ShotSpotter, Inc.

Fourth Quarter and Full Year 2018 Earnings Call

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CONFERENCE CALL PARTICIPANTS

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PRESENTATION

Operator:

Good afternoon, and welcome to ShotSpotter's Fourth Quarter and Full Year 2018 Earnings Conference Call. My name is Matt (phon), and I'll be your Operator on today's conference. Joining us are ShotSpotter's CEO, Ralph Clark; and CFO, Alan Stewart.

Please note that certain information discussed on the call today will include forward-looking statements about future events and ShotSpotter's business strategy and future financial and operating performance. These forward-looking statements are only predictions, and are subject to risks, uncertainties and assumptions that are difficult to predict and may cause actual results to differ materially from those stated or implied by those statements. Certain of these risks and assumptions are discussed in ShotSpotter's SEC filings, including the registration statement on Form S-1.

These forward-looking statements reflect Management's beliefs, estimates and predictions as of the date of this live broadcast, February 19, 2019 and ShotSpotter undertakes no obligation to revise or update any forward-looking statements to reflect events or circumstances after the date of this call.

Finally, I'd like to remind everyone that this call will be recorded and made available for replay via a link available in the Investor Relations section of the Company's website at ir.shotspotter.com.

Now I'd like to turn the conference over to CEO, Ralph Clark. Thank you. You may begin.

Ralph Clark:

Thank you for joining us to discuss our 2018 fourth quarter and full year results. This quarter was an exceptionally strong finish in a transformative year for ShotSpotter. Q4 2018 revenues grew 49% to $9.7 million, which was beyond our expectations. As our guidance predicted, we achieved our first ever quarter of GAAP profitability. We couldn't be more thrilled that we earned $302,000 of net income, or $0.03 per share.

Alan will provide more of the specific details around the quarter and the year, so I want to review our progress and achievements through the lens of our full year 2018 execution. Revenues for 2018 increased 46% to $34.8 million. This was driven by a solid deferred revenue position and strong renewal execution, along with 168 square miles going live in the year. This includes 24 miles going live with zero miles of attrition this quarter. As we said before, deploying new miles can be uneven on a quarterly basis throughout the year. As we ended 2018, we were deployed in over 640 square miles, up 35% from 2017.

We now have deployments in 95 cities at year-end, including the addition of two new cities this quarter, Bridgeport, Connecticut and Little Rock, Arkansas. Some notable new cities added to our customer roster this year, include Baltimore, West Palm Beach and Jackson, Tennessee, among others, just to name a few. We've also expanded deployments in nine cities and reached a three-year agreement with Chicago worth approximately $23 million. ShotSpotter is also now deployed on 10 campuses and other sites, such as our highway deployment in Richmond, California.

We are very excited to have completed our first acquisition as a Public Company with the purchase in October of HunchLab, now rebranded as ShotSpotter Missions. We believe this puts us at the forefront of the nexus of predictive analytics, artificial intelligence and precision-policing. We are pleased with the early positive feedback from current ShotSpotter Flex customers and prospects as we build our deal pipeline. We see Missions as a critical platform extension for our solution with the potential to become over the long-term a growth and margin driver for our business. Missions will be an important focus for us this year as we invest to extend its market penetration and broaden its capabilities.

Our larger platform strategy ties directly to our increased investment in marketing this past year. We hired Sam Klepper as our Senior VP of Marketing and Product Strategy, and have further expanded the marketing mandate to be able to execute on our product roadmap strategy, as well as develop new lead generation programs. The goal of these new lead-gen programs is to drive and qualify new leads at a faster rate, accelerate the sales cycle for existing prospects and free up critical bandwidth of our direct sales team. These programs include engaging directly with communities and cities that have significant gun violence issues.

In fact, we saw a recent example in Pleasantville, New Jersey of how citizens can drive the adoption of ShotSpotter. On Election day, 70% of voters approved a small municipal tax to fund the ShotSpotter deployment, covering 90% of the city. Pleasantville was the first municipality in the country to put a ShotSpotter tax measure on the ballot, which we believe is a strong statement about how community members value the safety our solutions can help bring to their city. Our marketing efforts are also focused on creating a conversation around the impact of gun violence, with leading trauma care hospitals. We believe that working with hospitals directly not only creates an opportunity to improve gunshot wound victims' outcomes, but it can also help generate strong advocates and possible new funding streams for ShotSpotter deployment.

We also expanded our sales reach this year by executing a reseller agreement with Verizon to sell our Flex product, augmenting the Smart Cities initiative that we already have in place. We have completed the training of the Verizon sales force and put in place a monthly sales team check in and deal pipeline process review. We see this collaboration as having an important and longer-term impact on our existing sales efforts and hope to begin to see initial traction in late 2019, helping us drive to our goal of adding approximately 100 new customers to our platform over the next four-plus years.

We also added resources to our international sales efforts and expect to see additional international revenues near the latter part of 2019. Indeed, our international expansion is already underway with the recent announcement of a new contract with the Bahamas. While progress across the business and the Company's financial success are very important, the reason we come to work every day is the positive role we have played in helping our customers reduce gun violence in their communities.

Not only do larger cities like New York City and Chicago benefit from ShotSpotter's gunshot detection technology, as a critical factor in the reduction of gun violence, but so do mid-sized and smaller cities. For example, Bakersfield, California with a population of approximately 380,000 went live with ShotSpotter in March 2018. In the first nine months of use, the Bakersfield PD identified over 300 gunshot incidents that they wouldn't have known about, made 30 arrests and seized 27 guns. Overall, the city saw a 13% reduction in gun assaults, while ShotSpotter was active at Bakersfield in 2018.

With our solution directing police to the precise location of gun crime, physical evidence can be more readily collected and witnesses can be located and interviewed. Our forensic data has been used in over 100 criminal prosecutions throughout the United States, and in 2018 alone, ShotSpotter expert witnesses have testified 25 times in support of their forensic findings.

Forensic services will be an increasing area of focus for us in 2019, as we make investments to expand the applications for our unique data. It is still in the early days for this part of our strategy, but look for further progress as the year unfolds as we continue to work to expand both our product portfolio and our addressable market. Yes, we are still very much in the early days of addressing the US market with our core Flex product, with a market that has less than 10% of the domestic TAM penetrated. While we will never take anything for granted, we continue to see no real viable competitive alternative to our solution. Our strong competitive position is evidenced by our efficient $0.30 spend for each dollar of annualized contract revenue added in 2018.

With large deployments in Tier 1 cities, like Chicago and New York mostly complete, our focus this year will be on adding more domestic Tier 2 and Tier 3 cities, along with international deployments, while we continue to lay the groundwork necessary to capture the next set of Tier 1 cities that make up the largest cities in the US. Our strategy of maintaining a keen focus on customer on-boarding and customer success is paying outsized dividends, as it enables us to maintain high rates of customer satisfaction, as evidenced by a strong net promoter score of 50, achieved very low rates of customer churn and helped drive expansions.

In fact, our revenue retention rate this past year was 118%, if you don't include the Chicago expansion. If we include the Chicago expansion, the revenue retention rate is 139%. To be clear, we don't expect the revenue retention rate of 139% to be sustainable over time. As seen with the Chicago expansion, revenue retention rates can be materially impacted by the presence or absence of large expansions or attrition. However, if we successfully execute on our business strategy, we would expect our revenue retention rates to stay above 100% for the foreseeable future.

After a successful 2018, we have set a very aggressive growth agenda for 2019 and beyond, and we are energized to get at it. As reported in our earnings release, we are reaffirming our guidance for 2019 to grow revenues approximately 30% to a range of $45 million to $47 million this year, while achieving full year GAAP profitability. Most importantly, we want to continue to lead the way in helping law enforcement apply our solutions in addressing and reducing violent crime and position the ShotSpotter solution as a standard of care.

That concludes my prepared remarks. I will now turn the call over to Alan, who will provide further details on the fourth quarter and full year 2018, along with our expectations for financial leverage and continued margin expansion in 2019.

Alan Stewart:

Thank you, Ralph, and good afternoon, everyone. We ended 2018 on a strong note. Revenues for the fourth quarter exceeded our expectations, increasing 49% from the fourth quarter of 2017 to $9.7 million. Our full year revenue increased by 46% to a record $34.8 million, which also exceeded the guidance we last updated back in November 2018, reflecting growth in the number of miles covered through expanded deployments for current customers as well as the addition of new customers.

Our revenue and gross margin were also positively impacted from a receipt of a payment of approximately $170,000 from the US Virgin Islands, where services provided prior to hurricanes Irma and Maria destroying their ShotSpotter systems. We added 24 net new miles in the fourth quarter. On top of this, our revenue retention rate ended 2018 at 139%. If the Chicago expansion were excluded, our revenue retention rate would still be in the 118%, which as Ralph mentioned is close to in line to what our expectations are for the future.

We're happy to announce our first quarter of GAAP profitability with a net income of $302,000 or $0.03 per share. Our stated objective was to reach this milestone by the end of 2018 and we're pleased to have achieved this goal.

Let's look at some of the details of the quarter and the year. Gross profit for the fourth quarter was $5.6 million or 58% of total revenues, up from $3.2 million or 49% for the fourth quarter of 2017. For the full year, our gross profit was $19.2 million or 55% of revenue, an improvement from the $11.6 million or 49% of revenues for 2017.

Now turning to our expenses, our operating expenses for the fourth quarter were $5.1 million, actually decreasing 5% from the fourth quarter last year due to larger one-time expenses in the fourth quarter of 2017 related to certain legal and filing expenses, professional and other outside service fees. For the full year, our operating expenses were $21.8 million or 63% of total revenue versus $15.9 million or 67% in 2017. The increase in operating expenses overall was primarily related to the growth in our business.

With our focus on careful deployment of capital, our sales and marketing spend per dollar of annualized contract revenue was approximately $0.30 per dollar in 2018, down from the $0.34 per dollar in 2017, while revenue retention rate of 139% was achieved for the full year.

Sales and marketing expenses for the fourth quarter were $2.2 million or 22% of total revenues versus $1.9 million or 29% of total revenues for the prior year period. As we stated, this increase in total dollars reflects our investments in marketing, international sales efforts and our customer success initiative. Our R&D expenses for the fourth quarter were $1.3 million or 13% of total revenues compared to $1.1 million or 17% of total revenues for the prior-year period. We continue to invest in R&D to add features and functionality to our Missions products, improve our analyst capabilities and conduct other initiatives.

G&A expenses for the quarter were $1.7 million or 17% of total revenues, which is a decrease from the $2.4 million or 37% of total revenues for the prior year period. Note that G&A in the fourth quarter of 2017 included higher legal and filing expenses, professional and outside service fees. We are pleased that we are beginning to see operating leverage in all of our expense lines. We continue to believe that our ongoing investments in sales and marketing, as well as R&D, are prudent and helping us reinforce our leading market position.

Our GAAP net income for the fourth quarter was $302,000 or $0.03 per share based on 10.8 million basic and 11.7 million diluted weighted average shares outstanding. This compares to a GAAP net loss of $2.5 million or $0.26 per share during the prior-year period based on 9.7 million basic and diluted weighted average shares outstanding. Again, we are so pleased that we achieved our first quarter of GAAP profitability on the timeline we laid out in early 2018 and on a much lower revenue base than most SaaS companies. For the full year, our GAAP net loss was $2.7 million or $0.26 per share based on 10.6 million basic and diluted weighted average shares outstanding versus a loss of $10 million or $1.61 per share based on 6.2 million basic and diluted weighted average shares outstanding in 2017.

Adjusted EBITDA for the fourth quarter was $2.1 million, up significantly from the $1.2 million Adjusted EBITDA loss for the prior-year period. Adjusted EBITDA for 2018 was $3.6 million, also up significantly from the $5 million Adjusted EBITDA loss for 2017. We added 24 new go-live miles in Q4 of 2018 comparable with the 23 miles we added in Q4 of 2017, reflecting the normal lumpiness of our business. For the full year, we added 168 new go-live miles, an increase from the 114 go-live miles we added in 2017. We ended 2018 with approximately 670 public safety miles under contract, of which approximately 640 were live.

Deferred revenue at the end of the year was $24.2 million, up from $20.3 million in the previous quarter. Of this amount, $23.1 million was short-term and $1.1 million was long-term. In general, we expect short-term deferred revenues to be recognized within four quarters. However, as always, we caution that you shouldn't read too much into the quarterly changes in deferred revenue as timing during the quarter when new miles can go live can have a significant impact on deferred revenue. We consider this another metric that is more informative on a year-over-year basis versus on a quarterly basis.

We ended the year on a solid financial position with $10.3 million in cash. Cash flow used in operations for the year was $1.4 million, primarily due to working capital use as our accounts receivable increased to over $15 million by the end of the year due to billings to Chicago in connection with their expansion. Also, contributing to the cash usage was our acquisition of HunchLab and the settlement of a contractor's litigation as we previously discussed last quarter.

While we have a $10 million line of credit with Umpqua Bank we've not yet used it and still have no short or long-term debt. We are reiterating our full year revenue guidance at a range of $45 million to $47 million. Our confidence in our full year outlook is based on the strength of our short-term deferred revenue, our historically strong renewal rates and new and expected contract awards that we expect to go live before the end of the year. Of course, we'll update the guidance during the year if business conditions, contract wins or deployment schedules change.

We plan to continue our investments in 2019, with the goal of further penetrating this largely untapped market. We are investing to expand our marketing efforts, which proved very valuable last year, to accelerate our sales and add new clients and expand our efforts to grow internationally. We also expect to accelerate our R&D spend, primarily to add enhancements to our Missions product. We expect operating expenses during 2019 to increase each quarter on a dollar basis in each category.

Historically, our first quarter revenues tend to be flat from the previous fourth quarter. Therefore, with the increases we plan to make in our operating expenses in the first quarter of 2019, we expect to incur a moderate GAAP net loss during the first quarter. However, as Ralph noted earlier, we anticipate achieving GAAP profitability for the full year of 2019.

In closing, we enter the year with significant financial and operational momentum. We're excited and energized for our prospects in 2019 and beyond and we look forward to sharing our progress with you throughout the year as we help communities reduce gun violence. Now back over to you, Ralph.

Ralph Clark:

Thanks, Alan. Before we open up the call to your questions, I want to thank the ShotSpotter Team for their hard work. Your commitment to reducing gun violence and enthusiasm in helping ShotSpotter fulfill our purpose is truly inspiring. I look forward to another successful year with all of you. To our customers, business partners and loyal Shareholders, thank you for your confidence in sharing this journey with us. We are now prepared to take your questions.

Operator:

Great, thank you. At this time, we will be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press star, two if you would like to remove your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question is from Matt Pfau from William Blair. Please go ahead.

Matt Pfau:

Hey, guys. Thanks for taking my questions. I first wanted to start off on the Missions product and maybe get some more details there. First of all, if you could sort of talk about, are you seeing any sort of trend in terms of types of cities or police departments that are most interested in the Missions product? Then, were you sort of anticipating—or what's the initial feel in terms of sales cycle related to Missions? Then Ralph, you hinted that there could be some changes with the product in terms of functionality and perhaps on the sales front. Anything you could provide, details on that would be helpful as well.

Ralph Clark:

Great. Great question. I'll start and Alan can jump in, as appropriate. I guess, the first part of the question is where we're seeing the interest. Our focus is really on existing ShotSpotter customers first and foremost. Then there are some ShotSpotter prospects that we've been having some conversations with them and the update has been actually quite, quite positive. We are building—we're in the process of building the pipeline right now. We've developed a pricing model. We have a product roadmap that we're working on in terms of improving the functionality and integration of the Missions, now Missions product with our existing ShotSpotter Flex solution.

We're really quite encouraged by the uptake, at least we are seeing in terms of people's interest in the solution. I think as we've stated on a number of occasions, we are going to expect that revenue contribution to happen for us on Missions specifically later in the year 2019.

Matt Pfau:

Okay, and then just a follow-up on that question, Ralph. You sort of reiterated earlier in the comments that how ShotSpotter Flex can be used for both large and smaller cities as well. Are you seeing the same with the Missions product or is the interest primarily with perhaps larger, more sophisticated police departments?

Ralph Clark:

Yes. No, so we're not really seeing it cut that way. I mean we are talking to some very large customers of ours that have very large ShotSpotter deployments in our Tier 1 cities and we're also seeing interest in Tier 2 and Tier 3 cities as well, it's really across the board.

Matt Pfau:

Got it. Okay, and last one from me, just, there's been some moving parts here early in the year that could have a potential impact on you guys. First, in terms of the severe weather, there has obviously in the Northern parts of the U.S., been some pretty bad weather. Has that impacted deployments at all? Then with the government being shut down for part of the year, did that have any impact either on deployments or contract signings?

Alan Stewart:

Sure, great question. This is Alan. Well, I think in general, go-lives are very lumpy by nature and of course, they can be affected by items such as getting permissions, bad weather or other factors. I think maybe bad weather affected a little bit in Q4, but we also generally expect less go-live miles in the winter months, especially for cities in the North. We haven't really seen an impact from the government shutdown, at least no material impact at this point. That doesn't mean that we won't see something in the future, if there is some effect on some of the agencies that occasionally provide funding to our customers, DOJ, things like that, little too early to tell on impacts, but we have not seen any at this point.

Matt Pfau:

Got it. That's it from me, guys. Thanks for taking my questions.

Operator:

Our next question is from Jaeson Schmidt from Lake Street Capital Markets. Please go ahead.

Jaeson Schmidt:

Hey, guys. Thanks for taking my questions. Just want to look at 2019. Alan, you mentioned sort of a normal seasonal pattern here in Q1, but should we expect the normal seasonality to continue throughout 2019?

Alan Stewart:

Sure. We do expect in general that Q1 revenues will be flat from Q4. We do expect that to occur as well this year. Generally, we would also expect Q3 to be somewhat flat with Q2. Although, we do expect to see that, it might be mitigated a bit this year and less pronounced than in past years.

Jaeson Schmidt:

Okay, that's helpful. Looking at the international opportunity, can you talk a little bit about how your customer engagement funnel has expanded over the past three months?

Ralph Clark:

Sure, so as you know, we hired a—this is Ralph—we hired a VP of International to focus on Latin America. Jon has been quite busy in market, both in Central America as well as South America, and we continue to be very constructive around the idea that we would expect to see some additional international revenues that come about later this year, later 2019.

As you heard on the call, which we typically don't do, we talked about a booking that hasn't gone live yet, but we did talk about a booking in Bahamas, Nassau, Bahamas, which is the international client as well. That's proceeding pretty nicely. We are also expecting to have some traction, additional traction in South Africa. We already have a deployment there in Cape Town, South Africa, which is very successful and there's a number of cities in South Africa that have very similar gun violence issues to that of Cape Town.

Between Cape Town potentially expanding and possibly another city or two coming on-board out of South Africa is where we'd expect to see some revenue, international revenue contribution outside of Latin America and Central America and Caribbean, I should say, if I'm going to include the Bahamas.

Jaeson Schmidt:

Okay, thanks a lot, guys.

Operator:

Our next question is from Chris Van Horn from B. Riley. Please go ahead.

Chris Van Horn:

Good afternoon and thanks for taking my call. Just as a follow-up on the international deployments, is there any difference in terms of pricing or investment needed? Then maybe you could talk a little bit about how the other Bahamas contract came about? Was it from a referral from another region in the U.S. or was it just an organic sales effort?

Ralph Clark:

Sure, so on the pricing model, we do charge more for our international sales. It's slightly more expensive to do business there, but we do charge more. It's still the same contractual term in terms of it's annual subscription fee, same kind of setup fee configuration and the like, but the pricing is higher for international deployments because the cost—one of the reasons is the cost is a little bit higher.

With respect to the Bahamas, I don't think we can ever underestimate how network effects happen from successful deployments in the U.S. People look to what we're seeing in Chicago, New York, Miami and other places and they're paying attention to those. I would say in the case of the Bahamas engagement is probably a combination of both kind of organic, kind of feet on the ground selling along with them kind of talking to very satisfied customers here in the U.S.

Chris Van Horn:

Got it, thanks, and then just a follow-up, on the guidance for revenues in 2019, does that include any Missions business or any Verizon reseller agreement business?

Alan Stewart:

This is Alan. I would say just in terms of guidance for '19, we do have some Missions revenues that are expected to come in, as Ralph mentioned. The majority of those will be in the latter part of 2019. In terms of Verizon, nothing specifically allocated to Verizon. However, we continue to do joint sales calls with Verizon at this point and some of those may lean into our actual pipeline with some kind of a factor. But nothing that's specifically allocated to Verizon per se.

Chris Van Horn:

Great. Thank you, and then last one from me, you've had tremendous success with your existing customer lineup. I just was curious on the bigger customers, like Chicago or New York, how much more adoption or penetration do you kind of see in the pipeline for those customers as you look going out?

Ralph Clark:

This is Ralph. I would say with those two customers, I think they are fairly fully deployed at this point in time and so our focus really this year, 2019 is to focus on a fairly robust pipeline we have with a number of Tier 2 and Tier 3 cities, as we kind of lay the foundational work to kind of bring on our next set of kind of Tier 1 cities that aren't on the ShotSpotter platform today. But I think Chicago and New York are fairly well deployed at this point in time.

Chris Van Horn:

Okay. Thanks, again, and congrats on the quarter.

Ralph Clark:

Thank you.

Alan Stewart:

Thank you.

Operator:

Our next question is from Jeremy Hamblin from Dougherty & Company. Please go ahead.

Jeremy Hamblin:

Thanks. Congratulations on another very strong quarter. I wanted to get into—you had a comment about expanding your forensic capabilities in 2019. Can we just tie that into maybe clarifying what you mean by expanding those capabilities? Is that tied into ShotSpotter Missions revs, but maybe just a little additional color on that?

Ralph Clark:

Great. Thank you for that question. Our thoughts are that we're going to be much more intentional around kind of building a professional services revenue component to our business. Right now, for example on the forensics side, we produce these detailed forensic reports and provide expert witness testimony and frankly only charging people customers' traveling expense for the bandwidth and hours that we're spending on a witness stand in a court case.

Our belief is that we can kind of package up those services and charge more of a consulting rate for that time, combined with what we're already doing with respect to training, kind of, let's see, what's the other one that we're doing. It's like training, forensic services, integration services, so we have notification engine that we charge a subscription fee for that we think we can be much more intentional around kind of bundling up these services and kind of putting them under a professional services umbrella and really focus on that as a revenue contribution to the Company.

Alan Stewart:

I would just add that as Ralph mentioned, this is what we hope to be incremental dollars, which should basically drop to the bottom line because these are things that we're already providing basically now, but for free.

Jeremy Hamblin:

Okay, and just in terms of thinking about how your customer feels about that, it sounds like it does expand your TAM overall. Have you gotten the sense from customers? I'm sure you've had conversations with them about paying for that capability or you're just kind of making them aware at this point of time spent doing the investigation work and getting that data together to be used in that type of setting?

Ralph Clark:

Yes, so this is Ralph. I would say in the case of forensic services, one thing to note is that it's really coming from a different wallet. Typically, our core customers been the law enforcement agency or police department, oftentimes when we're engaging expert witness testimony, it's really at the behest of a District Attorney, which is a separate budget line item. We are very confident that, that business within the realm of the heart of possible, they pay for expert witness testimonies of various types of forensic services, and so ours is really no different. I think we're just asking people to kind of value the real capability that we're bringing to the table and charging appropriately.

I don't want to mislead anyone to think that this is going to be, I mean, a huge revenue driver for us. Although, it is very nice margin business, as Alan pointed out, but you can just think of this as kind of being kind of incremental to what we're already doing from a revenue basis, and just managing in the way that is again much more intentional and having a real focus on monetizing, basically 8,000 hours of capacity that is out there that we could charge for to the extent that we can get them on witness stands and the like.

Alan Stewart:

I would just add that, I mean, as we roll this out, we're going to be thoughtful about implementation. It's easy to start a new customer out paying right away, where we might have a different plan for customers that are used to some of these services that have been provided for free. We're going to be thoughtful and, as always, customer focused when we implement this.

Jeremy Hamblin:

Is that something where you could foresee revenues in 2020 in that business line?

Alan Stewart:

I think we're going to see it for 2019, yes.

Jeremy Hamblin:

Okay. Then the other thing I just wanted to get a little additional color on is your G&A costs, I mean, you did incredible job on margins overall and operating expense. Your G&A costs on an absolute dollar basis were your lowest in Q4. I know that you had the comparison from last year, where you had a bunch of one-timers. But just in terms of putting some context around, even though this was obviously your highest revenue quarter, it was your lowest on the G&A front. Any color you could provide just in thinking about that in context as we look forward in 2019?

Alan Stewart:

Sure, this is Alan. I would say, there is a couple of things. We are being very thoughtful about our G&A expenses, I would also say that there is just some aspect of certain areas that the accrual is sort of maxed out earlier in the quarter. For example, bonus accruals, such that an accrual in Q4 might be slightly lower than accrual in Q1, where we would need to be starting over on that, there's little bit of an impact from there. But in general, we're not adding significantly to our G&A costs and we are being very thoughtful when we do add them.

Jeremy Hamblin:

Okay. Just to confirm, your legal accruals, those are now done with from what you had several quarters earlier in 2018 and 2017?

Alan Stewart:

I think the legal accruals you're talking about is related to the litigation that we had with the contractors. Yes, that's been complete. We are still—we still want outstanding litigation that we can't really comment on, we don't have any accruals at this point related to that, we can't accurately measure what those might be. When we can, then we'll evaluate any necessary accruals there.

Jeremy Hamblin:

Great. Thanks, guys, and good luck this year.

Alan Stewart:

Thank you.

Ralph Clark:

Thanks.

Operator:

Our next question is from Richard Baldry from ROTH Capital Partners. Please go ahead.

Richard Baldry:

Thanks. Can you talk maybe about how you see growth split in 2019 between expansions versus new cities or regions? I'm trying to gauge how much visibility you have entering 2019 versus prior years. Thanks.

Alan Stewart:

Sure. This is Alan. I guess, in general, we give our guidance in a way that we think is realistic and achievable and we do have a lot of visibility in those revenues. I would say, if we were to look at a split as probably the majority of the new revenues are coming from new city captures as opposed to expansions, but I don't want to really give a percentage split in terms of 60-40 or 50-50 at this point.

Richard Baldry:

Then maybe talk about how you feel about the sales team, you've been adding selectively now with the new Missions capability. Do you feel like you need to add more aggressively? Are the types of people that you think you need to have to sell changing or still very similar to what you've had in the past? Thanks.

Ralph Clark:

Yes. This is Ralph. I mean, we feel really constructive on our kind of sales resources. They're very capable in skill. They did a great job in 2018 and we've walked through this sales pipeline with the direct sales team domestically and feel really good that we have the right resources and focus to bring about what we need to make happen to be successful this year.

I would say, with respect to Missions, I think we probably are maybe a headcount higher in the future to kind of focus more on the Missions product, but we're going to be looking at kind of probably maybe bringing that person on more in a kind of customer success role as opposed to more of a direct selling role.

I think I would just add, again, that, as we always do that, we shouldn't underestimate the benefits that our customer success and on-boarding team kind of brings to the sales effort. Although, they're not quota-carrying folks, they're really quite instrumental in trying to drive very high customer satisfaction and kind of high net promoter scores to our solution, which are so critical in getting that very strong word of mouth for reference sales out there because that's how the market moves here in domestic public safety. People pay attention to successful cheese and a successful cheese for incorporating our solution and driving outcomes, it makes it a lot easier for us to kind of sell that new prospect.

Richard Baldry:

Great, thank you.

Operator:

Our next question is from Joseph Osha from JMP Securities. Please go ahead.

Joseph Osha:

Hello, everyone. Sorry, I've got a bit of a cold. To return a bit to the previous question, I'm wondering, if you can talk about what kinds of resources and what the engagement process looks like for these smaller Tier 2 customers that you're engaging now versus the Tier 1 customers?

Ralph Clark:

Yes, this is Ralph. That's an interesting question. I mean, it's very similar, I would say—I mean, you're engaging—the buying center's the same. The buying center tends to be the police department. What makes it a complex sale is that you have to get, I guess, engagement and alignment around people that are kind of sitting around the police department, be it elected officials or sometimes even community to kind of get engaged. We saw that process actually play out in Pleasantville. That's an interesting case study there. I would say that the process is very, very similar; the scale is different.

Maybe larger Tier 1 cities are certainly a little bit more complex, it's a lot more people, you got to get in a room and try to have a conversation with to kind of get them socialized to the idea of incorporating ShotSpotter solution as a part of their overall gun violence reduction efforts. But it doesn't—it's really not that different. We might take a little bit longer. The dollars are bigger oftentimes. The square miles we're talking about are bigger. But it's basically kind of the same recipe, respecting and understanding the buying center is the Chief of Police or Deputy Chief of Police and that we need to kind of coordinate with that buying center along again with the people that are sitting outside of the buying center to help influence that sell.

Again, leveraging existing customers that are seeing great outcomes. We see (inaudible) about ShotSpotter, Mayors talk about ShotSpotter, so really bringing that content to the conversation is important.

Joseph Osha:

Okay. Thank you. Part of where I was headed with this, just thinking about 2019, is wondering whether these smaller customers perhaps have a more quick—a more rapid close cycle than the bigger ones.

Ralph Clark:

I think that's probably a fair assessment. We're still looking at longer sales cycles, kind of 12 to 18 months. It could be the case that the medium to smaller sized cities might be kind of closer to kind of 12 to 15 months versus more of the 15 months to 18 or 20 months in terms of the kind of very large Tier 1 cities. In fact, with large Tier 1 cities, you can probably look at sales cycles longer than 18 months frankly.

They can take up to two years. That's why we tried it in part on this call, that, at least, from 2019, our expectation is that we're going to get there, kind of hitting a lot of doubles with Tier 2 and Tier 3 cities, while we're laying the foundational work to kind of capture those next one, two, three Tier 1 cities because those do take a little bit longer to kind of bring about. But those will probably be more of a 2020 opportunity for us versus 2019.

Joseph Osha:

Okay, great. Then just on a related point, at your Analyst Meeting, you talked a lot about the notion of rather than just adding sales people willy-nilly, really adding customer success people, retention people sort of putting a wrapper around your sales force as opposed to expanding the number of direct sales. Does that still continue to be the thought process as you think about how 2019 looks?

Ralph Clark:

Yes, certainly. Very much so. But I think I would add to that. We have a very powerful ally down certainly in terms of kind of lead generation and working with Verizon on the reseller front. I mean, they just have a much kind of bigger footprint across the public safety market, at least domestically. That, I think, is going to be quite interesting lever for us that we're expecting to generate some kind of interesting bookings opportunity for us later in the year.

Joseph Osha:

That kind of neatly anticipated my question, we really should think of Verizon as a lead-gen opportunity that would feed into your existing business process, not something that's adjacent necessarily?

Ralph Clark:

Yes, I think that's the way to think about it. I think we're still going to be required to be very much intimately involved in the sales process. I mean, it's a certain skill and set of experiences to I think be successful in selling this type of solution to public safety customers. I think Verizon is going to want to leverage our expertise and experience in that matter. I think we're going to be very much involved I think in the sales process with them. But I think they can help bring us to the party in several places, where we otherwise might not be able to be just because of their reach.

Joseph Osha:

Okay, thank you, and the last one from me, any just quick update on the uptake or general efficacy of NIBIN and how that's being utilized?

Ralph Clark:

Anecdotally—this is Ralph—I mean, we continue to see very, very strong evidence that agencies that engage in the NIBIN process, for those of you on the phone that aren't familiar with what NIBIN is, you can think of it as essentially a kind of fingerprinting database for gunshot shells. What we are asking customers to do as a result of the ShotSpotter alert, kind of getting a cop to a dot, they're more likely to recover the shell casings and then once they run them through the NIBIN system, being able to do the network analysis to figure out the movement of a crime gun, which then helps them respond to and identify those very few shooters that are driving most of the gun violence problems in these very small at-risk communities.

That strategy is proving to be very successful. We see the anecdotes of this all over the place and as one chief of police says, if you want to predict tomorrow's homicide, investigate today's shooting, and that's what we enable, ShotSpotter on the front end combined with NIBIN on the back end, it's a very strong combination.

Joseph Osha:

Thank you very much.

Operator:

Our next question is from Tim Klasell from Northland Securities. Please go ahead.

Tim Klassell:

Hey guys, congrats on the nice quarter. A sort of follow on your marketing comments and on what you said earlier. We've noticed a lot of press in particularly around talking about some of the benefits of ShotSpotter shell casings, and what have you that you mentioned. Is that showing up with your customers? Are your sales guys walking and talking to a potential customer and are they further along in understanding the value proposition now? Do you think that will sort of shrink that sales cycle down a bit here going forward or—I'll leave it at that. Thanks.

Ralph Clark:

Yes, so we lean in pretty heavily on the idea of NIBIN in what they call Crime Gun Intelligence Centers because that's a very clear measurable benefit that customers get when they deploy ShotSpotter. Our assumption is at some point in time, the ShotSpotter solution will become the standard of care, where it's just something that you do as a part of having the agency; just as you would have a non-lethal or body worn cameras that you would want to have ShotSpotter in the event that you were dealing with violent crime in your city.

I think it's fair to say we're not there yet. We're still kind of expecting frankly that we're looking at 12 to 18 months sales cycles. When we do reach the tipping point, our expectation would be that those sales cycles would shrink pretty rapidly, and then we're dealing with a whole different kind of go-to-market strategy. But I don't think we're anticipating that happening certainly in 2019. But hopefully, it will happen sooner versus later. But we're not planning or depending on it to happen for this year.

Tim Klassell:

Okay, good. Just a quick follow-up, you've mentioned obviously the Bahaman win, congratulation, and U.S. Virgin Islands made a payment to you. How about Puerto Rico? Any thoughts there about them potentially coming back to life or is that still a ways out? Thank you.

Alan Stewart:

Sure. This is Alan. We are hopeful that Puerto Rico returns as a customer, right. We do have them in our pipeline and the pipeline in general has different probabilities assigned to those. When we give our guidance, we do a weighted average on those. Puerto Rico was and continues to be on our prospective pipeline. We have seen some movement there. But it's still honestly too early to tell exactly when something might happen.

Tim Klassell:

Okay, great. Thank you very much.

Operator:

Our next question is from Jeff Kessler from Imperial Capital. Please go ahead.

Jeff Kessler:

Hi. Hi, Alan. Hi, Ralph. It's Jeff. Good to talk to you again. I recently was at a safe city—Secured Cities Conference. One of the things that they talked about in terms of funding various programs was a catalyst, something to kind of tie the various services together around which the public private partnerships could actually agree on funding.

My question to you is, do you think that you—in your relationships with companies like Verizon, are you able to get that mind share in which these, let's just say, these groups would be able to get mind share around you too, taking on—essentially you being the brand name that they used to go out to the community and try to get funds for, not just the ShotSpotter, but you serving as a catalyst for other types of safety and public safety measures. In other words that builds up your value proposition as well?

Alan Stewart:

This is Alan. I would say that we're still cautiously optimistic about how large providers and smart cities, smart communities like Verizon and GE and others can use ShotSpotter as a launching platform, is what I think you're saying. Sometimes there might be a city that isn't necessarily ready to do a full smart city or smart community deployment, where Verizon or someone else might be able to say, well, let's get started with something like this and sort of prime the pump. I think that is possible. We have seen very little movement there frankly in terms of how fast they move in these deals, but we are certainly hopeful that that can and will occur either later on this year or into 2020 and beyond.

Jeff Kessler:

All right. Good. Second question is, have you ever considered the marketing of ShotSpotter to places where there are guns in place already, military bases, protective areas like Brink's Centers, things like that? I cover— in covering Brink's, there's, from time to time some violence in some of these depots. Do you market commercially at all or is it all municipal city-related?

Ralph Clark:

Yes. This is Ralph. I would say, the vast majority of our marketing efforts and focus really is on municipalities and police departments because that's where the low hanging fruit is certainly. We've seen some kind of interesting things come over, for instance, I think you're familiar with our freeway project, which is little bit of a different type of a model for us. Certainly, our secure campus solution is an example of a slightly different variance to our kind of law enforcement focus.

But I think our focus is really kind of been on to those umbrellas like kind of thinking doing more kind of commercially-oriented things like protecting banks or Brink's or things like that. That's maybe out there. But I think we just have too much low hanging fruit for us to go pick up before we get fancy and dilute our focus to those other things.

Jeff Kessler:

Right. One final question, at the last ASIS Conference, and obviously the (phon) ISC West Conference, there is a lot of companies that you do technology for inside and they've been trying to develop something that works out of doors. Clearly, they have not made any dents in the road. Can you talk a little bit about where the competitive landscape, meaning, is there—you are essentially a brand name, a standard at this point, are there any companies that you see out there that essentially would be of, either concern or of interest to you, if they were to become big enough?

Ralph Clark:

This is Ralph. We try not to take anything for granted, to be perfectly honest with you. But honestly, we have not seen any real strong viable direct competition to our outdoor kind of wide-area franchise. I think what we do is extremely difficult and challenging. We've got a lot of intellectual property kind of built into our solution and certainly a lot of experience curve attributes and benefits. I think it would be extremely challenging and difficult for new entrants to kind of come in the space and execute at the high fidelity that we've trained the market to expect in terms of quality of service.

Now I will also quickly say that you can't take anything for granted because who knows, I mean, tomorrow, somebody could come on to the scene, but we've seen a little bit of chatter, we haven't seen any real deployment that make us particularly concerned or worried at this point in time.

Jeff Kessler:

All right, great. Thank you. Thank you for taking my call and you'll be hearing more from me.

Ralph Clark:

Thanks.

Operator:

Our next question is from Will Power from Robert W. Baird. Please go ahead.

Will Power:

Great, thanks. Hey, Alan, maybe first with you. I think you talked about the investment costs or OpEx rising through the year. Any color on gross margins? Should we expect that to tick up and any seasonal factors to be aware of there?

Alan Stewart:

Sure. I would say, in general, we expect our gross margins to increase as well. Don't expect any real seasonality related to that. It is something that we would certainly expect at the end of next year, Q4 to be higher than Q4 this year. I can't say it will be in a straight-line increase, but generally upwards and to the right.

Will Power:

Okay, and then just more broadly as you look at, still a number of Tier 1 opportunities out there, are there any common areas of push back or barriers that you're running into? I guess, kind of as a follow-up to that as I think about some of the earlier forensics commentary, is that something that some of the cities that you don't have maybe or looking for that can maybe push you over the edge to help win some of those contracts? I guess really trying to figure out, what gets you over the line on some of these Tier 1 cities, or is it just you are getting the right advocates in place over time?

Ralph Clark:

Yes, so this is Ralph. Every single one is different. I would say we have kind of serious active pursuits in a number of these Tier 1 cities where we are not deployed now and each one has its own kind of unique story or narrative. I can't really kind of boil it down to a singular kind of use case or same friction point that is kind of preventing us from getting here to there. I think it's really important that we are impatiently patient about some of these new pursuits and engagement, because at the end of the day, it really does take a prepared mind to adopt this technology and use it the right way to drive positive outcomes.

I think my personal feeling is I would rather wait until we have everybody aligned, buying and reading and waiting to deploy and use this technology the right way to drive great outcomes versus kind of forcing a transactional sale where maybe a customer is not ready. The nice thing for us is that there are so many opportunities out there for us in kind of Tier 2, Tier 3 land for now that we can afford to be persistently patient until we can get one, two or three of these other kind of Tier 1 cities to decide and adopt the solution. Because what we do know from, experience and there is a singular use case for our case study relative to Tier 1 usages, once that Tier 1 agency comes on-board and starts using the technology, they tend to expand and become very, very big important customer for us.

That would be the way, I guess, I would answer that question. Hopefully that was helpful.

Will Power:

Yes. That makes lot of sense. Thanks.

Operator:

This concludes the question-and-answer session. I'd like to turn the floor back to Mr. Clark for any closing comments.

Ralph Clark:

No, I want to thank everyone very much for dialing in and listening into our earnings call. As I mentioned in my earlier comments, we're super excited about 2019 and we're also incredibly grateful for all the hard work that went into 2018 on behalf of the Team and myself at ShotSpotter. Thank you very much. I'm looking forward to chatting with you all again in three or so months and updating you on our progress in early 2019. Thank you.

Operator:

This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.