S&P Global
Market Intelligence

AudioEye, Inc. NasdaqCM:AEYE

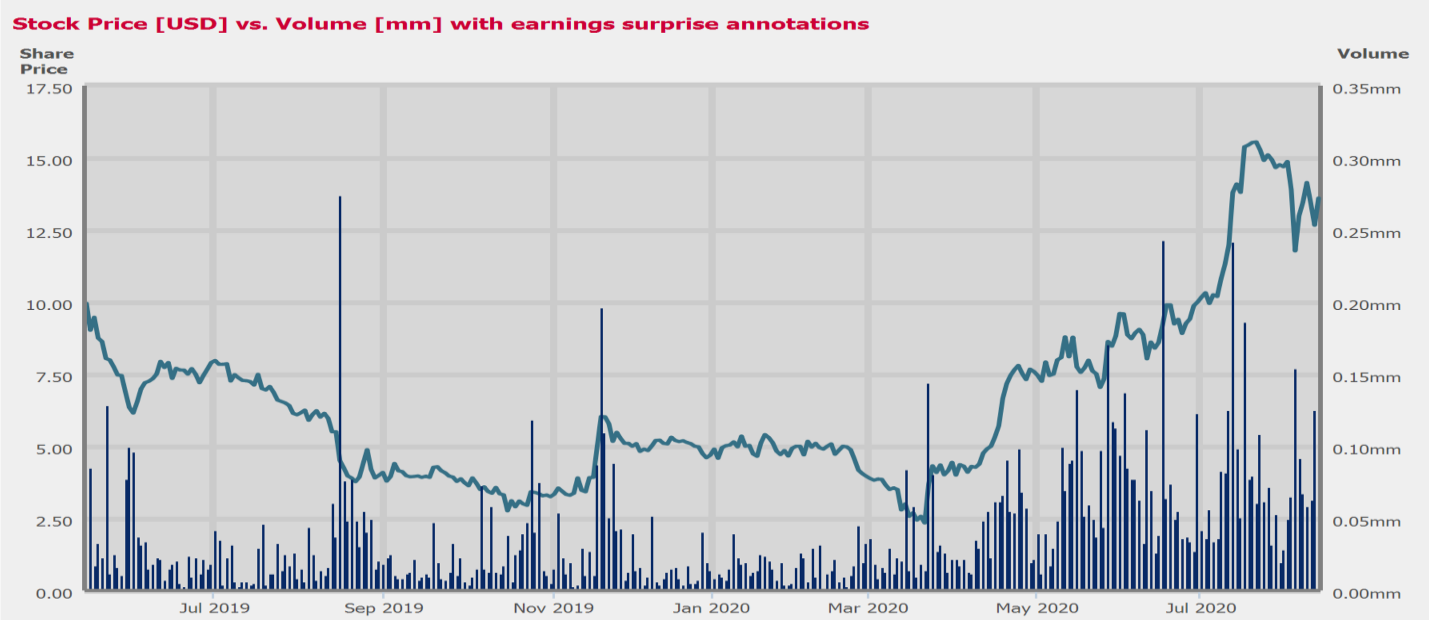
FQ2 2020 Earnings Call Transcripts

Thursday, August 13, 2020 8:30 PM GMT

S&P Global Market Intelligence Estimates

	-FQ1 2020-	-FQ2 2020-	-FY 2020-	-FY 2021-
	CONSENSUS	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	(0.18)	(0.13)	(0.50)	0.12
Revenue (mm)	3.69	4.33	18.25	26.50

Currency: USD
Consensus as of Aug-11-2020 7:30 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ2 2019	(0.18)	(0.27)	NM
FQ3 2019	(0.25)	(0.23)	NM
FQ4 2019	(0.27)	(0.14)	NM
FQ1 2020	(0.18)	(0.16)	NM

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Carr Bettis
Executive Chairman

Sachin Barot
Chief Financial Officer

ANALYSTS

Allen Robert Klee
National Securities Corporation, Research Division

Zachary Cummins
B. Riley FBR, Inc., Research Division

Presentation

Operator

Good afternoon and welcome to AudioEye's Second Quarter 2020 Earnings Conference Call. Joining us for today's call are AudioEye's Executive Chairman, Dr. Carr Bettis; and CFO, Mr. Sach Barot. Following their remarks, we'll open up the call for questions from the company's publishing analysts.

I would like to remind everyone that this call will be recorded and made available for replay via link available in the Investor Relations section of the company's website at www.audioeye.com.

Before I turn the call over to AudioEye's Executive Chairman, the company would like to remind all participants that statements made by AudioEye management during the course of this conference call that are not historical facts are considered to be forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for such forward-looking statements. The words believe, expect, anticipate, estimate, will and other similar statements of expectation identify forward-looking statements. These statements are predictions, projections or other statements about future events and are based on current expectations and assumptions that are subject to risks and uncertainties. Actual results could materially differ because of those factors discussed in today's press release and the comments made during this conference call and in the Risk Factors section of the company's annual report on Form 10-K, its quarterly report on Form 10-Q and our reports and filings with the Securities and Exchange Commission. Participants on this call are cautioned not to place undue reliance on these forward-looking statements, which reflects management's beliefs only as of the date hereof. AudioEye does not undertake any duty to update or correct any forward-looking statements.

Now I would like to turn the call over to AudioEye's Executive Chairman, Dr. Carr Bettis. Sir, please proceed.

Carr Bettis
Executive Chairman

Thank you, operator. Welcome, everyone. Thank you for joining us today.

After the market closed, we issued a press release announcing our results for the second quarter ended June 30, 2020. A copy of the press release will be available later in the Investors section of our website at audioeye.com.

I'd like to open with recognition of a really important milestone for accessibility, the 30th anniversary of the ADA and the ongoing need for digital accessibility. Just a few weeks ago, we celebrated the 30th anniversary of the ADA becoming law. This important legislation transformed the U.S. and much of the world by making the world a more physically inclusive place for everyone. But the digital world now being as important, perhaps even more so lately, especially due to the global pandemic. And with about 98% of all websites still having critical accessibility barriers, it's clear that much more work is needed to create a truly digitally inclusive world. As we recognize this important milestone in the journey to an inclusive world, the true underlying demand for digital accessibility has never been stronger, and AudioEye is well positioned to lead this continued transformation.

I'll begin, as we always do, with an overview of our business. AudioEye is a leading provider of SaaS-based digital content accessibility solutions. I'll remind you of our mission: to eradicate all barriers to digital accessibility. We provide ourselves in addressing the largest range of services and issues that impact many people around the globe. At AudioEye, we do more than just identify these accessibility issues. We strive to fix, to maintain and continuously monitor them.

We also certify websites to demonstrate compliance with both the ADA and the latest Web Content Accessibility Guidelines, or WCAG 2.1. Because many of the remediation capabilities we provide are automated, our customers more quickly gain compliance with accessibility standards, regulations and laws. For our managed product, these automated processes are coupled with manual testing and remediation by subject matter experts. The result is we provide our clients with the best solution to make their websites and digital content more accessible. We keep their content more accessible through continuous monitoring and remediation, and we offer a trusted certification of conformity with standards. Furthermore, for our private sector clients, we also provide them a product that gives them an opportunity to gain an ROI from their investment in and commitment to the enormous population of individuals with disabilities.

With this overview of the business completed, I'm looking forward to moving on to highlights about our Q2 execution and our operating environment.

Overall, we are very pleased with the company's execution in the second quarter again. Q2 marks the 18th straight quarter of record revenue, ending the quarter at just over $5 million. That is a 117% year-over-year growth since 2019. Our results continue to be driven largely by growth and adoption in our vertical partner and enterprise channels, and monthly recurring revenue at the end of June 30 was $1.6 million, a 105% year-over-year growth from 2019.

Gross profit for the second quarter was $3.7 million or about 70% of revenue. This is a 180% increase from $1.3 million or about 54% of revenue last year. The increase in gross profit and gross margins is a result of our continuous focus on increasing efficiency and the expansion in the level of remediation automation as revenues grow. As mentioned in the past, while gross margin may fluctuate somewhat between quarters, overall, we expect gross margins to continue to improve on an annual basis. We remain very excited about the benefits of being a scalable SaaS business.

New customer acquisition was also strong in Q2 driven largely by traction in our vertical partner channel, ending Q2 at a major milestone of over 20,000 customers. We have almost tripled our customer count since the year-end 2019. I'll point out, we had our first ever $5 million revenue quarter in Q2, solid performance against all internal metrics that we have executed against.

Building on the strategic initiatives we put in place last November, we continue to implement organizational changes in order to accelerate our efforts to build out the scalable technology and IP and the infrastructure to succeed. The center for our technology base, which had been Atlanta, is now Portland, which has also resulted in some changes in our technology personnel.

Heath Thompson will be moving from his position as CEO of the -- of AudioEye effective today. And although his tenure was short, we're very grateful for Heath's leadership and contributions to AudioEye. Heath will transition to work with AudioEye as a strategic adviser, and he will advocate for AudioEye's mission to create a more digitally inclusive world.

David Moradi, he joins us as Chief Strategy Officer and the interim CEO. He is a member of the Board of Directors and the Founder and Manager of Sero Capital. He is fully -- we fully expect to receive the benefit of his deep understanding of the company and his many years of technology and business leadership experience. David has had a significant influence on the company's strategy and operations since he joined us on the Board in the fourth quarter of last year. He served as the Chairman of the Strategy Committee of the Board of Directors. His guidance and his insights that's significantly helped the business scale and to gain efficiencies during this time. David is not only willing to assume role as the interim CEO, but his commitment and belief in the company is reflected in his anticipated compensation package, whereby he is willing to take a $1 an annual salary and only receive additional equity if the company achieve significant MRR and stock growth -- price growth. David and Sero Capital have been ardent supporters of AudioEye since 2014, having participated in every company financing since that time. His continued confidence in the prospects of the company is even further evident by Sero's capital decision to exercise warrants this month, all for cash, even though the warrants had a cashless exercise right. These warrant exercises will result in $880,000 in cash for the company and a further investment by Sero Capital.

In addition, Dominic Varacalli, who has been recently our CTO, has been appointed President. Dominic, who is located in Portland, along with a number of engineers, has a strong -- very strong background in technology and digital products. He will manage and drive our digital and e-commerce presence. He will foster innovation, creativity and agile development to ensure continued rapid scalability. Dominic was previously the CEO and co-owner of his own technology consulting firm and has held various technology leadership roles at Kroger Digital.

I'm also pleased to say we've added another top-tier talent at the company. The Chief Marketing Officer we recently hired, Khurrum Malik. Khurrum has a strong and proven track record as a leader in marketing that is growth-centric. He has led multifunctional marketing teams at leading global brands, including Microsoft, Facebook and Spotify. He has broad expertise in product marketing, in performance marketing and in demand generation. We look forward to his contributing -- him contributing to our hyper growth efforts when he joins us later this month.

Finally, I will continue as Executive Chairman, and you'll have to continue to hear from Sach and me on these quarterly calls. Our focus is still going to remain the same. We're going to acquire customers, grow revenue in MRR, focus on increasing margins and becoming cash flow positive in 2021.

It's worth taking a minute to talk about COVID-19 as well. While we meet or exceed our internal targets and did so in key metrics in Q2, like other businesses, we continue to operate in a challenging economic environment that's driven by the global pandemic. And although demand for digital accessibility solutions remains very strong, we continue to see impacts due to COVID-19 with our customers and prospects across all our channels.

On the new business front, we've seen some deals that have been delayed a little, even though they still move forward and closed at times later than originally expected, in some cases. We also have continued to extend, in some cases, more flexible pricing and other options to our customers on a case-by-case basis to help them manage through the impact of their own businesses from the pandemic. So far, we've only seen, fortunately, a marginal impact on our renewals, substantially in these cases due to events that are out of our control such as bankruptcy proceedings or outright business closures. Overall, we're still pleased to see retention levels near the 90% rate. And we continue to achieve Net Promoter Scores, or NPS, as many people know it, within our installed enterprise client base in the top quartile for technology and SaaS companies.

Our priority throughout this period has been to continue to deliver best-in-class product and service and to focus heavily on customer and partner success. This is the right thing to do for the long term in any event but especially during the current economic conditions.

Of course, we do not know how long the COVID-19-related economic factors will persist. We're now entering the third quarter where the global pandemic has been affecting businesses worldwide and even more so in the last quarter. And as such, it's going to be reasonable to expect some impact on AudioEye's financial and operating performance. We are, however, on the -- also very encouraged, on the other hand, by the continued focus on the need for digital accessibility solutions, which was highlighted again by the 30th anniversary of the ADA recently.

I'll provide just a brief update for our different sales channels now, beginning with our enterprise or direct channel. We continue to bring on new customers at the same consistent level as we've seen in recent quarters. In the second quarter, new customers included prominent brands in large enterprises such as Holland America and TBC Corporation.

Also, our PDF remediation business continued to contribute to revenue in Q2. The business continues to provide a good complement to our core web accessibility offerings. As a reminder, that part of our business is project-based and is not part of MRR.

Moving to our vertical partner or indirect channel. Customer growth in Q2 was very strong. Vertical partner count remained constant in Q2 at 20 partners, and we continue to focus on increased penetration with those partners.

We launched the marketplace as part of our strategy to make AudioEye more accessible to even more businesses and organizations. And we've simplified in the marketplace our pricing. We've enhanced our integrations, and we've expanded our tools there. More specifically, over the last couple of months, we've released more clearly defined, simplified pricing, enables our marketplace customers to quickly and easily identify the AudioEye plan that's most appropriate for their current needs, making it a much better usability experience for our customers.

We're also committed to meeting customers where they are. Not only can they purchase and install AudioEye from our marketplace, we are natively integrated into some content management system app stores. That includes places like Shopify, Duda, Drupal and others. Customers creating websites on these platforms simply select AudioEye and are immediately on the path to a more accessible website.

We've also power -- expanded the power of our AudioEye Pro builder tool, strengthening our artificial intelligence. It's more AI machine learning suggested fixes and better guidance. Even non-developer customers can more easily accelerate their accessibility using AudioEye.

So with that overview completed, I'm going to turn the call over to Sach, our CFO, who can walk through some of the rest of our financial results for the quarter. Sach?

Sachin Barot
Chief Financial Officer

Thanks, Carr. Welcome, David, Dominic and Khurrum. I'm really excited to work with David in his new capacity and continue to drive strategy execution and profitable growth for AudioEye. I will review the financial highlights, and then we'll open the call up for questions.

Let's jump into it. Starting with revenue. Revenue in Q2 was about $5.3 million, reflecting a 117% increase over the last year. The increase in revenue was mainly driven by continued growth in our vertical partner channel as we build our end customer base. This revenue performance also benefited from timing of PDF delivery where we're able to procure and deliver a couple of projects ahead of time. As mentioned earlier, we continue to better our gross margins that stand at 70% for this quarter. While it may fluctuate, we expect our margins to continue to grow over time.

Moving to operating expenses. In Q2, OpEx was $4.5 million, which was an increase of 36% versus Q2 last year. This increase in OpEx was driven by increased investments in talent across various functions, infrastructure and product development.

As we grow the business, we continue to have some variability in expenses from quarter-to-quarter. As we move our technology center to Portland, we'll be investing in technology and intellectual property development. Additionally, we'll continue to invest in marketing and infrastructure as well. Our investments will help us build scalable technology stack and help drive profitable growth. The company also expects to pay separation costs as we make executive and team member changes, resulting in a higher normalized run rate for the next couple of quarters.

Turning towards the bottom line. Net loss available to common stockholders for the second quarter of 2020 totaled $1.4 million or $0.16 per share. This compares with net loss of $2 million or $0.27 per share in Q2 last year.

Some additional metrics. As noted earlier, as of Q2, monthly recurring revenue, or MRR, was about $1.6 million, which was an increase of 105% year-over-year.

Some balance sheet items, beginning with deferred revenue. In the second quarter, deferred revenue was $5.2 million, which was up 65% from $3.2 million last year. Our accounts receivable balance at the end of Q2 was $4 million compared to about $2.5 million at the end of last quarter. The sequential increase in AR was primarily due to both continued growth and some delayed payments. The AR aging is primarily with customers who have chosen to delay payments temporarily. Of note, we continue to collect on our receivables, albeit slightly slower on average than before. At this point, we did not see any major issues with collectability of our AR portfolio.

We ended the quarter with about $2.1 million in cash compared to about $1.8 million at the end of first quarter. Our cash balance reflects contribution of [$1.3] million from PPP loan.

Sero Capital exercised their warrants related to line of credit this week, which will infuse $880,000 of additional capital into the company. During the quarter and to date, we have not drawn on our existing $2 million line of credit, which expires tomorrow, and we don't intend to draw on it.

We are confident in the underlying strength of our business models as well as the diversity and strength of our customer base. We will remain focused on executing against our strategy, drive sustainable long-term growth and continuing to invest in the areas mentioned earlier.

In closing, I'd like to thank all our employees, our customers, partners and all our shareholders for their continued support as we execute against our vision to bring equality in digital. And I wish everyone and your family safety [sound] health.
With that, we'll open the call for questions. Operator, please give instructions for our publishing analysts.

Question and Answer

Operator

[Operator Instructions] Our first question comes from the line of Zach Cummins with B. Riley FBR.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Congrats on a strong quarter.

Carr Bettis
Executive Chairman

Thanks, Zach. Thank you. Thank you very much.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Yes, absolutely. I mean just starting off with that indirect vertical partner channel. I mean were there any particular verticals that stand out in terms of adoption?

Carr Bettis
Executive Chairman

We're seeing some traction across some of the different verticals, Zach. That's not all one focused area. We are seeing some pretty broad and interest in adoption and finding accessibility solutions. So continuing to make progress within those -- within the channel.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Understood. And then I know you don't break it out by partner. But I mean in terms of the entire base, I mean, can you give us a sense of where you're at for penetration rate and kind of give us a sense of what's the opportunity that's still ahead?

Carr Bettis
Executive Chairman

We're still -- within many of the partners, we're at side -- still, we're in early innings, and we're making good progress, but early innings. So we're not publishing, as you said, penetration rates, but there's a lot of runway left. Significantly, the majority of the runway left across the majority of the partners that we're still having success with. So we're -- we still remain optimistic that we have a lot of runway with them on average.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Understood. That's helpful. And then you did note, there was a little bit of attrition in the quarter. I mean was this related to any specific verticals? Or any sort of trends you could point out?

Carr Bettis
Executive Chairman

No. There's no alarming trends here at all. We did have what I would call selective cases. There have been some bankruptcies, and there's been some other things that have occurred that have had an impact on us. Again, it's not material to where we are in the business during the business cycle, and we'd like for that to continue, of course.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Understood. And then I guess in terms of the renewal cycle, it seems like you had a few clients that are taking a little longer than normal. I mean what are you seeing thus far just in recent months and maybe even into the start of Q3 here in terms of the pace of renewal cycles?

Carr Bettis
Executive Chairman

It's -- overall, it's pretty good, actually. There are isolated cases, I would call them, where they're a little slower. But I would say, actually, it's going pretty well overall. Nothing alarming at all. And it is selective cases where renewals are a little slower, and we're being more flexible. It's not the norm.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Understood. That's helpful. And then, I guess, just kind of go across all the customer bases. I mean for your marketplace offering, I mean, could you give us a sense of the adoption trends you've seen there thus far? I know when you were rolling this out, you're giving a 90-day free trial. So I was wondering if you're starting to get to the end of those where you're seeing -- if customers are deciding to proceed for it and actually become a paying customer.

Carr Bettis
Executive Chairman

Zach, we're pleased with the progress we're making there. We really do. We've been learning a lot also in that new channel for us. So yes, we are starting to see conversions. We're pleased with the progress we're making there.

And I'll point out, you may have noticed we have a new hire, the CMO, who's going to bring a wealth of experience and skill that we believe is going to benefit all channels. And certainly, I think we'll continue to benefit what we're doing in that marketplace on our own channel. So we have a -- we're early, but I would say it's going well, and we're pleased with the progress we're making in that channel right now.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Got it. That's helpful. And then pretty nice transition into the next question. I mean why now in terms of all the executive changes that you're making and moving much of your development resources from Atlanta to Portland?

Carr Bettis
Executive Chairman

We're really trying hard to put in place what we started last November, really, with the organizational teams we're making now are just trying to accelerate our efforts to build out the scalable tech and our IT and the infrastructure necessary to succeed. We're not here to -- we're here to eradicate the barriers of digital accessibility. Dominic and his team, which has joined us not too long ago, are really, really strong in directions that we're taking the technology. We're going to continue to focus our efforts there on scalable tech. That's going to grow -- help us grow our customer base and bring MRR higher and margins higher. So I feel like we're -- David is joining as interim CEO, but he's also joining us as Chief Strategy Officer. He's really been very important since he joined the Board in November. So we really thought as a Board the best way to achieve our objectives to go fast, hard and lean is to make the changes that we made. And it's been very -- and by the way, it's been a very amicable and smooth transition as we've unfolded it here today.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Understood. And then, Carr, in terms of the legal environment, I mean, with the surge in e-commerce and the digital world really becoming that much more important during COVID-19, can you give us an update in terms of what you're seeing on the front for digital accessibility lawsuits? Has there been an uptick in any specific verticals with the rise in e-commerce?

Carr Bettis
Executive Chairman

I would say that the activity has been high this year again. And it's not just in the federal court. It's in the state court. So it's continued to be a focus area. We are -- we continue to remain optimistic that there are tailwinds here that are strong. So yes, there's been -- there's a lot of demand [hunters] still in play, probably more diverse than they were 9 months or a year ago in terms of the segments. It's clearly more diverse. I think the issue is going to remain.

There's just not enough websites providing accessibility. And it's caught the attention of the, as you know, the legal community. I think it's in the minds of many more people than it was 9 months or a year ago. And so we see the tailwinds still very, very strong for the market for digital accessibility.

Zachary Cummins
B. Riley FBR, Inc., Research Division

Understood. And Sach, I guess just closing out, I figure I might as well ask a financial question. But I mean excluding the loan from the PPP this quarter, I think cash burn was close to $950,000 in some off one way or the other. I mean you're going to have another almost $900,000 coming on to the balance sheet next quarter. I guess how are you thinking about the progression of the cash burn rate as we move towards your target of positive free cash flow at some point in FY '21?

Sachin Barot
Chief Financial Officer

Yes. Thanks, Zach. So look, the way I think about cash burn, you have to consider year-to-date. And if you -- when you compare year-over-year first half of the year, the cash burn is significantly down. It's 1/3 of what it used to be in the first half last year. And you know we'll be getting some capital infusion from Sero Capital exercising warrants as well.

Look, as we continue to grow revenues and continue to expand margins, we strongly believe that we'll continue to generate more cash versus what we are generating today from sales. And we are confident in becoming cash flow positive in 2021.

Operator

Our next question comes from the line of Allen Klee with National Securities.

Allen Robert Klee
National Securities Corporation, Research Division

You guys have been doing a really nice job with steadily improving the gross margin, coming up with 70% in this quarter. I was just wondering if there was anything about the mix this quarter. I know you mentioned PDF was pretty active. Does that have a higher margin than the average? Or is there anything unusual? Or would you say that the mix was kind of a reasonable number to think about going forward?

Carr Bettis
Executive Chairman

Yes. Allen, thank you for that question. The place we're going to have our highest margins over time is going to be the continued expansion within our relationships and the continued high margins that we can get through enterprise efforts as well. We're going to continue to expect margins to grow and improve over time.

There's no question that we are investing in the earlier cycles of the new product markets that we're serving where our margins are going to reflect the mix of sort of acceleration in margins for our historical product offering in segments that are SaaS-based and earlier stage markets where initial margins may be lower or PDFs or margins may not be quite as sustainably high over time. But I think we're well -- I think we're set up well to continue to grow and improve it over time, and that's our expectation.

Some of the moves we've made today are centered around -- continuing to remind us that we are focused on MRR, growing MRR and improving margins over time, and we expect to be able to do that on our path to being cash flow positive next year.

Allen Robert Klee
National Securities Corporation, Research Division

And can you remind us the exercise of the warrants? Is that going to increase your diluted share count? And if so, by how many shares?

Sachin Barot
Chief Financial Officer

Yes. It's about 146,000 shares. And yes, it will increase the dilution amount once we convert it.

Allen Robert Klee
National Securities Corporation, Research Division

Okay. And then you talked about that you were going to do some certain type of higher expenses in the next few quarters, but I missed what you said that was related to. Could you delve into that?

Carr Bettis
Executive Chairman

Yes. There's a mix, right? Because we're going to gain -- we're going to continue to gain efficiencies, but we are going to carry around some separation costs over the next several weeks, even months, and as we reallocate resources into Portland. So it's a little overlap there. We're continuing to invest in new key people. I mentioned the CMO. So we're going to continue to make investments. But look, all of this is designed to do, what, to make us accelerate growth and to accelerate growth faster, which over time is going to show up in MRR and then improved margins. So the Board feels very confident about this strategy and the decisions that, that's the ultimate goal here, and they were on the right path.

We have the right pieces in place to continue on that path, accelerating MRR and improving margins over time here.

Allen Robert Klee
National Securities Corporation, Research Division

I would agree that it sounds like it's definitely the right thing to do for the long run. Is there any way you can help us with our models in terms of the magnitude of what these kind of temporary type additional costs would be?

Carr Bettis
Executive Chairman

No. I think we don't have -- I mean the Q is going to disclose some information, I think, that you'll be able obtain tonight to work through in terms of what some of the severances -- how the severance will show up. That's probably a good starting point. But we're -- we are still making adjustments along this path. Again, we're going -- in the long term, we're going to be gaining the -- we really believe we're going to be gaining efficiencies and improved margins as a result of the sort of dynamic moves that we're making today -- or we wouldn't be making them. We're focused on -- like I say, we're focused on MRR growth, customer acquisition and improving the margins, and we think these steps are the right steps to do that for the longer term.

Operator

Thank you. At this time, this concludes our question-and-answer session. I'd like to turn the call back over to Dr. Bettis for any closing remarks.

Carr Bettis
Executive Chairman

I just want to say thank you to all of you for joining us today. We had good attendance. I really appreciate you being here. I also want to thank our employees, partners and investors for their continued support in general. And we certainly look forward to updating you on our next call. Thanks, everyone. Be well.

Operator

Thank you. Before we conclude today's call, I would like to remind everyone that a recording of today's call will be available for replay via link available in the Investors section of the company's website.
Thank you for joining us today for AudioEye's Second Quarter 2020 Earnings Conference Call. You may now disconnect.