

Coinbase Global, Inc.
Second Quarter 2021 Earnings Call
August 10, 2021

Anil Gupta, Vice President, Investor Relations

Good afternoon, and welcome to the Coinbase Second Quarter 2021 Earnings Call. Joining me on today's call are Brian Armstrong, Co-Founder and CEO, and Alesia Haas, CFO. I hope you have all had the opportunity to read our shareholder letter, which was published on our Investor Relations website earlier today.

Before we get started, I'd like to remind you that during today's call, we may make forward-looking statements. Actual results may vary materially from today's statements. Information concerning risks, uncertainties and other factors that could cause results to differ from these forward-looking statements is included in our SEC filings and shareholder letter available on our IR website at investor.coinbase.com.

Our discussion today will include references to adjusted EBITDA, a non-GAAP financial measure. We believe that certain non-GAAP measures of financial results provide useful information to management and investors regarding trends relating to our financial condition and results of operations. Non-GAAP financial measures should be considered in addition to, not as a substitute for, or in isolation from GAAP measures. You can find additional disclosures regarding adjusted EBITDA, including a reconciliation to net income, the comparable GAAP measure, in our shareholder letter and current report on Form 8-K, which are posted on our IR website.

Similar to last quarter, we are using Say Technologies to enable all Coinbase shareholders and analysts the opportunity to submit and upvote questions for our management team. We had several thematic questions, so I'll summarize some of them. With that, let's go ahead and get started.

So Brian, Q2 was a strong quarter for Coinbase. What trends do you think are most important to highlight to our investors?

Brian Armstrong, Co-Founder & CEO

Thanks, Anil. So you're correct. So Q2 was a really a strong quarter for us. We had amazing growth in terms of users added to the platform, assets on the platform, revenue, just about everything. And also great diversification across our revenue lines and users.

So this is really good to see more and more people are using crypto and using the cryptoeconomy, individuals, businesses, developers, all over of the world. Now it's important to remember that just because we had a strong quarter, we at Coinbase always think about longer-term cycles of crypto. This is a theme you're going to hear us talk about a lot here on these earnings calls. So we don't try to get too excited about any particular quarter being up or down. We're always looking at the long-term trends about how are people using this new technology, how is the cryptoeconomy growing and how is that eventually influencing our mission of creating more economic freedom in the world.

So, the question asked about trends as well, there's really two that came to mind for me that I think were really important in the last quarter. The first one, is that we're continuing to see this trend of people using crypto for more and more things beyond trading. So for example, we shared in the letter that we now have 1.7 million users doing staking in crypto, which is a way to earn yield on your assets. And this is up from -- basically, that number was probably zero a year ago. I think if you go back to 2019, late 2019, we had less than 1 million MTUs on our retail side for Coinbase in total. And now we have 1.7 million just doing one type of activity that is staking. So we're seeing people do more and more things with crypto, whether that's earning money with

crypto, borrowing and lending, staking, using Coinbase card and then, of course, trading. And so I think we'll continue to see that percentage go up over time, which is great. That tells us that a truly a cryptoeconomy is forming, it's not just the trading platform.

And then the second big trend we're seeing is this idea of Coinbase embracing decentralization. And I wrote a blog post about this. Really, what this means for us is that we believe the future of this industry is going to be decentralized.

There's going to be more third-party apps that are being created where people want to connect their wallets to it and Coinbase is their primary financial account so we need to make it easy for people to connect to and integrate with all of these third-party apps out there that are happening, NFTs, DeFi and there's hundreds of crypto startups now being built.

We're also focusing on international expansion - another form of decentralization - and just listing more and more assets. We want to be the Amazon of assets, list every asset out there in crypto that's legal. And there's thousands of them today, there's eventually going to be millions of them. These are -- this is the all into the theme of embracing decentralization. So those are the two big trends that I'm seeing today.

Anil Gupta, Vice President, Investor Relations

Great. Thanks. And Alesia, could you recap the financial highlights before we dive into investor questions.

Alesia Haas, CFO

Thanks, Anil. Second quarter was a strong quarter for Coinbase. To just elaborate on some of the things that Brian just spoke about, we saw user growth across the board with our retail MTUs, institutions and our ecosystem partners.

The metric that we really focus on is what percent of our retail MTUs are now using multiple products on Coinbase. And in Q2, this grew to 27%, up from 25% in the first quarter. What's really notable to me though, when I look at this number is the growth in the underlying MTUs and how many users we now have using multiple products on our platform. Brian shared we have 1.7 million users staking, but we also saw 2.3 million users engaging in an earn campaign during the quarter.

Separately, on our institutional side, we're seeing broad adoption. One of the things that we highlighted for you all is that we now have 10% of the top 100 hedge funds measured by AUM, now clients of Coinbase and engaging with the crypto economy.

Just like Brian shared a few years ago, where we had very few MTUs like a year ago, very few stakers. About a year ago, hedge funds weren't participating in crypto. This is really a new theme that we see where more and more hedge funds are making allocation to the crypto economy and engaging in multiple assets on our platform.

Combined, our users generated \$462 billion of trading volume, which led to \$2.0 billion in net revenue and \$1.1 billion of adjusted EBITDA. We were also pleased to see the growth in our subscription and services revenue, which totaled \$103 million in Q2, roughly 5% of our total revenue.

I want to take this moment just to remind everybody that crypto asset prices and volatility heavily influenced our transaction revenue. And these inputs continued to be volatile and very hard to forecast. We do not

extrapolate our quarterly results. We shared our current outlook of potential future full year 2021 scenarios with you in our shareholder letter, and we believe that any of those outcomes are possible for the full year.

Anil Gupta, Vice President, Investor Relations

Okay. Great. Thanks. So let's now turn to the questions that we've received from our analysts and investors through the Say Technologies platform. We had several questions centered around the regulatory landscape from our analysts. So, Will Nance at Goldman Sachs, Sean Horgan at Rosenblatt, Rich Repetto at Piper Sandler, Lisa Ellis at MoffettNathanson, Harshita Rawat at Bernstein and Patrick O'Shaughnessy at Raymond James, all asked about this topic. So Brian, let's start with your view on the current regulatory environment. What kinds of proposals or actions do you view as likely coming off of the recent events and commentary? And how should that be viewed for the industry overall? What does it mean for Coinbase relative to perhaps less conservative competitors?

Brian Armstrong, Co-Founder and CEO

Yes. So the regulatory environment has been super interesting recently, if you've been following along in the news and on social media, just recently with the Senate vote on the language in the infrastructure bill, which has kind of gotten a lot of attention.

So a couple of things that I've taken away from this, I mean the first one is that, the crypto community has really kind of come out as a powerful constituent, which has something like on the order of 20 million people in the U.S. who have crypto, we don't know exactly, but they're now actually becoming a vocal participant in the policy efforts around the U.S., and I think that's going to happen around the globe eventually.

And the other thing is that there's still a really big gap in understanding. We're seeing a number of our policy makers out there go to bat, really for the crypto community, and understand the potential of this technology, and what it can do, and others who still have quite a bit of skepticism or just frankly, a lack of understanding.

And so just like with the birth of the Internet, I think there's a huge opportunity here for governments around the world to benefit from the economic growth and the innovation that could happen with crypto. But of course, some of the risks need to be mitigated and that's just an opportunity for us to go out there and educate.

So what is Coinbase doing? Well, really from the earliest days of Coinbase when it was founded, we made this decision that, we wanted to go out there and be an educational resource with regulators, and folks in government, try to be the most trusted crypto company out there and really invest in compliance have that kind of tone from the top. And we felt like that was a more difficult path to go on, but it was the right long-term approach that would pay dividends. And really be a business enabler for us.

And so, we've continued that approach. We're doing that in a variety of ways. We just recently hired Faryar Shirzad, who is the former -- he's our Chief Policy Officer and was previously the co-head of government affairs at Goldman Sachs. And he was also a White House National Security Council member. So that's been great, he's building out his team, as you can imagine, just having started, he's quite busy these days.

We're also investing in something called the Crypto Council for Innovation, which is an advocacy group that a number of other companies in the industry have come together on. And we're using that as a vehicle to kind of go out there and educate. And so, I think we've always welcomed sensible regulation in this space. We basically just want to be treated on a level playing field with any other traditional financial services companies out there.

And I think unlike maybe some traditional tech companies that sort of have waited for something bad to happen, then they like reluctantly go engage with the government. I think we view it as our role to kind of go out there proactively, before a kind of issue comes up, did that educational resource and kind of advise world leaders and finance ministers on how they can adapt their economies to capture the opportunity of [inaudible] with the crypto economy.

Central Bank Digital Currencies are a hot topic. Competitiveness with China, who's really kind of taken a lead on this, and so it's about shifting people's mentality from thinking about crypto as a set of risks they have to deal with, to thinking of it as an opportunity. And yes, we can mitigate those risks, but that's actually not the most important thing in front of us. So that's what we're doing on the policy side.

Anil Gupta, Vice President, Investor Relations

Okay, great. And as a follow-up for Alesia, lending, in particular, seems top of mind, not just for SEC Chairman, Gensler, but for states as well that have taken action against other companies. Could you talk about what types of lending activities Coinbase is currently engaged in? And what concerns do you have around scaling these efforts while also remaining compliant with any forthcoming regulations?

Alesia Haas, CFO

Thanks, Anil, great question. So we began to build out a robust financing business. Today, we offer bilateral lending and post-trade credit to our institutional clients. On the retail side, our retail bore product has seen growth. And we now enable our customers to borrow up to \$100,000 against their crypto holdings.

These products are offered through Coinbase Credit, under our state lending licenses that we have. It's important to note that today we lend funds off our own balance sheet. We are paying careful attention to SEC Chairman Gensler's public statements, and we're eager to understand the legal framework for the concerns that he has raised and how and if those may impact our product roadmap. As Brian said, we are engaging with staff and we reiterate our commitment to bring just the market reality to their attention and are looking forward to engagement with regulators to drive smart regulation, to provide the clarity, and to enable our product growth.

Anil Gupta, Vice President, Investor Relations

Okay. Let's turn to some questions that we received from our investors. We had a number of questions this quarter, including some of the top voted ones that deal with the topic of decentralization in applications like DeFi, NFTs, Web 3.0 and others. Brian, could you help our investors understand a bit more about that shift and talk about the investments coin-based is making here?

Brian Armstrong, Co-Founder and CEO

Yes, sure. So it's funny for a long time, Coinbase was founded probably about nine years ago, and people would always ask me kind of what -- where are the use cases, aside from trading? And the good news is that we're now seeing tons of use cases pop up in crypto. Some of them were mentioned - DeFi, NFTs and all the third-party dApps or the Web 3.0 concept. There's literally hundreds of start-ups out there being funded by top-tier VCs with really great founding teams. It's kind of like basically the dotcom start-ups of the Internet era. And so, there's tons of use cases out there that are being created.

With Coinbase as the primary financial account for many of these people participating in the cryptoeconomy, they, of course, want to take those assets they're storing with us and go use them with all these different new applications out there, these third-party applications. So what do we need to do to make sure we can enable that? Well, with Coinbase wallet today, which is our self-custody app, you can go participate in all these things,

DeFi, NFTs, third-party applications and a number of our customers are taking advantage of that. But how do we bring that functionality to the main Coinbase app, the one that has the majority of our users? Well, that's the next thing that we're working on.

And so, we're doing that with a kind of crypto app store, if you will, that can be built right into the app. We're also doing some work to re-architect our hot wallet using a technology called MPC or multi-party computation, which is going to make our hot wallet compatible with these dApps or third-party applications. So there's some really important engineering architecture work happening there.

And just the concept of embracing decentralization is bigger than just NFTs or DeFi or whatever the hottest thing is that's happening this month in crypto. It's also about us embracing a global mindset. We are trying to build a company that enables people all over the world to access the cryptoeconomy. So, we're doing a lot of effort in international expansion.

It's also about enabling all the new assets that are being created in crypto. Like I mentioned earlier, we really want to be the Amazon of assets. We actually added 22 assets in Q2, which was great. That was the most we ever added in the quarter. But we need to keep scaling that. I think there's eventually going to be millions of crypto assets out there. You can imagine that there's going to be a crypto asset for every crypto startup that wants to get created and who wants to raise money or every kind of individual might create a coin or there's NFTs and so many new assets being created that we eventually need to support millions of these. And so there's a lot of work going into how we scale that process internally and manage, we're ready for all of that growth.

Anil Gupta, Vice President, Investor Relations

Great. Switching gears a bit. We got a question about asset listings. So Sean Horgan over at Rosenblatt Securities asked about engagement and activity on Coinbase after the introduction of DOGE last quarter and how that approach has -- if that approach has changed as we look at new assets. And Brian, could you just overall expand on our approach to asset listings in general?

Brian Armstrong, Co-Founder & CEO

Yeah. So no major changes as a result of that asset listing, but that was one of the 22 that we did in Q2. I mean our overall approach is we're agnostic about which assets are going to win. We really just want to support every asset that's legal for our customers. And we have a very rigorous process we've created on the compliance and the legal and the cybersecurity evaluation of these assets to make sure they comply with those standards. But once we get comfortable with that, we want to list every asset that meets the listing criteria.

Bitcoin and Ethereum still make up about 50% of our trading volume. And the other 50% is kind of the long tail of all the other assets that we support. No single one of those long tail assets accounts for more than 10% of our trading volume. So it's really starting to become quite a diverse set of assets out there. And in any given week or month, there's something interesting happening in one of them and it tends to trend up or down. So we never know which one is going to be the active one that week, but we need to know -- we know that we need to support the entire ecosystem of assets out there for our customers.

Anil Gupta, Vice President, Investor Relations

Great. Brian, several shareholders asked about our institutional business and how Coinbase's offering is not only differentiated relative to other service providers in the market today, but also how you believe the product evolves over time as more established players enter the space. Could you talk a little bit about that?

Brian Armstrong, Co-Founder & CEO

Yeah. Sure. So I'm really excited about our institutional product. And it's going super well. We've now basically become the dominant institutional platform out there. We're serving customers like SpaceX and Tesla, also PNC Bank, Third Point and WisdomTree. Alesia mentioned earlier, 10% of the top 100 hedge funds by AUM have now onboarded with our institutional product. And so we're just really excited about this product. The asset managers, corporate treasuries are now using this product, pension funds. So there, it's really quite a lot of adoption that we've seen.

And so the question you asked about why are they choosing Coinbase, what's defensible about it? So I think the main thing that's defensible is that we are really the fully integrated solution here, right? So people not only trust us to do custody and store crypto assets, but we also have our prime brokerage product integrated, so they have the full suite of products there in terms of our smart order router, which connects into more than 10 venues to get best liquidity. We also have a number of products -- services for them like post-trade credit. If they want to be staking on those assets and earn yield or if they want to participate in the governance of some of these blockchains, these are all features that our institutional customers ask for. We've also integrated our market and on-chain data analytics products in a way that it's providing them a lot of value. And so, we basically have this one-stop shop where you can store your crypto, trade it, earn yield, do post-trade credits and things like that, they are needed all in one place.

I think it also really helps that we've established ourselves as the first public crypto company offering this kind of service. It's now larger companies are much more comfortable trading with us. And the work that we've done to create this product is really difficult. People sometimes don't realize that integrating with all these different blockchains, doing transaction monitoring for compliance, storing these private keys and material in a way that's distributed globally. So it has redundancy and consensus mechanisms, and it's audited and pen tested. This is all a really core differentiator for us.

And so, we're really -- the last part of the question really just asked about what's going to happen as more established players enter the space. I mean, first of all, I think we're really excited about that. We want every single financial services company out there to enter the crypto space because we believe this is going to be a huge part of the economy in the future, a substantial portion of global GDP. And so we want every bank and financial service company and fintech out there to integrate crypto, if they haven't started already, and many of them have. So I think this is partially a competition for us, but it's also partially an opportunity because one of the things we're building is called Coinbase Cloud, and this is kind of our AWS for crypto product. It's taking all those difficult things that we've had to build that I mentioned, integrating with blockchains and transaction monitoring and custody and everything and exposing those through APIs in a way that any third party can actually build on top of those services, those APIs to get to market faster. And we're seeing interest from a number of those financial service players, for instance. And so I think that we may have an opportunity to actually create a big business out of that as more and more people enter the space and not have it just be purely competitive.

Anil Gupta, Vice President, Investor Relations

Thank you. Alesia, investors often ask about our marketing efforts in the wake of the incremental investment we spoke about last quarter. Could you outline our marketing efforts and what they've looked like to date, what we've learned? And any clarification on the marketing strategy, for the remainder of the year and beyond for Coinbase?

Alesia Haas, CFO

Thanks, Anil. So yes, our marketing spend has grown and grew about 65% quarter-over-quarter. So we're definitely ramping up our efforts here. To date, our spend is primarily centered on paid media on digital channels. And we believe the step-up marketing was a key component of the growth of our MTUs this quarter. As we look forward though, we plan to really ramp up additional marketing investments in three ways: with the goal of driving brand awareness, growing customer acquisition and increasing our customer retention globally.

They're going to see us focus on scenarios of brand awareness like partnerships and sponsorships. We're going to look to new strategic channels and new venture channels for us, which could include TV or out-of-home also the digital space. These will be fundamentally new marketing channels for Coinbase, and we expect them to perform differently than the optimized core performance marketing moves invested in to date. What we're looking to do here is test. We need to learn and iterate to get the right balance between optimize and new channels to drive additional growth and return on our investments over time. We believe all these new investments in brand campaigns and strategic and venture channels will drive the full funnel of customer growth and bring more and more people into the crypto economy, which is really our long-term goal of driving 1 billion people in the crypto and creating economic freedom.

As we look to the rest of the year in terms of spend, we've left our outlook unchanged, and we believe sales and marketing expense as a percent of our net revenue for full-year 2021 will range between 12% to 15% of our net revenue.

Anil Gupta, Vice President, Investor Relations

About half a dozen shareholders inquired about topics related to our capital allocation principles, how Coinbase evaluates investment opportunities, how we fund these opportunities? And ultimately, if and when capital may be returned to shareholders? Alesia, can you provide a framework for helping investors understand our approach to capital allocation?

Alesia Haas, CFO

Happy to. So we are a high-growth company, and we are in what we think of as the earliest days of a massive global opportunity to bring crypto to 1 billion people. As such, we think it's the best opportunity to put our capital to work in our growth flywheel for product development, to add users to our platform, to add new assets to our platform and build the exciting product roadmap we have. We invest this resource in a 70-20-10 framework. Thinking about 70% as a percent towards core work, 20% to strategic investments and then 10% to innovative new ideas.

We also think about investing both organically and inorganically, and we think about using our capital for the potential for opportunistic acquisitions in service of our product roadmap. When we think about the use of our cash overall then, it's to fund our operations, just core business operations. We also think of it for strategic purposes. And lastly, what we would think of it for investment cash. We're very mindful that crypto is volatile, and we want to ensure we have enough cash and resources to weather any prolonged crypto winter cycle and still be able to grow our business and execute on our business goals.

So as we said previously, we have no intention of any near-term return of capital to shareholders in the form of a dividend or share repurchase.

Anil Gupta, Vice President, Investor Relations

Okay. Thanks. Brian, customer service continues to be a hot button issue and a very important topic for many of our shareholders and consumers. What would you tell shareholders about the state of customer service at Coinbase? And what are we doing to address ongoing customer concerns?

Brian Armstrong, Co-Founder & CEO

Yes. Well, with all of this hyper growth happening in the last couple of quarters, you can imagine this has been a big focus for us. So proud to report that we are doing much better, but there's always more to do. We've increased the headcount 5x or so since January, beginning of this year working on support specifically. And so that means there's now more than 3,000 people dedicated to solving customer support issues. We're also rolling out live support for customers via chat and phone later this year in a more robust fashion. So some of these things along with our – just improving our education resources, making sure the help center is up to-date with all the latest features. These are all investments that are happening. And I think we'll continue to make progress there.

Anil Gupta, Vice President, Investor Relations

A few investors honed in on the consumer financing products we brought to market recently, like Coinbase Card and Bitcoin Borrow. Brian, can you talk about the vision for those offerings, early learnings from how consumers are engaging with them and how and when we intend to expand those programs?

Brian Armstrong, Co-Founder & CEO

Yes. Sure. So Coinbase Card and Coinbase Borrow are both examples of what we think of as expanding the crypto economy, right? It's this trend that we've talked about where crypto started off as something that primarily people were trading. And then they thought about what else can I do with this? Can I spend it? Can I get a loan? Can I earn money with crypto and participate in the crypto economy in a broader way, doing all those things people might do with money eventually.

So the Bitcoin borrow feature is a great way that we've allowed customers to secure a USD loan using the Bitcoin as collateral. And it's been great to roll our product out. Coinbase Card is allowing customers to actually go spend their crypto on a debit card anywhere that Visa is accepted. So one of our goals long-term is how do we get more and more commerce transactions for goods and services in the everyday economy happening with crypto. And there's a few things that need to get in place for that to happen. One is that you need to get the blockchains to be more scalable. And so there's some work we're doing behind the scenes on that. The other is that we need to get both a set of merchants and a set of consumers who both want to spend crypto. So that's kind of a two-sided marketplace, a chicken and egg problem. And so Coinbase Card is a way for us to dial-up one side of the two-sided market by allowing -- you don't need the merchant to specifically accept crypto. They can -- as long as they accept Visa, you can spend your crypto with them. So we'll dial up one side of the market, people spending their crypto. And once we get that to be larger, we can then go see who are the merchants accepting the most payments in crypto and then we can go direct to those merchants and say, hey, maybe want to think about accepting crypto directly and see what kind of fees you can set and things like that.

So that's a little bit of how we think about it. And it all fits broadly under this concept of how do we grow the crypto economy, how do we get people using crypto for more and more things, all the things they would use money for value for traditionally, but also probably some new ones, which are -- don't have a direct equivalent in the traditional economy.

Anil Gupta, Vice President, Investor Relations

Okay, great. I think we're going to have time for one last question here, which comes from Owen Lau at Oppenheimer about fees. Alesia, you mentioned before Coinbase doesn't compete on fees, but could you elaborate on our reported fees in Q2, as well as thoughts on both fees and spread going forward?

Alesia Haas, CFO

Yes. So you are correct. We have said before that we do not compete on fees. And instead of focusing on being the lowest priced platform, we focus on providing the most value to customers, through our custody, our security and storage, in addition to trade execution, which is critical for bearer instruments like crypto.

On the retail side, these services are bundled into our transaction fee. We're really competing though for these users based on the product suite, as we shared earlier, our users continue to further engage with the crypto economy, in non-trading products like, Staking and Earn, these types of services, new assets, new ways to engage with crypto are what attract users to Coinbase.

If you look at retail transaction revenue, relative to our retail trading fee -- sorry, volume, you will see that our weighted average retail transaction fees were 1.26%, as compared to 1.21% in Q1, driven by a mix shift between our customers. We saw more volume on Consumer versus Pro in Q2. I'd also remind investors we report matched volume.

On the institutional side, customers are choosing us for our deep liquidity and the integrated product suite that Brian spoke about earlier as well as our heritage of security and compliance. If you look at our institutional transaction revenue relative to our institutional trading volume, you'll see that our weighted average fee was 3 basis points, as compared to 4 basis points in Q1, driven by our tier-based pricing and the higher volume that we saw in Q2.

We haven't made any broad modifications to our pricing in some time, but we are constantly running pricing experiments and testing if there are opportunities to better serve different customer segments with different pricing models.

Anil Gupta, Vice President, Investor Relations

Great, well, thank you. And so with that, I think we're done. Thanks, everybody, for joining us on the call today. And we'll talk to you again next quarter.

Operator

And this concludes today's conference call. Thank you for participating. You may now disconnect your lines.