Phunware, Inc. (NASDAQ: PHUN) Q2 2019 Earnings Audiocast (Pre-Recorded)

August 13, 2019, 4:30 PM Eastern

Company Participants

Alan Knitowski - Co-Founder, CEO and President

Randall Crowder - COO

Matt Aune - CFO

Operator

Greetings, and welcome to the Phunware Second Quarter 2019 Earnings Audiocast. This call has been pre-recorded, so there will be no question and answer session upon its completion.

I would now like to turn things over to your host, Marcus Chan, Phunware's Director of FP&A and a member of its Investor Relations team.

Marcus Chan

Thank you and welcome to Phunware's inaugural Earnings Audiocast presenting our financial results for the second quarter of 2019. I am Marcus Chan, Phunware's Director of FP&A.

Joining me today are Alan Knitowski, Co-Founder, Chief Executive Officer and President; Randall Crowder, Chief Operating Officer; and Matt Aune, Chief Financial Officer. The format today will include prepared remarks by Alan, Randall and Matt.

Today's discussion will include forward-looking statements. These forward-looking statements reflect our current views as of today and are based on various assumptions that are subject to risks and uncertainties disclosed in the Risk Factors section of our SEC filings. Actual results may differ materially, and undue reliance should not be placed on them.

Additionally, the matters we will be discussing today may include Non-GAAP financial measures. Reconciliation of GAAP to Non-GAAP financial information is set forth in our earnings press release, which is available on the investor relations section of our website at investors.phunware.com. I further encourage you to visit investors.phunware.com to access not only our earnings press release, but also our current investor presentation, our SEC filings, this pre-recorded Earnings Audiocast and to learn more about Phunware.

At this time, it's my privilege to turn it over to Alan.

Alan Knitowski

Thank you, Marcus. Good afternoon everyone and thank you for joining us on our first Earnings Audiocast as a public company. I want to welcome many of you who we have met over the last 10 years and have supported Phunware on our journey first as a private company and now as a publicly company trading on Nasdaq as PHUN.

For those new to our story, I'd first like to give a quick overview of what Phunware does, including the capabilities of our platform and our overall business model and strategy.

Phunware is the pioneer of Multiscreen-as-a-Service, or MaaS, a fully integrated enterprise cloud platform for mobile that provides companies the products, solutions, data and services necessary to engage, manage and monetize their mobile application portfolios and audiences globally at scale. Phunware helps the world's most respected brands create category-defining mobile experiences, with approximately one billion active devices touching our platform each month.

Founded in February 2009, Phunware helps brands transition from the web to mobile by enabling enterprise-level mobile applications through its MaaS platform, including the software, data and infrastructure needed to support these mobile application portfolios on Apple iOS and Google Android devices, including smartphones, tablets, wearables, smart televisions and digital signage. Our ideal customer is a Fortune 1000 brand that standardizes on our MaaS offerings for all of their mobile initiatives and needs, much like they would standardize on Microsoft Office for their productivity software or Salesforce for their CRM. Over the past 10 years, Phunware raised over $100 million in private financing from notable investors including Cisco Systems, Samsung, PLDT, WWE, Firsthand Technology Value Fund, Wavemaker Partners, Maxima Ventures, Fraser McCombs Ventures, Khazanah and the Central Texas Angel Network amongst many others, while providing Fortune 1000 brands everything they would need to succeed on mobile.

We focus our competitive efforts globally at the intersection of mobile, cloud, big data and blockchain through four key differentiators:

1. Building robust mobile ecosystems for enterprises that can't afford to fail at scale.
2. Locating and engaging mobile devices and mobile application users both indoors and outdoors, both onshore and offshore, and both on the ground and in the air, in real-time.
3. Curating disparate, real-time data sets to make big data actionable, while enabling 1:1 interactions between brands and consumers anywhere and anytime globally.
4. Leveraging blockchain technology to optimize media spend, reduce fraud, enhance transparency, drive profitable behaviors and maintain an immutable, auditable public record of brand interactions with consumers worldwide.

Fig 1.

We have a diverse enterprise customer base across multiple verticals because we offer a comprehensive platform with products and solutions for mobile that are seamless, flexible, cost-effective and proven at production scale globally.

A few current and representative customers across five of these verticals include:

- **In Healthcare:** MD Anderson Cancer Center, Cedars-Sinai and Houston Methodist;

- **In Media and Entertainment:** Fox Network Group, the CW and Live Nation;
- **In Hospitality and Real Estate:** the Wynn Resort in Las Vegas, Brickell City Center in Miami and the Silverstone Property Group in New York;
- **In Retail:** Kohl's and Caruso;
- **And In Sports:** Fox Sports, AT&T Stadium and the Miami Heat.

Our short-term focus is organic growth, growing our balance sheet through new MaaS customer wins and achieving cash neutrality by the end of 2019. In the quarter, we closed some key new customer contracts and partnerships, including American Made Media Consultants, otherwise known as the "Trump-Pence 2020" and "Keep America Great" Campaign, Mount Sinai, Parkview Health, Kaiser Permanente and a Fortune 50 company building a smart corporate campus in Israel.

We are especially proud of going head-to-head with Salesforce to compete for and win the mobile application portfolio business for the President of the United States of America. Key determinants of this win were our longstanding track record of delivering, managing and evolving the mobile application portfolios of the world's largest brands and events, speed of delivery execution and off-the-shelf-ready use cases and feature sets unique to physical and virtual engagement environments on mobile. This isn't the first time we've come out ahead against a much larger public technology company. We similarly beat Google head-to-head to win the location-based services and mobile engagement business of Kaiser Permanente across their medical facilities nationwide. In that win, our expertise in solving complex indoor location, positioning, navigation and engagement were key, as was our ability to provide turn-by-turn directions without networks or hardware, including software solutions for handicapped, hearing impaired and visually impaired visitors, patients and staff.

Over the mid and long term, our ideal operating scenario is to achieve and maintain cash neutrality while reinvesting excess cash and profit for growth, both organically and inorganically. To that end, we intend to accelerate our top line growth in the coming quarters ahead, ultimately getting back to 30% or more year-over-year net revenue growth.

At this time, we have no intention to issue equity at the current stock price or valuation, whether for organic operations or inorganic acquisitions. Debt is always an option we can explore and we will consider debt alternatives should attractive credit facilities with terms conducive to our organic or inorganic growth initiatives present themselves. We will revisit equity issuances in a future period when we believe that our underlying stock price and valuation represent what we believe to be a fair market value. As a reminder, when we consummated our merger with

Stellar Acquisition III to become public on Nasdaq in December 2018, we were valued at $301 million at closing on a fully diluted basis, representing an enterprise valuation roughly 10 times our trailing 2018 net revenues.

Going forward, we are committed to driving awareness of everything Phunware has to offer and also to increase exposure to our stock. During the quarter, we were excited to be added to several important indexes, including the FTSE Russell 2000, FTSE Russell 3000 and FTSE Russell Microcap. Large institutional stock ownership is a high priority for both our Board and our Executive Team and these initial ETF additions were a welcome development towards achieving that goal. In parallel, we are also actively working to engage and finalize an initial mid-market investment banking relationship to facilitate both research coverage and institutional outreach for our stock.

In conclusion, today I want to express a very special thank you to our employees and their families who have supported us tirelessly throughout our first decade of operations. In parallel, I also want to thank our customers and partners, who not only are our biggest advocates, but also trust us with their most valued assets regularly. Finally, I want to express our gratitude to our public and private investors for their continued assistance and support in all that we do as we continue to execute and scale operationally and financially on their behalf.

To now discuss our operations, including our MaaS platform and blockchain initiatives, I will turn things over to our Chief Operating Officer, Randall Crowder.

Randall Crowder

Thanks, Alan. Q2 was a continuation of our corporate strategy to grow responsibly while ensuring that we are operationally efficient.

Our current strategy actually dates back several years when we exited over $24 million of low-margin application transaction business and focused on backfilling that with higher margin platform subscription and services deals, as well as data enriched application transaction campaigns. To that end, we finished 2018 with approximately $25 million of backlog, which represented a complete replacement of the prior low-margin application transaction business, even though we require one to five years for forward revenue recognition against these contract wins and terms. Throughout 2019, we have accelerated our efforts to reduce our burn rate and streamline our operations, which ultimately reduced our OPEX spend by 11% year-over-year. Our cash used in operations improved 57% quarter-over-quarter as we continue our efforts toward reaching break-even on both operating cash and adjusted EBITDA.

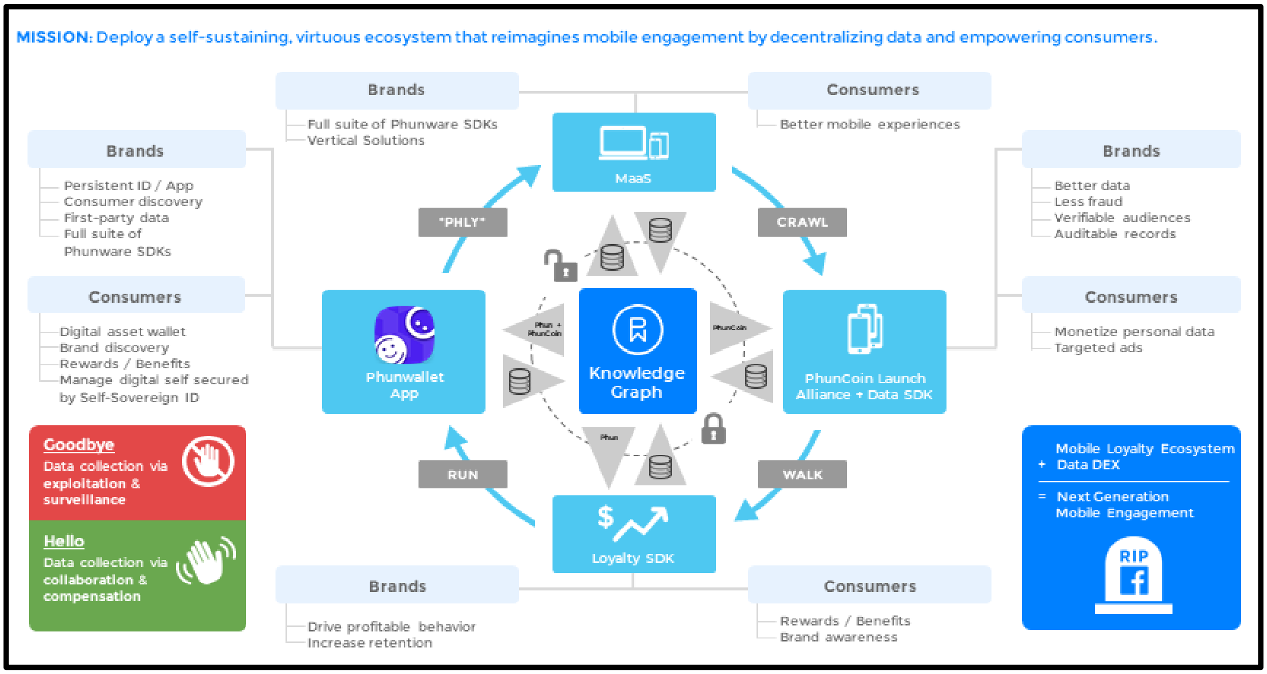

Fig 2.

Many brands struggle to transition from having a mobile application to having a true mobile strategy because they are managing numerous vendor relationships, with numerous point solutions, that were never designed to be interoperable. Phunware enables brands to power their entire mobile strategy, with a single vendor relationship to ensure accountability and responsiveness. With MaaS, a brand can access all of the proven features and capabilities that we have developed over the past decade to deliver everything you need to succeed on mobile.

During the quarter, Frost & Sullivan recognized Phunware with its 2019 North American Company of the Year Award for MaaS. A Frost & Sullivan executive commented:

"Phunware extended MaaS to a range of verticals, offering turnkey native solutions to address various industry-specific needs. Leveraging its experience across industries, it created an exceptional 'one-stop-shop' suite of offerings designed to appeal to newcomers and incumbents in the mobile space."

With the integration of our blockchain initiatives to MaaS, we've now laid the groundwork for our very own Flywheel, to borrow from Jim Collins, author of Good to Great. What began with mobile applications 10 years ago has grown into so much more, with each component of MaaS driving the next and creating a dynamic data engine that is revolutionizing how brands identify, engage, monetize and retain their customers. Our platform allows brands to finally get the right content to the right consumer at the right time in the right place on the right screen in order to drive meaningful engagement and profitable behavior.

With PhunCoin and our MaaS Data Software Development Kit (SDK), we intend to compensate consumers for their data with a regulated security token, which is available to select accredited investors through a Regulation D 506(c) offering. In the quarter, we also launched the Phun utility token in support of our MaaS Loyalty SDK, which is available for purchase by select members of the international community outside of the United States and Canada. We intend to work closely with regulatory bodies such as the Securities and Exchange Commission (SEC) to ensure that we maximize the availability of our cryptocurrency products to as many people as possible in a compliant manner. To ensure the highest quality experience, security and privacy, our engineers are developing the MaaS PhunWallet, a first-of-its-kind mobile application that we expect to release in Q4 to serve as the nerve center for our blockchain ecosystem.

It's also important to point out why we were selected by IBM for its inaugural blockchain accelerator as a part of the Columbia-IBM Center for Blockchain and Data Transparency. We were one of only 10 high growth companies selected globally because we have a real-world solution to a real-world problem that positions us for mainstream adoption. While PhunCoin will enable consumers to monetize their digital identity, Phun tokens will enable consumers to monetize their digital activity as they engage with the brands they love today while discovering the brands they'll love tomorrow by completing surveys, viewing branded content, participating in marketing campaigns and so much more. This seamless integration of blockchain is why Susan Miller's Astrology Zone decided to integrate our solutions in order to better engage over 11 million unique readers all around the world. Unlike other solutions, we do not require consumers to change their behavior or download a new browser, nor do we require brands to have any knowledge or in-house expertise of blockchain. In effect, we are providing a turn-key platform that delivers Blockchain-as-a-Service (BaaS), all within the broader umbrella of MaaS which is already in use by Fortune 1000 companies worldwide, and operating currently at hundreds of thousands of transactions per second across more than four billion transactions per day.

While engagement is important, our work around blockchain is also critical to decentralizing data and ending an era of exploitation by large technology companies. That's why we were honored to announce two new advisors to our team in the quarter. Brittany Kaiser is well known for being the Cambridge Analytica whistleblower which is captured in the eye-opening Netflix documentary The Great Hack. She has also been instrumental in passing important new legislation in Wyoming that lays the foundation for recognizing data as your property. Sean Koh has also worked at the cutting edge of data management with a specific focus on driving engagement with some of the most recognizable sports and entertainment brands, including world-renowned musical artists. In addition, he brings expertise in cross-border transactions in finance, technology, entertainment and various other fields. He has deep family ties in Korea that trace back to the invention of HDMI and he has sourced, structured and funded billions of dollars of transactions globally through his family office Koherent, Inc., an extension of the Koh Family Office. Sean is also a humanitarian who regularly engages with the World Economic Forum (WEF), the United Nations (UN) and other such organizations worldwide to leverage his influence for the betterment of humanity.

Now I'd like to turn things over to Matt, who will discuss our second quarter financials in more detail.

Matt Aune

Thanks, Randall and good afternoon everyone.

In addition to our second quarter results, I would like to take a few minutes to share more about Phunware and how we engage with our customers.

Our business is geared toward driving platform subscription bookings while building our deferred revenue and backlog. We license our MaaS platform to customers under one to five-year contracts, consistent with a Software-as-a-Service (SaaS) business model, in which we typically invoice annually, prepaid in advance. If a customer engages us to enhance an application with our SDKs, Application Programming Interfaces (APIs) or custom services, we provide software licensing, application development services and support and maintenance subscriptions which are then invoiced in advance and added to deferred revenue. Revenue is then recognized in accordance with ASC 606, once the company has satisfied its performance obligations. The timing of revenue recognition is determined by the period over which these obligations are met, either on a one-time basis or ratably over time, often representing 12 to 60 months for one to five-year contract terms.

We implemented ASC 606 effective the first quarter of 2019. The new revenue standard has allowed us to recognize the application development services at the time of delivery to the customer versus ratably over time as we did under the old revenue standard, ASC 605. We typically pay sales commissions upon bookings, but with the implementation of ASC 606, the costs are matched with the timing of revenue recognition, aligning sales commissions over the period commensurate with the revenue. The net effect of these changes is that we removed $718 thousand from deferred revenue, added $369 thousand to prepaid expenses for sales commissions and added $1.087 million to accumulated deficit. As a result, we will not recognize $718 thousand in net revenues over the applicable contracts' terms.

Backlog represents future amounts to be invoiced under current agreements and is a key business metric for us to measure the health of our business going forward. Together, deferred revenue and backlog represents the total billed and unbilled contract value that has yet to be recognized in revenue, and it provides us visibility into future revenue streams, along with insight into the diversification of our revenue.

In Q2, Fox Network Group and Houston Methodist accounted for 57% and 8% of net revenues, respectively, but our backlog and deferred revenue is widely more distributed, with our top five customers accounting for 50% and no single customer accounting for more than 17%.

$5.5M Revenue	$1.8M Cash Used in Operations	51% Gross Margin	$2.4M Adjusted EBITDA Loss
6% Subscription Revenue Growth Q/Q	57% Reduction in Cash Used in Operations Q/Q	+96 Subscription Basis Points Q/Q	$18.5M Backlog
89% Net Dollar Retention	11% Reduction in Operating Expenses Y/Y	6 Customers with >$100K in Revenues	($0.08) Earnings per Share Narrowed by 34% Q/Q

Fig 3.

Net revenues totaled $5.5 million, of which non-GAAP adjusted platform subscriptions and services revenue was $5.1 million, increasing 17% year-over-year, while comprising 92% of net revenues. We are excited that our platform subscriptions and services revenue increased for the 6th consecutive quarter.

Non-GAAP adjusted gross margin was 51.2% compared to 47.2% in the same period last year. We have made a conscious decision to focus the business toward higher margin software and data deals and away from lower margin legacy application transactions. We are pleased to see overall Non-GAAP gross margins continuing to rise year-over-year as a direct result.

Total GAAP operating expense was $5.7 million, down from $6.5 million for the same period last year, as we continued to streamline our business and limit our overall losses.

Non-GAAP adjusted EBITDA loss was ($2.4) million, a $1.2 million improvement year-over-year.

GAAP net loss for the quarter was $3.1 million, or $0.08 per share, a 34% improvement quarter-over-quarter sequentially.

Please note that our Non-GAAP adjusted net revenues and gross margins are adjusted by excluding items from net revenues that are one-time in nature, including, but not limited to, forfeited customer deposits and contract settlements. As a reminder, our earnings press release, its accompanying Form 8-K filing and the investor relations portion of our website at investors.phunware.com all provide a full reconciliation of our GAAP to Non-GAAP financial results.

Before I turn to our balance sheet, I'd like to first highlight how the dual token structure that we launched during the second quarter operates for PhunCoin, our regulated security token, and Phun, our utility token, within our MaaS blockchain platform offerings. Namely, and as previously stated in our prior press releases and filings, PhunCoin security tokens remain a regulated store of value that afford fractional interests in our blockchain-enabled data exchange, including any dividends. To date, there continues to be limited accounting guidance around both security and utility tokens alike. However, we reanalyzed the economic characteristics of the PhunCoin Rights issued as they relate to our dual token economy and ecosystem. As a result, we have reclassified the $1.2 million that we received previously for PhunCoin Rights from deferred revenue to a liability of PhunCoin deposits. Our current belief is that once PhunCoin has been issued to the Rightsholders and custodied in their digital wallets, that the PhunCoin deposit liability will be further reclassified to a non-controlling equity interest on our balance sheet. We will continue to monitor all relevant accounting guidance from authoritative governing bodies worldwide regarding both our coin offerings and sales and will adjust accordingly should circumstances dictate.

With the change reclassifying PhunCoin from deferred revenue, our Q2 ending deferred revenue was $7.1 million compared to $8.3 million in the same period last year.

Ending cash for the quarter was $248 thousand, with $1.7 million of cash used in operations. This represents a 57% reduction in operational cash burn compared to last quarter sequentially and is consistent with our internal focus to drive to cash neutrality from operations by year end 2019.

As Alan mentioned earlier, we do not intend to issue equity at current prices to raise cash for either organic operations or inorganic acquisitions. While our board has authorized us to issue up to $20 million in convertible five-year notes, as of today we have only issued $250 thousand of these convertible notes and do not expect to be continuing their issuance in the near-term. We will remain open to exploring debt options for the company should we source any credit facilities that we deem attractive for organic or inorganic growth but have no specific plans or details to share currently.

Looking ahead, we are well positioned with our SaaS, data and blockchain offerings to deliver true digital transformation for our customers. As we continue to win deals and help customers enhance their mobile experiences, we intend to drive revenue and gross margin expansion to reduce our operational cash burn to zero by the end of 2019 and move toward break-even on an adjusted EBITDA basis in the first half of 2020.

With that, I'll turn things back over to the Host.

Operator

We have reached the end of today's prepared remarks. As a reminder, there will be no question and answer session, so this concludes today's Earnings Audiocast.

Please visit and monitor investors.phunware.com for the latest information on the Company.

Additionally, please visit Phunware executives at the Essex House in New York City from September 16th through September 17th for the Fall Investor Summit.

Thank you.