ShotSpotter, Inc.

Third Quarter 2017 Earnings Conference Call

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CORPORATE PARTICIPANTS

Ralph Clark, *Chief Executive Officer*

Alan Stewart, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Richard Baldry, *ROTH Capital Partners, LLC*

PRESENTATION

Operator:

Good afternoon, and welcome to the ShotSpotter's Third Quarter 2017 Earnings Conference Call. My name is Ben, and I will be your Coordinator for today's call. Joining us for today's call 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 the 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 its registration statement on Form-S1. These forward-looking statements reflect Management's beliefs, estimates and predictions as of the date of this live broadcast, November 7, 2017, and ShotSpotter undertakes no obligation to revise or update any forward-looking statements to reflect events or circumstances after the date of this conference 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.

I would now like to turn the call over to ShotSpotter' CEO, Ralph Clark. Please go ahead, sir.

Ralph Clark:

Thanks, Operator. It's great to be talking with all of you again. I'm going to give you a quick look at our progress last quarter and Alan will run through the numbers before we take your questions.

Before we begin, I would like to take a moment to acknowledge and thank my work colleagues whose passion and hard work in collaborating with our valued customers is making a difference in the many communities that we serve. I'm sincerely grateful for all of your efforts. This is our second earnings call since going public and we're pleased to report that we've accelerated our operating momentum from last quarter Q2 '17.

We posted Q3 '17 revenue of $6.8 million which represented a 72% increase over the last year's Q3 '16 revenue of $4.0 million. The $6.8 million includes $900,000 in accelerated set up fees associated with Puerto Rico and the U.S. Virgin Islands, which Alan and I will discuss in this call. But even without the $900,000 our revenues were slightly ahead of our revenue expectations.

In addition, our other operating metrics were equally encouraging. We went live with 50 gross new square miles, including customer Go Lives in Jacksonville, Florida, Syracuse and Newburgh, New York, as well as Cincinnati, Ohio. We also had expansion in the existing customer deployments in San Pablo, California, Birmingham, Alabama, New York City and Chicago, which, by the way, has become our second largest customer as measured by miles deployed.

Our net new miles deployed for the quarter was 17 square miles reflecting the reduction in live miles from Puerto Rico and U.S. Virgin Islands, which I will speak to in a moment. This represents a 55% increase compared to the 11 net new square miles deployed from Q3 of last year. Alan will parse the financials in a little bit more detail, but I do want to acknowledge the cessation of our service in Puerto Rico and the U.S. Virgin Islands.

We have been in the process of negotiating renewal agreements, which included some portion of services already delivered earlier in 2017 that have not yet been paid by Puerto Rico and USVI when hurricane Maria devastated the region. Accordingly, we have classified those contracts as expired, and, at this point in time, are not pursuing renewal agreements while the Island's focus on rebuilding critical water, electricity, communications and other key infrastructure. As a result, we accelerated the long-term deferred revenue associated with the original set up fees of those contracts, along with the remaining capitalized expenses. This resulted in a one-time recognition of $900,000 of revenue this quarter.

As some of you know, Puerto Rico was one of our largest customers. While limiting gun violence and improving police responsiveness remains an important goal for the Puerto Rican authorities, there are far more pressing needs to be addressed on the Islands post-hurricane Maria. We intend to reengage both of these valued customers at the appropriate time in the future. This does not significantly affect the strong positive momentum in our top line given the accelerated growth we're experiencing from miles generated from both new customers and expanding customers, such as Chicago, coming on to our platform.

It seems as though tragedies have been in our thinking a lot this quarter, given the catastrophic weather events, the horrific mass shooting incident in Las Vegas, and the even more recent tragic truck shooting in Texas. In the most cynical calculus, it is easy to consider these types of high-profile gun violence incidence as a catalyst for our business. In truth, we really don’t know if that's the case. However, we are increasingly being included in the conversation on the impact on the gun violence and how to be better prepared, not only for the frightful active shooter event, but also the more persistent and on-going urban gun violence that so many of our underserved communities sadly experience.

Certainly, the Las Vegas incident put a spotlight on gun violence. It is our job to pivot some of that spotlight on the chronic urban gun violence problem. It is this type of unchecked gun violence in at-risk communities that is diluting the fabric of trust between citizens and law enforcement. That is one of the specific problems that ShotSpotter is intended to address.

As it turned out, we were in the last stages of implementing a six-square mile system in Las Vegas and had been transitioning from final testing to lighting up their systems just prior to the Las Vegas strip incident. That system will cover neighborhoods in the Northeast, Southeast and South Central parts of the

City. Las Vegas Metro Police's objective is to improve the speed of police response and ultimately prevent and reduce gun violence incidents in those neighborhoods. We know our solutions can have this type of positive impact on police effectiveness and community relations in many other jurisdictions.

We believe that we are approaching the tipping point, where gunshot detection will become a standard of care requirement for the over-1,400 cities in the U.S. and 200 cities around the world with similar gun violence problems, that would benefit from our solution. Recently, Chicago Police Department publicly discussed their experience in leveraging technology to prevent and reduce gun violence. ShotSpotter is the central element to that strategy in delivering actionable data to help Chicago PD respond quickly and precisely to all shootings.

Thus far, shootings in Chicago's most at-risk neighborhoods where ShotSpotter is deployed is down as much as 44% from last year. That's 135 fewer shootings. Thought leaders are taking note of all of this. Attorney General Jeff Sessions recently spoke to a gathering of U.S. municipal police chiefs where he announced that violent crime reduction is a priority and that the Department of Justice is funding a growing number of crime gun Intel centers or CGICs which incorporate new technologies like gunshot detection.

We are investing ahead of the anticipated market pull, with a focus on our customer success team which is organized to on-board new customers in order to guide their customer journey, deliver peak customer experiences and deliver high renewal rates. Evidence of our efforts in this regard are bearing fruit. In our recently conducted annual net promoter survey, we achieved an NPS score of 53, up from an NPS score of 36 in 2015.

We have also continued our efforts to collaborate with other pioneers in municipal safety and advanced infrastructure. Last quarter I talked a bit about our work with GE Current to embed ShopSpotter technology into their smart city IoT platform call CityIQ. Our smart city efforts have moved steadily forward and just last week we successfully closed our first GE AT&T smart city deal through a Georgia Power-led initiative for the city of Atlanta, Georgia. These types of collaborations make perfect sense for ShotSpotter. Through these collaborations, we believe we can position ourselves to achieve a larger footprint and streamline installation and maintenance for our sensors with minimal capital investment.

That will do it for me. Clearly, we are feeling positive about our performance and momentum in all areas of the Company. I look forward to answering your questions. But, first, here's Alan to give you more detail on our financial results and guidance.

Alan Stewart:

Thank you, Ralph, and good afternoon, everyone. I think you will see from our numbers, Q3 reflects continued success for ShotSpotter. We grew revenues to a record $6.8 million, a 72% increase over third quarter of last year. Approximately $900,000 of this quarter's revenues were related to the acceleration of a deferred set of revenue fees—incentive fees related to Puerto Rico and the U.S. Virgin Islands which ceased to be live customers due to the unfortunate effects of recent hurricanes.

We also incurred an approximately $700,000 impairment charge to expense the remaining netbook value of the acoustic sensor networks that were presumed destroyed by the hurricanes. Our net loss for the quarter was $1.6 million. We continue to invest in and focus on customer success, which is driving our growth. We believe that our subscription-based revenue business model will keep us on this positive trajectory for the foreseeable future. We were also operating cash flow positive for the second quarter in a row.

Now, turning to our financial numbers, we encourage you to reference today's earnings release which is posted on our website. As I mentioned, revenues for the third quarter increased 72% to $6.8 million from $4 million in the same quarter last year, and were up 17% from the second quarter of 2017. For the quarter, aside from the one-time $900,000 in accelerated revenue related to the loss of Puerto Rico and USVI as customers, our revenue increases were driven by new customer orders, mileage expansions with existing customers and customer renewals. Even without the additional revenues related to Puerto Rico and the U.S. Virgin Islands, we believe our Q3 performance is evidence of the momentum that we are seeing from continued and expanding customer adoption.

Turning to expenses, our gross profit for the quarter was $3.4 million, or 50% of total revenue. This was an improvement from $1.6 million or 40% of total revenue in the third quarter of 2016. The gross margin was somewhat lower for the quarter than would have been the case without the impact of the hurricanes, because of revenues related to Puerto Rico, U.S. Virgin Islands customer losses. After deducting expenses related to the impairment charge of the associated acoustic sensor networks were recognized at a gross margin lower than that of our continuing business operation. Excluding this impact, our gross margin would have been approximately 53%.

Our R&D expenses for the third quarter of 2017 were $1.1 million or 16% of total revenues compared to $1 million or 25% of total revenues in the third quarter of last year. We expect R&D expenses, as a percentage of revenues, to be around 14% to 16% going forward.

Our selling and marketing expenses for the quarter were $1.8 million or 26% of total revenues compared to $1.1 million or 28% in Q3 of last year. The increase in selling and marketing expenses third quarter is primarily due to increased labor costs associated with our expanding sales, marketing and customer success efforts. We expect selling and marketing expenses as a percentage of revenues to be around 23% to 27% going forward.

For the third quarter of 2017, our general and administrative expenses were $1.3 million or 19% of total revenues compared to $600,000 or 14% of total revenues in Q3 of last year. Our G&A expenses are increasing as we operate as a Public Company. We expect our G&A expenses, as a percentage of revenue, to be around 18% to 22% going forward.

For the third quarter GAAP net loss totalled $1.6 million or $0.17 per share as compared to $1.5 million or $0.96 per share for the prior year period. For the year-to-date through Q3, GAAP net loss totalled $7.5 million or $1.49 per diluted share based on 5 million shares on a weighted average shares outstanding basis. Net loss for the first nine months of 2017 was up 25% compared to the same period a year ago. However, our results for the first nine months of 2017 included the $3.7 million charge related to the preferred stock warrants that we covered in our second quarter earnings call. By way of comparison, this charge was approximately $650,000 for the first nine months of 2016.

Cash flow generated from operations for the first nine months of the year was $1.6 million compared to $1.7 million in the first nine months of 2016. We continue to maintain a strong balance sheet with $19.3 million in cash. We repaid all of our outstanding debt of $13.5 million during Q3 and are now debt-free. Capital expenditures have been $4.5 million for the first nine months of the year. During the third quarter of 2017, we added 50 new Go Live square miles. Due to unfortunate hurricane that devastated Puerto Rico and the U.S. Virgin Islands we discontinued service to those coverage areas which resulted in a reduction of 33 coverage miles.

As a result, the net new Go Live miles for the third quarter of 2017 was 17, up from 11 in the same period of 2016. While we are hopeful that Puerto Rico and the U.S. Virgin Islands will recover their infrastructure and once again become customers, we are uncertain of if or when this will happen. Partially due to the new miles that went live in Q3, we added $1.4 million in deferred revenue, ending the quarter with $18.4 million of deferred revenue, $15.9 million of which is short term and $2.5 million of which is long-term.

As you can see from our strong numbers across the board, both for the third quarter and for the first nine months of 2017, our team generated impressive results on our Companywide objectives.

Shifting gears to our financial outlook for the rest of the year, we are increasing our revenue guidance. Our prior guidance was for revenues to range between $21.5 million and $22.5 million. We now expect our revenues for fiscal year 2017 to be approximately $23 million based on our operational momentum and the current pipeline of expected deployments. Twenty-three million dollars would represent approximately 48% growth over 2016.

Our full year guidance is predicated on our ability to continue to Go Live in new miles already sold and maintain healthy renewal rates. We understand that many of our Investors may be concerned with the loss of Puerto Rico and U.S. Virgin Islands as customers, especially given the fact that, until early 2017, Puerto Rico was our second largest customer. While we hope to regain Puerto Rico and the U.S. Virgin Islands as future customers once the Islands have recovered from the hurricane damage, we cannot predict when or if this will occur.

That said, we are confident in our ability to add new customers and expand deployments with our existing customers, such that we are providing preliminary full year revenue guidance for 2018 of between $30 million and $32 million, which, at the midpoint, would represent approximately 35% top line growth from the 2017 revenue guidance figure. This guidance does not include any revenues from Puerto Rico and the U.S. Virgin Island.

Please understand that this revenue guidance update is based on current Company estimates. Actual results could differ materially depending on business conditions and other factors including those mentioned in the forward-looking statements discussed at the beginning of the call. This completes my financial summary. For a more detailed analysis of our financial results, please reference our Form 10-Q which we plan to file by November 14.

Ralph, over to you.

Ralph Clark:

Thanks, Alan. Let me close by saying we're extremely positive about our position in this unique market space that we've created. We believe that we're in the early innings of broad customer adoption of our solution as a standard of care. We will continue to focus on building strong customer relationships and judge our success by the level of success that our customers have in responding to, investigating and ultimately decreasing and forbidding gun violence.

Thank you very much, and we will now take your questions.

Operator:

Thank you. We will now take questions from ShotSpotter's publishing analysts. To join the question queue, you may please press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two. We will pause for a moment as callers join the queue.

The first question comes from Richard Baldry of ROTH Capital. Please go ahead.

Richard Baldry:

Thanks. I'll try to keep it quick, I think there is some background noise here. Could you put that existing gross miles in perspective, was that one of your best quarter or top two or three? Then possibly then talk about how sustainable that is, repeatable, if there is any one-time sort of things that are hard to kind of repeat going forward in that number? Thanks.

Ralph Clark:

Sure, thanks, Rich. This is Ralph. I'll take a crack at the first part of your question. With respect to net or gross miles going live, it's probably one of our best quarters ever at 50. I think I would be very careful to not comment on how sustainable that is every quarter. But we are, I think, doing a great job in converting these customers over to live status, and had a great experience in Q3 of this year.

Richard Baldry:

Could you talk a little bit about how much of your 2018 guide relies on new sales versus how much is built on what you've already booked that has yet to deploy, sort of give us a view of how much visibility you have into 2018? Thanks.

Ralph Clark:

Sure, another great question. Rich, I guess I would point you to look at our nine-month ending balance sheet and look at the short term deferred number that we have there. I mean, we start the year 2018 with a lot of visibility. To the extent that we run a good track record on renewals, I think we've always said that we have excellent visibility into our long-term rev—I'll call it medium-term revenue, not long term revenue, but medium-term revenue over the next twelve months. I don't know, Alan, would you add anything to that or …

Alan Stewart:

No, only other than to say that, internally, from our backlog and the projects that we are working on, we felt comfortable enough to put the $30 million to $32 million revenue preliminary guidance out there for 2018. We feel pretty confident in that.

Richard Baldry:

Then maybe can you talk about sort of how many heads you have added or think you'll be adding to the sales and marketing team to keep up to building the pipeline for the demand that you expect, now you think you hit this inflection point on the demand side? Thanks.

Ralph Clark:

In terms of our hunters for domestic public safety, I think we are in a pretty good position. I think we'll continue to look at making some limited investments in our customer success team, or more the farmers, and those folks, again, are responsible for the on-boarding experience which is so critical to what we do. I think we still very much are planning to add some go-to-market sales capability to drive international sales. We haven't done that yet, but I think we've committed to get that done no later than early Q1 of next year.

Richard Baldry:

Thanks, and last thing, can you talk a little bit more about the AT&T GE Smart City deal? What scale will that first deployment be? Is that using very much off the shelf hardware now or is there some sort of—because it's the first one, will there will be some unique sort of deployment issues around getting back first one up and running? Thanks.

Alan Stewart:

Yes, this is Alan, great question. This is the first Smart City deployment. We do expect to learn things during this first deployment on all sides, from the—we're using the GE Smart nodes, we're using a combination of the nodes as well as some of our censors, so that's something that we are taking a look at. We certainly hope that it will be fully successful but as we roll it out, we are—and the customers' standing by to work with us through any challenges we might have with that first deployment.

Richard Baldry:

Okay. Thanks, and congrats on a great quarter.

Alan Stewart:

Thank you.

Ralph Clark:

Thanks.

Operator:

As a reminder, if you'd like to ask a question, please press star, then one.

There are no more questions at this time. If your question was not taken, you may contact ShotSpotter's Investor Relations team at ir.shotspotter.com. I would now like to turn the call back over to Mr. Clark for his closing comments.

Ralph Clark:

Great. Well, thank you very much. We really appreciate everyone that dials in to listen to our second quarterly earnings announcement. We are really proud of the fact that this is our second beat and raise quarter. Looking forward to putting our heads down and continuing to work really hard in Q4 and looking forward to speaking with you all again in about three months or so. Thank you very much.

Operator:

Thank you for joining us on today's call. I especially—thank you for joining us for ShotSpotter's third quarter 2017 earnings call. You may now disconnect.