AudioEye, Inc.
Second Quarter 2024 Earnings Conference Call
July 25, 2024

<u>Presenters</u>
David Moradi, Chief Executive Officer
Kelly Georgevich, Chief Financial Officer

<u>Q&A Participants</u>
Richard Baldry - ROTH
James - B. Riley Securities
Scott Buck - H.C. Wainwright

Operator
Good afternoon and welcome to AudioEye's Second Quarter 2024 Earnings Conference Call.

Joining us for today's call are AudioEye's CEO, Mr. David Moradi, and CFO, Ms. Kelly Georgevich. Following their remarks, we will open 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 a 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 Chief Executive Officer, 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, confident, 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 is subject to risks and uncertainties. Actual results could, materially, differ because of 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 reports on Form 10-Q, and in its other 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 reflect management's beliefs only as of the date hereof. AudioEye does not undertake any duty to update or correct any forward-looking statements.

Further, management's remarks today will include certain non-GAAP financial measures. A reconciliation of the most direct comparable GAAP financial measures to these non-GAAP financial measures is available in the company's earnings release or otherwise posted in the Investor Relations section of its website at www.audioeye.com.

Now, I'd like to turn the call over to AudioEye's Chief Executive Officer, Mr. David Moradi. Sir, please proceed.

David Moradi
Thank you, Operator. We're pleased to report that our business momentum is strong. Sequential revenues grew from approximately $8.1 million to $8.5 million, representing an annualized growth rate of 19%. ARR increased sequentially by $1.3 million, an increase of 60% ,compared to ARR growth of $800,000 in the first quarter.

We were able to grow revenues and ARR without adding additional costs, with operating expenses roughly flat, sequentially. As a result of revenue growth and prudent expense management, we generated record adjusted EBITDA of approximately $1.5 million, a margin of 17%.

Looking at free cash flow in terms of EBITDA minus CapEx, we generated a record $1 million in free cash flow from operations.

We were close to achieving the Rule of 40 in the second quarter and expect to hit the Rule of 40 in the third quarter.

We saw notable growth in both our enterprise and partner and marketplace channels, with both channels contributing equally to revenue growth, sequentially. The enterprise channel is growing at the fastest rate in several years, due to our investment in R&D and the effective implementation of our go to market approach. We are excited to report that this momentum is continuing and driving a further increase in our full year guidance, which I will discuss shortly.

I'll now cover a few other notable developments in the quarter. On our April earnings call, we discussed significant regulatory developments for digital accessibility, including the Department of Justice's final rule under Title II of the Americans with Disabilities Act, which mandates that state and local government entities ensure their websites and mobile applications are accessible to people with disabilities.

The regulation applies to a wide range of state and local government entities, including public schools, community colleges, universities, hospitals and clinics, police departments, libraries and transit agencies.

Shortly after the Title II announcement, the Department of Health and Human Services Office for Civil Rights published a final rule that bolsters protections for individuals with disabilities under Section 504 of the Rehabilitation Act.

The rule stipulates that web content and mobile applications provided by organizations that receive funding from HHS, including hospitals, doctors' offices, social services, nursing homes and others, are accessible for people with disabilities.

Like the DOJ Title II rule, the HHS rule outlines specific digital accessibility requirements, including adherence to WCAG 2.1, and requires compliance by May, 2026, or May 2027, depending on the organization's size.

To understand the impact of the HHS rule, we scanned over 96,000 healthcare website pages, over the United States. The average page had 84 accessibility issues, which is alarming.

Approximately 96% of the Internet is currently inaccessible to people with disabilities. Title II and HHS represent significant expansion opportunities, and we are uniquely positioned to meet the increase in demand with our direct sales team and reseller channel. Our AI and human assisted technology approach is the only way to address the problem at scale and deliver a solution to millions of websites.

Over the last three months, we have been working hard to develop strategic initiatives and growth plans with our existing partners, including Finalsite, the market share leader in K through 12 schools. The goal is to penetrate all of their installed base over the next three years with a comprehensive go to market plan. Both of us will contribute significant resources to make this happen.

There is a significant opportunity to penetrate other industries under Title II and HHS, which includes state and local government, higher education and the healthcare industry. We already have a partnership with the dominant platform for cities, towns and municipalities, as well as key partnerships in the healthcare industry.

We expect to create new partnerships in these industries as we execute our go to market plan and expect further announcements, soon.

We are also monitoring demand from the European Accessibility Act and California's AB 1757 legislation. We expect to see further developments on these items over the next few months.

Moving on to guidance. We continue to expect quarterly revenues to increase without significant additional expense, resulting in increased operating leverage and cash flow generation. For the third quarter, we are guiding for revenue between $8.85 million to $8.95 million, representing an annualized growth rate of approximately 20%.

We expect to generate adjusted EBITDA between $1.85 million to $1.95 million and adjusted EPS between $0.15 and $0.16. We expect to become a Rule of 40 company in the third quarter with the potential to increase growth rates and adjusted EBITDA margins in 2025, and beyond.

We are increasing our 2024 revenue guidance to between $34.5 million from $34.8 million. We are also increasing our adjusted EBITDA guidance from $4.5 million to $5.5 million, to $6 million to $6.3 million. Adjusted EPS is now expected to be between $0.48 and $0.51 per share, an increase of $0.08 at the midpoint. This represents an increase of around 18% from previous guidance.

I'll now turn the call over to AudioEye CFO, Kelly.

Kelly Georgevich
Thank you, David. As David discussed, revenue again hit record levels with Q2 2024 revenue at $8.5 million, marking our 34th quarter of record revenue and a 19% annualized growth rate.

Annual recurring revenue, or ARR, at the end of the second quarter of 2024 was $33.3 million, a $1.3 million increase and a 60% improvement in ARR growth from the first quarter of 2024.

Our two revenue channels are both showing strong performance with high teen annualized sequential growth rates in both channels. The partner marketplace channel includes all revenue from our SMB focused marketplace products and revenue from a variety of partners who deploy these same products for their SMB customers. In the second quarter of 2024, this revenue channel grew 13% year-over-year, representing 59% of revenue and around 60% of ARR.

AudioEye's enterprise channel consists of our larger customers and organizations, including those with non-platform websites who generally engage directly with AudioEye sales personnel for pricing and solutions. The enterprise channel grew 2%, year-over-year, and 5%, sequentially, or 18% annualized. In the second quarter, the enterprise channel contributed 41% of revenue and around 40% of ARR.

On June 30, 2024, our customer count was approximately 121,000, a 16% increase from 104,000 customers on June 30, 2023, and an increase of approximately 9,000 customers from March 31, 2024. The increase in customer count was driven by additions in both the partner marketplace and enterprise channels.

Gross profit ticked up 1% ,sequentially, and 2%, year-over-year ,to 79% of revenue, or $6.7 million compared to $6 million in Q2 of last year. The increase in gross margin was a result of approximately $650,000 of revenue growth, year-over-year, and a $25,000 decrease in cost of revenue, over the same period.

While revenues increased approximately $650,000 from the second quarter of 2023, operating expenses decreased approximately 11%, or $900,000 to $7.2 million. The decrease in operating expenses was due primarily to increased efficiencies in sales and marketing and the completion of significant initiatives in R&D, partially offset by higher non-reoccurring expenses in G&A.

Our total R&D spend in Q2 2024 was approximately $1.7 million with approximately $450,000 reflected the software development costs in the investing section of the cash flow statement. This was down approximately $900,000 from $2.6 million in Q2, 2023. The total R&D spend is about 20% of our revenue this quarter, versus 33% in the comparable period of prior year and 22% in the first quarter of 2024. We continue to believe the current investment in R&D of around 20% is appropriate for 2024.

Net loss in the second quarter of 2024 was $700,000, or $0.06 per share, compared to a net loss of $2 million or $0.17 per share in the same year ago period. Total net loss decreased 63%, or $1.2 million from the prior year's comparable period, driven by an increase in revenue, strategic and efficient spending in sales and marketing and technological investment.

Our Q2 adjusted EBITDA was a record $1.5 million or $0.12 cents per share, a $1.7 million improvement year-over-year. The primary adjustment to GAAP earnings and EPS for Q2 2024, for non-cash share-based compensation, depreciation, amortization, interest expense, and litigation expense.

Our balance sheet continues to be well capitalized with $5.1 million of cash as of June 30, 2024. Cash decreased by approximately $1.9 million in the quarter, primarily due to the $2.4 million final earnout payment related to the acquisition of the Bureau of Internet Accessibility in March, 2022.

In the second quarter of 2024, we also repurchased approximately $300,000 of shares and received net proceeds from our aftermarket offering of approximately $650,000.

Free cash flow calculated as $1.5 million of adjusted EBITDA, less $450,000 of software development costs, was $1 million in the second quarter. We expect free cash flow to continue to increase in the third and fourth quarter of 2024.

With that, we open up the call for questions. Operator, please give appropriate instructions.

Operator
Thank you. We will now take questions from the company's publishing and analysts. At this time we will be conducting a question-and-answer session. If you would like to ask a question, please press “*”, “1” on your telephone keypad. A confirmation tone will indicate your line is in the question queue. You may press “*”, “2” 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 comes from the line of Richard Baldry with ROTH. Please proceed with your question.

Richard Baldry
Thanks. You've done a really good job sort of growing your adjusted EBITDA pretty fast. As revenues have started to grow again, you've been in a sort of a cost containment or in cutting mode. How do you feel about the existing sort of infrastructure headcounts in different places? If the growth sort of continues to pick up the way it has. When do you feel like you really kind of need to get back to hiring, whether that's in sales or support areas to support the increasing revenue base? Thanks.

David Moradi
Hi, Rich. Yeah. As you can see, the model is pretty scalable. We've made a lot of investments in R&D and the go to market. There would be some incremental investments, generally, to generate and then support new business. But a good amount of incremental revenue, I think, is going to drop straight down. So, I don't think we need to invest a ton more, just mostly on sales and marketing, not the infrastructure.

Richard Baldry
Yeah. I wanted to ask specifically about the COGS line because it's been flat to down even on a sequential basis, or pretty steadily for almost the last two years. What would cause that to start to climb again? Like how fixed can that be, as your top line grows?

Kelly Georgevich
Yeah. We've been happy to see gross margin improve now to 79%. We feel pretty good about the efficiencies we've run through that line. It is a matter of looking at the mix of support and different investments in that line, but we feel pretty good about holding that 79% through 2024 and kind of continuing into 2025. We feel pretty good about our gross margins, overall.

Richard Baldry
Got it. And can you talk a little bit about the balance sheet? Your access to capital is obviously a lot better in recent periods now. Does that change sort of any of your acquisition plans or willingness to sort of invest in the business on a more accelerated basis? How comfortable do you feel, what the debt levels, where they're at? Would you prefer basically just wipe them out ASAP and then move forward from there? Just help us think about that a little bit. Thanks.

David Moradi
Yeah. We feel pretty good. Kelly can get into the ATM a little bit. I don't think we really need money. So that's the good news. We're cash flow generative.

Kelly will get into the ATM a little bit, though.

Kelly Georgevich
Yeah. We did open up an ATM for a relatively small amount, compared to our market cap of the $7 million. We do like to have that dent there and be opportunistic about, potentially, raising capital to paydown our debt and reduce our interest expense.

Richard Baldry
And maybe just a few seconds on how you do view acquisition potential now that you've got a much larger market cap to deal with.

David Moradi
We don't really discuss M&A. We're always looking around, but we're not going to discuss it on this call.

Richard Baldry
Okay. Thanks for your help.

David Moradi
Thank you.

Operator
Thank you. Our next question comes from the line of Zach Cummins with B. Riley Securities. Please proceed with your question.

Zach Cummins
Hi, good afternoon, David and Kelly. Congrats on the solid results and thank you for taking my questions. David, first one for me is, can you just talk about the progress you're seeing in the enterprise channel there? And really, what sort of momentum are you expecting to see there in the coming quarters as you've really started to regain traction with that segment returning to year-over-year growth?

David Moradi
Yeah, it's been pretty good. We made a lot of investments there in R&D, which really gives us a full product suite to beat the competition. We've also made a lot of investments in our go to market and we're seeing record leads, strong conversions. The pipelines continue to grow, so it's really clicking. I think we're outgrowing the market generally by 2x to 3x, right now.

Zach Cummins
Got it. My follow up question is really just around your partnerships. I think on the prior call you mentioned that just within your current partners, you had access to 80,000 websites that would be really great targets under the new regulation. Can you talk about--obviously, you've made more inroads with Finalsite, but can you talk about some of the work that you're doing on that side to really accelerate momentum, within that partner channel?

David Moradi
You saw the press release. We're both super excited about the opportunity of penetrating their entire customer base. Both of us are going to have a huge focus on it, deploy resources and really the opportunity for Title II is huge, and we're in a great spot with the dominant platform in K to 12. So, we're really excited about that one and more to come on the other one, so stay tuned.

Zach Cummins
Got it. Well, thanks for taking my questions and best of luck with the rest of the quarter.

David Moradi
Thanks, Zach.

Operator
Thank you. Our next question comes from the line of George Sutton with Craig-Hallum Capital Group. Please proceed with your questions.

James
Good afternoon. This is James on for George. Nice results. As a follow up to the Finalsite commentary, can you provide some more detail on what those resources are that you might be contributing; quantify any incremental costs?

And then, how should we think about operating expense growth or operating leverage over the next couple of years, as you target some of these mandated opportunities?

David Moradi
Yeah, we're not really getting into the details of that, the confidential contract, but I would figure marketing resources and awareness campaigns, comarketing, but I can't really get into all the details that we're going to do.

What was the second part of your question?

James
Just sort of how to think about operating leverage, operating expense growth over the next couple of years, sort of as you target these mandate opportunities. Just because since you're kind of going indirectly, I'd assume there wouldn't be a lot of incremental expense as you sort of add new customers.

David Moradi
Yeah. I think we feel pretty good with where we're at. I've already made the investments, like I said, and R&D model is scalable. So, we feel good about the investing a little bit on sales and

marketing in the future potentially. But like I said before, I think that's it's a scalable model with potential to really increase margin.

James
Sounds good. And then I'm just also kind of curious on any initial interactions you maybe had with some of the constituents that are going to be impacted by the mandate. That's it for me. Thanks guys.

David Moradi
Constituents, I'm trying to understand that.

James
Just basically people that would be impacted by the mandate. So, any government agencies, anybody that's required--

David Moradi
--Yeah, yeah. We're seeing a lot of government leads come in, more than ever. So, we're having a lot of conversations at the moment. Those deals aren't all closing, but we're having a lot of conversations. So, they're very aware of it. I think it's going to start to tick up into 2025 from a demand standpoint. We don't have this in our numbers for this year at all.

James
Great. Thank you.

David Moradi
Thank you.

Operator
Thank you. Our next question comes from the line of Scott Buck with H.C. Wainwright. Please proceed with your question.

Scott Buck
Hi, guys. Thanks for taking my questions. David, as a bit of a follow up to that last question, I'm curious, historically, have you seen customers be proactive in addressing these mandates, or typically, does it take more of a push past the mandate date, whether that's DOJ lawsuits or whatnot, to really get people moving in the right direction?

David Moradi
We don't have a lot of experience with this, so I can't really tell you. There's a lot of mandates happening at the moment with the EU, Title II and HHS now. So, we'll have to see how that plays out. My guess is in 2025, it's going to really start to pick up.

Scott Buck

Right. Okay. Okay. So that's perfect. And then in terms of capital allocation, as you guys build cash through the remainder of the year and into next with positive free cash flow, how are you thinking about allocation? I mean, do you start piling more into marketing at that point to further accelerate growth, or just what are your thoughts there?

David Moradi
Yeah. We like being profitable. Look, if the LTV to CAC increases, we'd like to potentially spend more on sales and marketing there, but that would really have to tick up. But we like growing off free cash flow, so expect that to continue.

Scott Buck
Okay. And then last thing, I know you guys repurchase some shares during the quarter. Stocks obviously moved in your favor. How are you feeling about the repurchase today, and what's left on that authorization?

David Moradi
Yeah, we are buying the stock pretty cheap, like, I don't know, two to three times revenue. And it's a lot higher, so, I don't know if we're going to be buying back anymore. And we have an ATM out there, so I don't think so on the buyback side.

Scott Buck
Yeah. All right. Appreciate it, guys. Thanks for the time.

David Moradi
Thank you.

Operator
Thank you. At this time, this concludes our question-and-answer session. I would now like to turn the call back over to Mr. Moradi for his closing remarks.

David Moradi
Thank you for joining us, today. I want to thank our employees, partners, and investors for their continued support. We look forward to updating you on our next call.

Operator
And 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 a link available in the Investors section of the company's website. Thank you for joining us, today, for AudioEye's second quarter 2024 earnings conference call. You may now disconnect.