AudioEye
Third Quarter Earnings Call
November 7, 2024

Presenters
David Moradi - Chief Executive Officer
Kelly Georgevich - Chief Financial Officer

Q&A Participants
George Sutton - Craig Hallum
Richard Baldry - Roth Capital Partners
Zach Cummins - B. Riley Securities

Operator
Good afternoon, and welcome to AudioEye's Third 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 and 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 risk and uncertainties.

Actual results could materially differ because of factors discussed in today's press release, in 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 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 directly comparable GAAP financial measures and 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 would like to turn the call over to AudioEye's Chief Executive Officer, Mr. David Moradi. Sir, please proceed.

David Moradi
Thank you, operator. We are pleased with our strong performance in the third quarter. We achieved the high end of our revenue guidance from July and beat adjusted EBITDA guidance. We also exceeded the Rule of 40 for the first time. Sequential revenues grew from $8.47 million in the second quarter to $8.93 million in the third quarter, representing an annualized growth rate of 21%. Adjusted EBITDA margin improved sequentially, from 17% in the second quarter to 23% in the third quarter. Third quarter revenue grew 14% year-over-year, while we reduced non-GAAP operating expenses by 10%.

Looking at adjusted free cash flow, in terms of EBITDA minus CapEx, we generated a record $1.6 million in the quarter compared to $1 million in the second quarter and negative $200,000 in the third quarter of last year. We continue to see impressive performance in our Enterprise and Partner and Marketplace channels. Both channels grew organically, around 5% sequentially or 21% annualized. Strong business momentum is leading us to increase our full year guidance, which I will discuss shortly.

I will now cover a few other notable developments in the quarter. As discussed on our last earnings call, we recently expanded our partnership with Finalsite, the market share leader in K-12 schools. The goal is to penetrate all their installed base over the next three years with a comprehensive go-to-market plan, which is being implemented now.

During the quarter, we announced a significant expansion of our partnership with CivicPlus, a leader in public sector SaaS technology solutions with over 10,000 government customers, the most of anyone in the industry. The partnership will include enhanced go-to-market strategies to provide our best-in-class digital accessibility platform to penetrate the local government market. The goal is to penetrate their entire customer base over the next three years. We have a long history of working with Finalsite and CivicPlus and expect that these partnerships will generate substantial revenue over the next three years.

Next, I'd like to discuss the accretive acquisition of ADA Site Compliance completed at the end of the third quarter. This acquisition is another positive step in our ongoing mission of eradicating all barriers to digital accessibility. ADA Site Compliance is a website accessibility compliance solution, providing audits and best practices. They have an impressive client list where we can leverage our products to expand customer relationships further.

We are also excited about ADA Site Compliance’s attractive financial profile. This acquisition is immediately accretive. In terms of top line, ADA Site Compliance generated around $2 million of revenue in 2023 with approximately 70% of its revenue being recurring. We have already integrated their employees into our departments and plan to move their customers on to our platform over the next few months.

By acquiring ADA Site Compliance, we gained a strong and knowledgeable team. I want to extend a warm welcome to these new AudioEye members. One key reason ADA Site Compliance wanted to combine with us is our breadth and depth of product offering, which is the most comprehensive in the industry.

Earlier today, we announced the launch of our Accessibility Protection Status. This innovation builds on our legacy as pioneers in digital accessibility. The Accessibility Protection Status gives customers a transparent picture of what we fix with automation and experts utilizing AI. Customers will receive comprehensive risk assessments, giving transparent reporting details of each customer's level of legal protection.

These features will help clients understand their risk profile. Most vendors in the industry use an accessibility score to give customers a level of risk, which creates a false sense of security. An accessibility score is arbitrary and varies significantly from vendor to vendor. Also, the accessibility score will only analyze what automation can detect and does not give you a full picture of your risk, as many high-risk issues can only be detected with experts.

Customers who implement AudioEye's platform and products gain up to 300% greater protection than with traditional accessibility consulting and 400% more than automation-only competitors.

In the third quarter, we announced the general availability of our Accessibility Testing Software Kit, or SDK. The SDK helps developers address accessibility issues early in the software development life cycle. These developers have time and resources to fix accessibility issues at the source. The SDK provides a flexible way to support different types of testing in pre-production environments. This offers yet another option to meet customers wherever they are to solve digital accessibility issues.

During the quarter, we also announced that we have achieved HIPAA compliance and SOC 2 Type II certification. These milestones reaffirm AudioEye's ongoing dedication to strengthening data protection, security measures and confidentiality for its customers, particularly those in the health care sector, which will be impacted by regulations under HHS and other industries with stringent data protection requirements.

Moving on to guidance, we expect revenue for the fourth quarter to increase without significant additional expense. For the fourth quarter, we are guiding revenues between $9.7 million and $9.8 million, representing 24% year-over-year growth. For the full year 2024, we expect revenues between $35.2 million and $35.3 million. We are increasing our adjusted EBITDA guidance for the fourth quarter to between $2.2 million and $2.3 million, representing a 23% margin. We are also increasing our full year 2024 adjusted EBITDA to $6.62 million to $6.72 million, with adjusted

EPS between $0.54 to $0.55. The updated forecast for the fourth quarter implies Rule of 47 at the midpoint.

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

Kelly Georgevich
Thank you, David. As David discussed, revenue again hit record levels with Q3 2024 revenue at $8.9 million, which translates to a 21% annualized growth rate and 14% growth rate over the comparable period of prior year, marking our 35th quarter of record revenue.

Annual recurring revenue, or ARR, at the end of the third quarter of 2024 was $36.2 million, a $2.9 million increase sequentially, which was driven by both a significant enterprise and reseller ARR increase and contributions from the acquisition of ADA Site Compliance.

Our two revenue channels are continuing to generate strong results, with high annualized sequential growth rates in both channels. The Partner and 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 and had near record-setting ARR growth with approximately $1 million of sequential ARR increase in Q3. In the third quarter of 2024, this revenue channel grew 13% year-over-year and 5% sequentially or 21% annualized. This channel represents 59% of revenue and around 58% of ARR.

AudioEye's Enterprise channels 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 organically around 14% year-over-year and 5% sequentially or 21% annualized. In the third quarter, the Enterprise channel contributed 41% of revenue and around 42% of ARR.

On September 30, 2024, our customer count was approximately 126,000, an 18% increase from 107,000 customers on September 30, 2023 and an increase of approximately 5,000 customers from June 30, 2024. The increase in customer count was driven by additions in both the Partner and Marketplace and Enterprise channel.

Gross margin picked up 1% sequentially and 3% year-over-year to 80% of revenue, with gross profit at $7.1 million compared to $6.1 million in Q3 of last year. The increase in gross margin was a result of approximately $1.1 million of revenue growth year-over-year and only marginal increases to cost of goods sold over the same period.

On a GAAP basis, operating expenses increased approximately 9% to $8.1 million, driven by higher nonrecurring and business combination expenses. Outside of these items, we saw decreases in expenses of approximately $500,000 year-over-year.

Our total R&D spend in Q3 2024 was approximately $1.6 million, with approximately $450,000 reflecting the software development cost in the investing section of the cash flow statement. This was down from $2.4 million in Q3 2023. The total R&D spend is about 18% of our revenue this quarter versus 31% in the comparable period of prior year and 20% in the second quarter of 2024. We continue to believe that current investment in R&D is appropriate.

Net loss in the third quarter of 2024 was $1.2 million or $0.10 per share compared to a net loss of $1.4 million or $0.11 per share in the same year ago period. The decrease was driven by additional revenue and gross profit and efficiencies in R&D, offset by increases in sales and marketing, nonrecurring litigation and business combination expense.

Our Q3 adjusted EBITDA was a record $2 million or $0.16 per share, a $1.7 million improvement year-over-year. The primary adjustments to GAAP earnings and EPS for Q3 2024 were noncash share-based compensation, business combination costs associated with the acquisition of ADA Site Compliance, depreciation, amortization, interest expense and litigation expense.

Our balance sheet continues to be well capitalized with $5.5 million of cash as of September 30, 2024. Cash increased approximately $400,000 in the quarter, driven by net cash provided by operating activities and proceeds from our at-the-market offering of around $2.9 million, offset by $3.1 million payment for the acquisition of ADA Site Compliance.

Free cash flow calculated as $2 million of adjusted EBITDA with $450,000 of software development costs, was $1.6 million in the third quarter. We expect to see this continue to increase in the fourth quarter.

On November 1, we completed the at-the-market offering, raising $7 million of cash at an average share price of $24.65.

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

Operator
Thank you. We'll now take questions from the company's publishing analysts. 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 to remove yourself from the queue. For participants using speaker equipment, it may be necessary to pick up the handset before pressing the star keys. One moment while we poll for questions.

And our first question comes from George Sutton, Craig-Hallum.

George Sutton
Thank you. Nice results, guys. So, David, I'm curious when you talk about Finalsite and CivicPlus both being resellers you can fully penetrate over a three year period, I just want to make sure I'm hearing that correctly. Is that a practical assumption, or is that just simply touching their

customers and then giving them the ability to buy? I just want to see how significant we're talking.

David Moradi
We think it's very significant. Full penetration would be all of their customers buying the product, so it changes the face of the company. I mean, it would be tens of millions of dollars additional.

George Sutton
Okay. We are 36 hours past finding out we're going to have a new administration coming in next year. And I'm just curious, given what I would expect to be a less pressured regulatory environment, the things that are driving our regulatory changes, can you talk about if there is any change to those? I believe they're in the register, so I don't think so, but I just wanted to confirm that.

David Moradi
I don't think so. We've analyzed it. I don't think the rule for Title II or HHS can be rolled back, so not concerned with that.

George Sutton
Okay. Last question is a go-to-market question. When I think of ADA being an audit business, you being a software business, those have historically been two somewhat separate offerings. Can you just explain to us how you're going to market with the combination, or are you still going separately and then finding cross-sell opportunities? Just curious how that's working.

David Moradi
Yeah. I think it's a good match with our customer base. We see an opportunity to migrate and up-sell their customers to AudioEye products and services. We are going pretty quickly with this integration. We've moved the employees over to our departments and expect to move their customers over over the next few months.

George Sutton
Got you. Okay. All right. I appreciate the time. Thanks, guys.

David Moradi
Thank you.

Operator
Thank you. Our next question comes from Richard Baldry, ROTH Capital Partners.

Richard Baldry
Thanks. When we look at the acquisition first, do you think you view the synergies you can get out of that more from sort of overlapping in OpEx, or do we view it as more you keep people

because they've got some domain expertise and you can slow your own internal hiring ahead? How do we think about when those two are integrated and how does it work?

David Moradi
Yeah, we think we're going to grow the revenue base like we did with the Bureau back in 2022. We grew that by about 50% from where we bought it. So we think there's a similar opportunity there over the next two, three years. And it's accretive from day one and will continue to be accretive.

Richard Baldry
Great. Then when you think about some of these partnerships, if they were to gain meaningful traction on sort of a near-term basis, what do you think the toughest scaling point for your ability to grow that quickly is? Is it on the implementation side, sort of adding heads to do that? Is it on the challenges of integration more determined by each customer's ability to sort of work with your teams? What -- how do you view your ability to respond if sort of that customer adoption was to take off? Thanks.

David Moradi
I think it's highly scalable. I don't foresee any problems on implementation, the way we do things with AI and automation. So I don't see that. We can handle it. They're doing the selling and account management, so we can handle the implementation side.

Richard Baldry
Last for me would be you're exceeding sort of Rule of 40 now. Do you think -- is it the right time to continue to try to scale the EBITDA line, or do you think it's more important to take any upside you have now and sort of push it back into the go-to-market part of the business? Or do you think you still have an ability to sort of balance the two and sort of grow that number over time? Thanks.

David Moradi
I think we can grow them both in the future, so there's more scale on EBITDA margin. I think it can push up over time, and we could generate in the 20s or 30s potentially on the revenue side.

Richard Baldry
Great. Thanks. Congrats on a great quarter.

David Moradi
Thank you.

Operator
Thank you. Once again, if you would like to ask a question, press star, one on your telephone keypad. That’s star, one.

Our next question comes from Zach Cummins, B. Riley Securities.

Zach Cummins
Hi, good afternoon. Thanks for taking my questions. David, I was curious if you've started getting any sort of inbound demand with the upcoming mandates for accessibility in Europe in June of 2025.

David Moradi
We're seeing quite a few leads coming in. They're not converting to deals yet, but people are more and more aware of it as the months go on. I'm seeing more and more in the calls that I'm monitoring.

Zach Cummins
Understood. And my one follow-up is really, on the gross margin side of it, nice to see it hitting the 80% mark this quarter. Just curious how we should think about the progression of that moving forward. Is there still room for expansion as we go forward on that side?

Kelly Georgevich
Yeah, I think we're pleased to see it tick up both year-over-year and sequentially. We feel good about the 80% going forward. It's all about product mix and efficiencies, but we have been able to scale that revenue and be efficient in cost of revenue. And we see that going forward, as well.

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

David Moradi
Thank you.

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

David Moradi
Thanks, everybody, for joining us, and we will see you on the next call.

Operator
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 website. Thank you for joining us for today -- for AudioEye's Third Quarter 2024 Earnings Conference Call. You may now disconnect.