large retail clients and know you have partnerships with other major e-commerce platforms. Can you maybe expand more on this distribution channel in terms of maybe how the economics differ from a direct go-to-market strategy and generally what the mix of new client wins looks like between the partnered and direct models.

Eido Gal
CEO, Riskified

Sure. Happy to expand on that. You're right. Also in our partnership strategy, we continue to target the larger merchants and we do that either through integrated partnerships or more referral-like partnerships. The economics for us, I would say that overall, they tend to be similar. You're just shifting some of the economics away from internal sales and marketing towards the more partner as a broad generalization.I think with the commerce tools having just announced that it's still early days of that specific partnership. But we are encouraged by the overall size of demand and how it helps us expand our reach.

Tim Chiodo
Credit Suisse

Great. And then just had a quick follow-up on travel taking has recovered nicely over the past year and it's definitely been a tailwind in some of our spreads growth recently, but wanted to dig in more into growth expectations ex travel and no risk of supports more discretionary verticals and you guys discussed the return to growth for some of these in this past quarter, they definitely have been macro impacted. But generally, on a more normalized basis, how do you see risk office merchant mix ex travel growing compared to industry e-com growth rates in the future?

Aglika Dotcheva
CFO, Riskified

Yes. So overall, the trend is that for this year the lowers are just better compared to last year. We've seen some normalization. I would say that overall, it's still -- as an aggregate, they're all contributing to our growth. But primarily, what is really happening is that our continued addition of new business is able to kind of negate some of the negatives from the same cohort growth. And over time, I expect this to continue to normalize, but we're not there yet.

Bob Napoli
William Blair

Thank you. And so I guess, maybe a little bit more color on the international business versus the U.S. business. I guess international was about 37% of the business last in 2022. So can you -- how is that international business different than the U.S.? Is there -- I mean we think there's more fraud internationally. Did that $3.8 million come from the international business? How does the economics of the international business look versus the U.S?

Eido Gal
CEO, Riskified

Bob, thanks. I'll take that one. So I think you're right. We are seeing faster growth in some of the newer regions, which would be kind of APAC, LATAM, our more established geographies would be both the U.S. and Europe, specifically kind of talking about the fraud event just because of different sensitivity and price reasons, I wouldn't want to get into the specifics of the merchant, but it's actually considered a safe category, and it's more U.S. domestic, so no international impact there.

Bob Napoli
William Blair

And the economics of the international business versus the U.S.?

Eido Gal
CEO, Riskified

I don't think I have anything meaningful to call out there. We think that broadly on an aggregate, we should be seeing similar things.

Bob Napoli
William Blair

Okay. And then the pipeline, it sounds like you added a lot of business. You said the pipeline has grown. Can you give some color on like the ARR added in the quarter, the number of new customers? Or just any color on that pipeline and how -- what you added in the quarter and how that pipeline has grown?

Eido Gal
CEO, Riskified

Yes. I would say, look, I think that Agi shared that most of the growth that we're experiencing is coming from our new and upsell business, and that they've been performing better than anticipated relative to kind of our internal projections and just ending in a better place. The number of logos that we've added in the first half is higher than last year. So we think overall, the trajectory is great, both in the additions, the revenue, the number of logos and the pipeline generated.

Terry Tillman

Truist Securities

Kind of building on the prior question, in terms of, I think, 8 of the top 10 new merchants were added outside of the U.S. Do you expect that kind of mix or dynamism to continue over the next couple of quarters? And if you had to kind of dig into maybe some of the traction with these new logos coming internationally, is it the go-to-market enhancements over the last year, key new sales talent, maybe the Deloitte relationship. Anything more you can kind of double-click into maybe rising above the other drivers? And then I have a follow-up for Agi.

Eido Gal
CEO, Riskified

I think it's hard to crystallize it into one thing. I think it's a confluence of factors. I think the go-to-market team and Ravi, who joined us last year to lead them, have been executing well with the new appointment of our new CMO, Jeff, as well has also been helpful in driving great outcomes and behaviors within the teams and the team members themselves. Obviously, you deserve most of the credit.

But it doesn't happen in isolation. I think a lot of the product enhancements that we've been making, whether it's kind of the more platform sale, that's also wider range of problems or the continued improvements to the core chargeback guarantee model, which just means that the outperformance of using risk of is greater than the internal team, maybe the current environment where merchants are just more focused on cost savings. So again, I think all of that is overall helping us with the demand environment and driving more growth there. And it's hard to pinpoint how much each of these factors I outlined is responsible for that.

Terry Tillman
Truist Securities

Understood. I guess, Agi, just a follow-up. I think you had remarked 50% to 51.5% gross margin for the full year. Do you foresee us into '24 and beyond getting back to that kind of consistent pattern where gross margins to expand a little bit. So whether it's the autonomous train models or platform enhancements, just the technology bringing to bear on improving margins next year at the gross margin side?

Aglika Dotcheva
CFO, Riskified

Yes. Just as Eido mentioned earlier, we are increasing our gross margin for Q4, and this is obviously like a reflection of some of the improvements that we're doing internally and an overall basis continue to improve our cohorts going into next year, I think we're well positioned, and I do expect to continue to build on that.

Eido Gal
CEO, Riskified

Thank you, everyone, for joining us. We look forward to continuing to update you in future quarters.