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AudioEye, Inc.

Fourth Quarter 2023 Earnings Conference Call

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CORPORATE PARTICIPANTS

David Moradi, *Chief Executive Officer*

Kelly Georgevich, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

George Sutton, *Craig-Hallum Capital Group*

Zach Cummins, *B. Riley Securities*

Scott Buck, *H.C. Wainwright*

PRESENTATION

Operator

Good afternoon and welcome to AudioEye's Fourth Quarter and Full Year 2023 Earnings Conference Call.

Joining us today on today's call are AudioEye's CEO, Mr. David Moradi, and CFO, Ms. Kelly Georgevich.

Following the remarks, we'll open up the call for questions from the Company's publishing analysts.

I would now 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 Audio Eye 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, accept, anticipate, estimate, confident, will, and other similar statements of expectation identify forward-looking statements. These statements are predictions, projections, and 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 and the comments made during the 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 its other reports and filings with the Securities and Exchange Commission. Participants on this call are cautioned not to place undue reliance. 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 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 would like to turn the call over to AudioEye’s Chief Executive Officer, Mr. David Moradi. Sir, please proceed.

David Moradi

Thank you, Operator.

Today I will discuss a few of the accomplishments since joining AudioEye in 2019 and why we are on the strongest trajectory in our history. But first, I want to thank all of our employees for their hard work to get us here.

As the largest investor and shareholder, I initially joined the Board in 2019 as Chair of the Strategic Committee of the Board of Directors to address operating efficiency and strategy. While AudioEye was growing off a small revenue base, operating efficiency needed to improve. Growth margins were in the mid-50s. Adjusted EBITDA margins were in the mid-negative 60s and revenue per employee was in the low $100,000 range.

The Company is in a much stronger position today. We have tripled revenue and dramatically improved operating efficiency. Growth margins have improved to the high 70s and Adjusted EBITDA margins have improved by approximately 80 points, to 17% in the fourth quarter. Revenue per employee is approaching $300,000. These efficiency metrics are now on the top tier of SaaS companies.

We are entering 2024 ready to capitalize on all this hard work. Our operating leverage will allow us to drive future revenue growth with only moderate increases in operating expenditures.

The fourth quarter was an inflection point. We achieved growth margins of 78% and record Adjusted EBITDA of $1.3 million while generating approximately $900,000 of free cash flow. We delivered solid ARR growth of approximately $700,000 sequentially, and we ended the year with 110,000 paying customers, the most of anyone in the digital accessibility industry.

The product development team has accomplished a lot over this time. After building a new platform and migrating all of our customers over, we invested further into products for enterprise customers. I'm pleased to report that we're seeing this debt pay off with one of the best enterprise ARR growth quarters to date.

Our balance sheet is strong. As Kelly will discuss, we received a $7 million term loan from SG Partners in November of last year. The term loan did not include any warrants or other equity dilution.

The Board and Management remain highly aligned with shareholders. In November, the Board announced a stock buyback of $5 million. As of March 5, we have repurchased 437,000 shares at an average price of $4.87.

In addition, under our previous stock buyback announced in June of 2022, we bought 139,000 shares at an average price of $5.44. Combining both programs, we have repurchased approximately 5% of the shares outstanding over the last two years at a valuation below two times revenue for the benefit of long-term shareholders.

Lastly, Management and members of the Board have purchased approximately 350,000 shares on the open market over the last 2.5 years.

We have also invested substantially in R&D, to our knowledge, the most of anyone in the industry. Our investment in R&D allows us to meet customers wherever they are in their accessibility journey, from the smallest businesses to large enterprise customers.

We recently announced a few new products and features. AudioEye's Accessibility Testing SDK allows developers to identify and quickly address accessibility issues at the source, empowering them to implement changes in pre-production environments proactively. Recognizing the need for consistency in issue detection, the SDK employs the same automated test logic utilized by AudioEye's Accessibility experts during customer site audits and automated monitoring.

With SSO, we address the stringent security requirements of enterprise clients, providing a deeper level of security and policy adherence. We continue to improve our rules engine and have made ongoing quality improvements to the test suite, incorporating advanced rules that more accurately test the compliance with current legal guidelines, further improving our industry-leading lawsuit protection.

Awareness of digital accessibility has grown and private plaintiff attorneys are filing record levels of digital accessibility lawsuits under the ADA. Further, we expect that a significant driver of future demand will come from the regulatory environment. In 2023, the Department of Justice proposed comprehensive accessibility regulations under Title II of the ADA. We expect further development and updates over the course of 2024. Also, several bills and regulations are currently being considered at the state level.

Lastly, the European Accessibility Act requires businesses in the EU to have accessible websites and mobile apps by June of 2025 or face steep fines. Approximately 96% to 97% of all websites on the internet remain inaccessible. It has become clear that the old way of trying to fix issues at the source does not scale and will not solve the problem. Our approach to combining AI with human-assisted technology is the only way to solve this problem at scale.

One of the most respected leaders in digital accessibility, Mike Paciello, recently joined AudioEye as Chief Accessibility Officer. He also believes that the old way is not working and a new vision is needed to meet the scale of the problem. Mike is a pioneer of digital accessibility with a deep understanding of the challenges faced by individuals with disabilities in the digital world.

Mike brings over 40 years of expertise to this critical role including authoring the first book on web accessibility, founding the Paciello Group, a pioneering accessibility solutions provider, and co-founding and co-chairing Accessibility Industry Committees to drive advancements in policies and legislation. As a former co-chair in the United States Federal Access Board Telecommunications and Electronics and Information Technology Advisory Committee and recognized by President Bill Clinton for his contribution to the W3C Web Accessibility Initiative, Mike has played a pivotal role in shaping accessibility standards and practices.

Moving on to guidance. For the first quarter, we are guiding to revenue between $8 million and $8.1 million. With Social Security taxes and other beginning-of-year expenses, we expect to generate Adjusted EBITDA between $700,000 to $900,000 and adjusted EPS of $0.06 to $0.08 per share.

We are entering 2024 with strong business momentum. In addition to continued operating margin improvement, we expect revenue growth to accelerate throughout the year. For 2024, we are guiding for revenue of between $34 million to $34.4 million, with growth rates approaching high teens by the fourth quarter. We expect Adjusted EBITDA between $3.5 million and $4.5 million and adjusted EPS between $0.29 and $0.38 per share.

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 in Q4 2023 with revenue at $7.87 million, a 2% increase from Q4 2022 and a minor increase sequentially from Q3 2023. On a full year basis, in 2023, our revenue grew 5% to $31.3 million from $29.9 million. As we have discussed on previous earnings calls, 2023 was impacted by several contract renegotiations.

Turning to channels. The partner and marketplace channel includes all revenue from our S&B-focused marketplace products and revenue from a variety of partners who deploy these same products for their S&B customers. For the fourth quarter of 2023, our partner marketplace channel grew 10% year-over-year and represented approximately 59% of revenue and 60% of ARR. On a full year basis in 2023, this channel's revenue grew 13% from $16 million in revenue in 2022 to $18 million in 2023. We continue to see expansion of existing customers and additional partners engaging with AudioEye, which continues to fuel growth.

AudioEye's Enterprise Channel consists of our larger customers and organizations, including those with non-platform custom websites who generally engaged directly with AudioEye sales personnel for pricing and solutions. Last year, the enterprise channel was impacted by a large enterprise customer rolling off. However, with the momentum we are seeing in enterprise growth, we expect to resume year-over-year growth in Q2 2024.

In Q4 2023, the enterprise channel contributed approximately 41% of revenue and 40% of ARR. Annual recurring revenue, or ARR, at the end of the fourth quarter of 2023 was $31.2 million, a 7% increase over ARR at the end of the fourth quarter of 2022. ARR grew approximately $700,000 sequentially, and as David mentioned, we expect this growth to accelerate going into 2024.

On December 31, 2023, our customer count was approximately 110,000, an increase from 107,000 customers on September 30, 2023, and an increase of approximately 24,000 customers from December 31, 2022. The increase in customer count was driven by additions in the partner and marketplace channels.

Gross profit for the fourth quarter was $6.2 million, or about 78% of revenue, compared to $6 million and 77% of revenue in Q4 of last year. For the full year 2023, our gross margins were approximately 78%, with gross profit increasing from $22.7 million in 2022 to $24.3 million in 2023. There are several factors that go into cost of revenue, including web hosting, customer support and other costs directly related to delivering the product.

In 2023, we were able to drive these costs down while also growing revenue and adding additional value to our customers. As we continue to implement efficiencies, we believe gross margin has room to expand in future quarters.

While revenues were up 2%, operating expenses in the fourth quarter of 2023 decreased 16% to $6.7 million from $7.9 million in the same quarter last year. On a full year basis, revenue increased 5% while operating expenses decreased $2.8 million from $33.1 million in 2022 to $30.3 million in 2023. The annual year-over-year decrease was driven primarily from efficiencies implemented in sales and marketing, which is continuing to produce impressive lead generation with lower investment needed and lower stock compensation and other non-recurring expenses, partially offset by investments in R&D. In Q4 2023, with major R&D initiatives completed, we were able to gain more efficiencies in R&D.

Our total R&D spend in Q4 was approximately $1.7 million, with approximately $465,000 reflected as software development costs in the investing section of the cash flow statement. This was down from approximately $2.4 million in Q3 2023. R&D spend for the full year 2023 was $8.9 million, inclusive of $1.9 million reflected as software development costs. The total R&D spend was around 22% of our Q4, and 29% of our full year 2023 revenue, compared to 25% of Q4 2022 revenue, and 24% of full year 2022 revenue. We feel the current investment in R&D is appropriate for 2024.

Net loss in the fourth quarter of 2023 was $500,000, or $0.04 per share, compared to a net loss of $1.9 million, or $0.17 per share in the same year-ago period. On a full year basis, net loss for 2023 was $5.9 million, or $0.50 per share, compared to a net loss of $10.4 million, or $0.91 per share in 2022. This is a dramatic improvement from net loss a few years ago, and is a result of both increases in revenue and efficiencies, including technological investment.

In the fourth quarter of 2023, we achieved record profitability, with Adjusted EBITDA of approximately $1.3 million, or $0.11 per share, compared to Adjusted EBITDA of $200,000, or $0.01 per share in the same year-ago period. On a full year basis, we also produced Adjusted EBITDA of approximately $1.3 million, or $0.11 per share, compared to a negative Adjusted EBITDA of $900,000, or a loss of $0.08 per share in 2022.

The primary adjustments to GAAP earnings and EPS for Q4 2023 and full year 2023 were non-cash share-based compensation, depreciation, and amortization, non-cash valuation adjustments to liabilities related to the earn-out of BOIA, and other miscellaneous costs. In November 2023, we partnered with SG Credit Partners for a $7 million term loan. We plan to use the proceeds from the loan for share repurchase and add additional liquidity to our balance sheet. In Q4 2023, we implemented a share repurchase program of up to five million, with 1.1 million of shares repurchased in the fourth quarter of 2023.

As David discussed, in the fourth quarter of 2023, we hit a significant milestone, positive free cash flow. In the quarter, we generated $900,000 of free cash flow, calculated as Adjusted EBITDA of $1.32 million, less $465,000 of software development costs. We are pleased we were able to achieve this milestone and expect to continue to generate positive free cash flow in 2024. With the addition of the term loan, our balance sheet is well-capitalized with $9.2 million of cash as of December 31, 2023.

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

Operator

Thank you. We will now take questions from the Company's publishing analysts.

(Operator instructions)

The first question will come from George Sutton with Craig-Hallum. Please go ahead.

George Sutton

Thank you. Hello, David. Hello, Kelly. Congratulations on the results.

David Moradi

Thank you.

George Sutton

I wanted to walk through what you were defining as an accelerating growth throughout the year ahead and just want to understand the factors behind that. Obviously, we do have some easier comps, but wanted to make sure I was fully appreciating what's driving the acceleration in growth.

David Moradi

Yes, when you look at the guidance, it implies revenues are going to ramp as the year unfolds. I said on the call we're expecting high teens revenue growth in the back half with strong EBITDA margins. Also, the sequential growth rates should pick up and compound even higher than the high teens as we get to the second half. Compounded ARR is what I'm talking about; and we expect the enterprise channel and the partner and marketplace channel to contribute to this. EU, by the way, is not in these numbers at all because I know you're about to ask that.

George Sutton

We are focused on your investment in Europe, but I would say that you've made some CRM changes, you've added analytics, you've added new salespeople. I wondered if you can give us a bigger explanation of what's driving the go-to-market plans.

David Moradi

Yes, I think it's just the full product suite we have now with all that R&D investment we've made. We can meet you wherever you are. Whether you're a small business or you're a big large enterprise, we have this breadth of offering and I think that's a major competitive advantage. Like you said, there's been a lot of optimization in our go-to-market, so we're seeing some record leads there and we're seeing the most robust pipeline on the enterprise side in our history.

George Sutton

Great. Lastly, if I could bring two things together. You mentioned a record number of lawsuits that you're seeing under the ADA. We're obviously, we believe, months away from getting a more defined law from the DOJ. What do you think is driving this record number of lawsuits right now, and is there any way you can quantify that?

David Moradi

Most sites are inaccessible on the internet today. Only 3% or 4% of sites are accessible, so lawyers find an easy time suing companies and making money off of this, and that’s why you’re seeing the record ADA lawsuits. It's just wide open here. The TAM is humongous and we're in the early innings, so I can't really quantify how big this is going to be, but it's going to be big.

George Sutton

Okay. I'll leave it there. Thanks, guys.

David Moradi

Thank you.

Operator

The next question will come from Zach Cummins with B. Riley FBR. Please go ahead.

Zach Cummins

Yes. Hi, good afternoon, David and Kelly. Congrats on solid results and the building momentum into 2024. David, just starting off, can you just talk a little bit more about what you're seeing from that enterprise team? I know it was a big focus for you throughout 2023 to really build up that motion, so just curious of maybe some of the initial payback you're getting from that investment here in recent months.

David Moradi

What do you mean in terms of payback? In terms of ARR? Or the driving it?

Zach Cummins

Yes, in terms of just productivity that you're seeing from that team now that they're fully built out in working towards fully ramped up.

David Moradi

Yes, like I said, the pipeline's building. We've optimized a lot. We have record leads. It's not going to stop. That's just going to continue. I can see it in the demo (phon) system we use, and so it's just really clicking, so I'm happy to see that.

Zach Cummins

Got it. When it comes to the step down in R&D expenses that we saw here in Q4, can you give me a sense of, is that really just a wind-down of some major projects that you've been working on for multiple quarters in the past or what's the appropriate way to think of ongoing R&D expense?

David Moradi

Yes, we made a lot of improvements to our product over the last two to three years. We're continuing to invest to maintain our lead but we have completed a number of initiatives in the R&D side, so we are able to drive some efficiencies, so you should expect similar levels of R&D going forward.

Zach Cummins

Got it. Final question is really just on the competitive landscape. Obviously another acquisition of one of your competitors at the end of last year. Just curious if any evolving nature of that competitive landscape in how AudioEye stacks up amongst this consolidation.

David Moradi

Yes, since PE got in the space three to four years ago, there’s been a lot of M&A activity. You’ve seen buyouts, you’ve seen capital raises. They think the space is going to grow a lot more. That’s why they’re putting all this money into this. A competitor was recently taken out, UserWay, for about eight times revenue, and that was a subscale company, about $12 million to $13 million in revenue, so the space is clearly consolidating. There'll likely be only a handful of players at the end here so I think it's a good setup.

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

The next question will come from Scott Buck with H.C. Wainwright. Please go ahead.

Scott Buck

Hi, good afternoon, guys. Thanks for taking my questions. First, David, I'm curious, the conditions that set up the high teen year-over-year revenue growth in the back half of this year, could they potentially carry over into 2025? I'm asking because I'm curious if we could see not only acceleration of revenue in 2024 but then further acceleration in the following year.

David Moradi

I think so. We've turned the corner here and nothing's going to stop this train. I think you'll see higher growth rates with EU in 2025, and the DOJ regulation on the state and local government. This train is leaving the station.

Scott Buck

Great, that's helpful. Then on the guide, it looks like the Adjusted EBITDA margin is somewhere around 12% based on the midpoints. What does the EBITDA margin look like on this business at maturity?

Kelly Georgevich

Yes, we'd like to see that, the 17% in Q4 2023, if you look at the guide, it does put you at double-digits. We do expect to accelerate revenue in the second half, and so you can assume EBITDA margins would accelerate at similar rates. But we do think there's an opportunity to—the 11% this fiscal year and grow further in the second half of 2024.

Scott Buck

That's helpful, Kelly. Then last one for me, guys, just on the buyback. Stocks obviously appreciated quite a bit from where your average purchase price was to date. I'm curious how you guys are feeling about the price today.

David Moradi

It's still pretty attractive. Can't get into levels with you, but last I checked it was around two times revenue or so, so that's still pretty cheap when companies are getting taken out for eight times.

Scott Buck

Yes. That's it for me, guys. Appreciate the added color and congrats on the results.

David Moradi

Thank you.

Operator

At this time, this concludes our question-and-answer session. I would like to turn the call back over to Mr. Moradi for any closing remarks. Please go ahead.

David Moradi

Thank you for joining us today. As always, I want to thank our employees, partners, and investors for their continued support. We look forward to updating you on our 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 a replay via a link available in the Investor section of the Company's website.

Thank you for joining us today for AudioEye's Fourth Quarter and Full Year 2023 Earnings Conference Call. You may now disconnect.