VIAVID
communications simplified.

ShotSpotter, Inc.

Fourth Quarter and Full Year 2020 Earnings Call

February 25, 2021

C O R P O R A T E P A R T I C I P A N T S

Ralph Clark, *President, Chief Executive Officer & Director*

Alan Stewart, *Chief Financial Officer*

C O N F E R E N C E C A L L P A R T I C I P A N T S

Hilary Cauley, *JMP Securities*

Richard Baldry, *ROTH Capital Partners*

Ryan Kimbrel, *Craig-Hallum*

Michael Latimore, *Northland Capital Markets*

P R E S E N T A T I O N

Operator

Good afternoon, and welcome to ShotSpotter's Fourth Quarter and Full Year 2020 Earnings Conference Call.

Joining us are ShotSpotter's CEO, Ralph Clark; and CFO, Alan Stewart.

Please note that certain information discussed on the call today will include forward-looking statements about future events and ShotSpotter's business strategy and future financial and operating performance. These forward-looking statements are only predictions and are subject to risks, uncertainties and assumptions that are difficult to predict and may cause the actual results to differ materially from those stated or implied by those statements. Certain of these risks and assumptions are discussed in ShotSpotter's SEC filings, including its registration statement on Form S-1.

These forward-looking statements reflect Management's beliefs, estimates and predictions as of the date of this live broadcast, February 25, 2021, and ShotSpotter undertakes no obligation to revise or update any forward-looking statements to reflect events or circumstances after the date of this call.

Finally, 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 ir.shotspotter.com.

Now I would like to turn the call over to ShotSpotter's CEO, Ralph Clark. Sir, you may proceed.

Ralph Clark

Thank you for joining us this afternoon. I hope everyone on the call is doing well. I'm thrilled to have Alan back in the saddle as my partner and our Chief Financial Officer. I want to personally thank Mary for her careful stewardship during Alan's absence.

As usual, I'll do a brief review of Q4 results and discuss our agile response to what has been an eventful year. We'll then share our outlook and focus initiatives for 2021 and beyond before taking your questions.

Two thousand and twenty proved to be a challenging year for everyone, and our Company and law enforcement agency stakeholder ecosystem was no exception. I'm extremely proud of how our Company has been able to adapt and respond to those challenges throughout the year. We finished 2020 on a positive note, putting us on a solid start to a fast growth path for this year and beyond.

We reported Q4 '20 revenue of $12.6 million, including some modest contribution from a partial quarter of LEEDS revenue. This represented 16% year-over-year growth from the $10.9 million of revenue we reported last year.

During the quarter, we went live with ShotSpotter response, our acoustic gunshot detection service, formerly branded as Flex, in five new cities, including marquee cities such as Cleveland and Fort Lauderdale, which represents our sixth and 14th cities deployed in Ohio and Florida, respectively. In addition, we expanded our footprint in a few cities, including New York City, St. Louis and Bakersville, California.

We're entering 2021 with $46.3 million in annual recurring revenue in our core ShotSpotter business and are well positioned with a robust number of respond projects in our pipeline scheduled to go live in the first half of 2021, which we believe sets us up for strong growth in the second half of this year into 2022 next year.

Among those projects are additional expansions in New York City and Columbus, Ohio, along with new city captures such as Mansfield, Ohio, which will be our seventh city in Ohio, Memphis, Tennessee, Detroit and Harris County, Texas. We're very excited by our early foothold in Texas, where we're able to go live on our pilot project in Houston in December of 2020. Houston is already producing promising results with Respond, which we expect to formally document in an independent academic study supported by Chief (Inaudible) in Houston PD.

In addition to the planned study in Houston, we are also supporting a separate academic research initiative that will study the efficacy of ShotSpotter Respond in a random sampling of agencies. Our goal is to build on a body of independent research that speaks to the impact of gunshot detection on positive public safety outcomes. We believe this can help accelerate our approach to the tipping point where gunshot detection is accepted as a standard of care solution.

We've seen what we believe as the tipping point play out regionally in Ohio, where we have captured seven cities, four of them in the past 24 months. The acoustic gunshot detection as a standard of care narrative has reached the state capital, where Governor Mike DeWine had specifically called for acoustic gunshot detection as a part of his public safety budget.

Our accelerated traction in Ohio started from the spark of one net promoter customer who demonstrated the value of acoustic gunshot detection in delivering measurable positive public safety outcomes. This validates our focus on our immersive and innovative customer success and on-boarding process and are leveraging the power of net promoter.

The return on investment we've realized in our customer success and on-boarding initiatives is reflected with a world-class NPS score of 70 in 2020. This achievement builds upon the success we had the year prior and our continued focus on improving process and the customer experience and journey.

Implementing, measuring and sharing of institutional best practices is a game changer and speaks to the unique value our services provide.

Our strong customer loyalty was further borne out in our ability to manage our GAAP revenue attrition to less than $500,000 in 2020, despite the pandemic, municipal budget pressures and recent calls to defund the police. We hear from our customers that our service is indispensable and mission critical. Strong word-of-mouth and positive referrals drive our customer creation costs of $0.51 per dollar of revenue. This puts us in an industry-leading position relative to other SaaS companies that have to spend well over $1 for a dollars' worth of revenue.

On a macro basis, the increased violent crime has been broadly reported by the press and very well documented by public safety associations, such as PERF, the Police Executive Research Foundation, and IHCP. Given our unique vantage point of engaging with over 110 cities with over 750 miles of coverage, we're able to alert on 234,000 gunshot activations in 2020 and have measured the material increase of gun violence from 2019. This uptick in violent crime is not unique to large urban cities, but it's also experienced in medium and small cities. We believe this broad experience has been a material contributor to our recent success in penetrating the large and untapped Tier 4 and Tier 5 market vertical.

In the past year, we've added six cities in this segment, which was consistent with our expectations prior to the pandemic in late 2019 when we launched a focused sales and marketing program to develop this segment. Smaller agency adoption is demonstrating the compelling need and viability of our gunshot detection services in this large and significantly underpenetrated market. We have a number of additional Tier 4 and Tier 5 pending projects and a large and growing sales pipeline. Our goal is to make every single deployed department a net promoter and a proof point in applying precision policing technologies, even at smaller, less well-resourced agencies.

A great example of our work in this segment is our partnership with the city of Kankakee, Illinois, which has a population of 26,000. Kankakee PD reported a 50% reduction in the response time to ShotSpotter alerts, enabling increased evidence recovery and witness interviews. In January, Kankakee PD made arrests or identified suspects in four out of the six ShotSpotter alerts they responded to. In one specific case, the police credited the precise real time ShotSpotter alert, combined with the quick action of the responding officer, in saving the life of the gunshot victim. These powerful results speak for themselves and are generating interest from similarly situated agencies, considering adding gunshot detection to their crime fighting toolkit.

While we've been able to successfully overcome the headwinds of the COVID-19 domestically, our international deal progression has been a bit more challenging. Unfortunately, the Top 3 focus areas for us outside of the United States, South Africa, Brazil and Mexico, have been among the most severely ravaged by the COVID-19 pandemic. We've seen material public safety budget cuts, reallocation of federal resources and political mindshare pivot to the response to the spread and mutation of the virus. While gun violence continues to be a pressing issue, it has taken on a lower priority in these countries for the time being. We continue to be present in those markets in order to maintain our key relationships and protect the pipeline that we've built, with the expectation that converting that pipeline into bookings is more likely to happen over the medium term versus the short term.

I am pleased to report that we've made good progress on integrating LEEDS into ShotSpotter. We see an attractive growth opportunity in offering a cloud-based investigative case management solution. Every law enforcement agency has the duty and mandate to document and investigate alleged crimes in order to hold perpetrators accountable and provide resolution for victims. Unfortunately, the options to do this in a digitized and automated way are generally lacking. We believe LEEDS have developed the most complete investigative case management solution that has been proven to be effective with one of the leading law enforcement agencies in the country. We're working on some refinements and integrations to make it an attractive option to small, medium as well as large agencies, before launching it in early Q3. We're already generating $6.7 million of annual recurring revenue from the licensing and support contract from the legacy deployment of the LEEDS investigative case management solution. Any commercial sales that will be launched and branded as ShotSpotter Investigate will be incremental.

ShotSpotter Investigate, in combination with ShotSpotter Respond and ShotSpotter Connect, unlocks a compelling new value proposition with which we can target an entirely new set of law enforcement agencies. We now have a complete precision policing platform that provides more efficient and effective ways to respond to, investigate and prevent crime beyond gunshot detection. We believe this integrated, data-driven platform can make an outsized impact on the way policing gets done without over-policing and underserving communities, thereby building community trust and legitimacy, which is the real MVP in delivering sustainable public safety outcomes.

We're maintaining and reaffirming our previous revenue guidance of $58 million to $60 million this year for the combined ShotSpotter, LEEDS business. If we're able to manage attrition loss lower than our current estimate of 3% to 4% and/or we get an earlier recovery on the international front, we believe we can come in on the high side of our guidance. At the midpoint of our current 2021 guidance, our revenue growth would be 29% year-over-year from 2020.

Okay. Alan's ready to go a little bit deeper into our results. I'll look forward to taking your questions when he's done. Alan, over to you.

Alan Stewart

Thank you, Ralph, and good afternoon, everyone. As Ralph mentioned, we went live in five new cities during the quarter and expanded coverage on several existing customers. For the Fiscal Year 2020, we went live on 13 gross and 10 net new cities, which culminated in 62 gross and 49 net new miles live for the year. This also ended the year with 779 miles live with approximately 813 miles under contract.

As we expand our product portfolio to provide a broader suite of precision policing solutions, we intend to report on new response miles deployed at the end of each year rather than each quarter. We will continue to highlight the new cities added each quarter.

Our revenue retention rate for the year was still excellent at 107% compared to 111% for 2019. Our current customers and potential new ones continue to have budget challenges. In spite of that, our attrition for 2020 was quite low and represented just over 1% of revenues, which is significantly lower than we expected at the beginning of 2020 and indicative of the value of our solutions. We're still cautious regarding 2021 though, and are estimating for attrition of up to approximately 3% to 4%.

Let me provide more details on the quarter and the full year. Fourth quarter revenues were $12.6 million, a 16% increase over the $10.9 million in the fourth quarter of 2019. Revenue increased as our deployed miles are up year-over-year, and we also recorded our first revenues from the LEEDS acquisition, although contributed for less than half the quarter.

For the full year, revenue was $45.7 million, up over 12% from $40.8 million in 2019. Gross profit for the fourth quarter of 2020 was $7.5 million or 59% of revenue versus $6.8 million or 62% of revenue for the prior year period. As expected, gross margin continues to be impacted as we work through our backlog of maintenance work. These efforts require using resources that are a bit more expensive as a result of COVID-19 restrictions. We believe these costs are now almost complete and expect gross margins to return to a more normalized level in the latter part of 2021.

For the full year 2020, our gross profit also increased versus 2019. It was $27 million or 59% of revenues, up 11% compared to $24.3 million or 60% of revenues in 2019.

Adjusted EBITDA for the fourth quarter, which we calculate by taking our GAAP net income and adding back interest, taxes, depreciation, amortization, stock-based compensation and acquisition-related expenses was $3.1 million compared to $3.2 million in the fourth quarter of 2019. For the full year 2020, Adjusted EBITDA increased to $11.9 million, up 28% from $9.4 million in 2019. Both fourth quarter of 2020 and the entire year of 2020, Adjusted EBITDA numbers include an add-back of approximately $630,000 for costs related to our LEEDS acquisition.

Now turning to expenses. Our operating expenses for the fourth quarter were $7.7 million or 61% of revenue versus $5.6 million or 51% of revenue in the fourth quarter of 2019. For the full year, operating expenses were $25.7 million or 56% of total revenue compared to $22.7 million or 56% of total revenue in 2019. Operating expense increases were primarily related to higher employee-related costs as well as increased costs related to the LEEDS acquisition.

Breaking down our expenses. Sales and marketing expenses for the fourth quarter were $3.1 million or 24% of total revenue versus $2.5 million or 23% of total revenue for the prior year period. Our sales and marketing teams continue to build our sales pipelines and are also expanding our marketing efforts. Continued emphasis on retention and renewals directly contribute to our low attrition for the year so we're pleased with the results of our investment in this area. As Ralph mentioned, our sales and marketing spend per dollar of new annualized contract revenue remained very low at only $0.51 per dollar.

R&D expenses for the fourth quarter were $1.5 million or 12% of total revenue compared to $1.3 million or 12% of total revenue for the prior year period. While we continue to invest in increasing the functionality of our products, we've been able to maintain expense control well.

G&A expenses for the quarter were $3.1 million or 25% of total revenue compared to $1.7 million or 60% of total revenue for the prior year period. The increase in G&A expenses were primarily related to our LEEDS acquisition and an increase in personnel cost.

Our GAAP net loss for the fourth quarter was $220,000 or a loss of $0.02 per share based on 11.5 million basic and diluted shares outstanding. For Fiscal Year 2020, our GAAP net income was $1.2 million or $0.11 per share based on 11.4 million basic shares outstanding and $0.10 per share based on 11.7 million diluted weighted average shares outstanding.

Our adjusted net income, which excludes acquisition costs related to the LEEDS acquisition, was a positive $418,000 for the fourth quarter or $0.04 per share on both a basic share and diluted share count basis. For the full year, our adjusted net income was $1.9 million or $0.16 per share on both a basic and a diluted share count basis.

In Q4, we ended the quarter with 779 miles live with approximately 813 miles under contract. Deferred revenue at the end of the quarter was $24.6 million versus $20.6 million at the end of the third quarter of 2020. We ended the quarter with $16 million in cash and cash equivalents versus $28.7 million at the end of Q3. While we paid $15 million in cash for the LEEDS acquisition in November, we did not repurchase any shares during the quarter.

We have no short or long-term debt outstanding. As we discussed last quarter, in August 2020, we did increase our available line of credit to $20 million to improve financial flexibility.

Turning to our full year 2021 outlook. There is no change to the $58 million to $60 million that we discussed last quarter. We continue to expect LEEDS will contribute approximately $10 million in revenue. We also expect that we will remain profitable during 2021.

Now back to Ralph for some final thoughts, and then we'll be happy to take your questions.

Ralph Clark

Thanks, Alan, and welcome back. I'm more excited today than I've ever been about the prospects for our Company. Our domestic pipeline remains strong, and we're hopeful that South Africa and Latin America will be able to pull through the pandemic, and will be able to soon reengage on critical public safety initiatives. We're excited about the TAM extension and traction we're seeing with ShotSpotter Connect and are confident about our ability to expand our product portfolio with the launch of ShotSpotter Investigate later this year.

We're mostly grateful, however, to play an important role in how policing is being reimagined in its adoption of precision policing strategies. Our expanded solutions suite fits perfectly into 21st century policing principles where data is transformed in actionable, real time intelligence that can help prevent, reduce and resolve crime with surgical precision. Our goal remains the same, and that is to continue our journey to be a trusted platform solutions provider to public safety agencies around the globe, helping them better serve and Protect communities. Yes, we want to continue to do great work that matters.

We're now happy to take your questions.

Operator

The first question is from Joseph Osha from JMP Securities. Please go ahead.

Hilary Cauley

This is actually Hilary on for Joe. Welcome back, Alan. It's great to hear your voice on the call. I just wanted (audio interference) at some point, we're going to start talking about coming back to being in person, on schools and work campuses. I was just wondering if you could give us an update on if you're having any conversations there and if we might see deployments at some point later this year on campus?

Ralph Clark

Sure. This is Ralph. Yes, we have a fairly active engagement on the security part of our business that is not only talking to college campus opportunities, but also speaking to corporate campus opportunities as well, particularly around—you can think of big-box retailers that have locations that are in, I would say, neighborhoods or communities that are transitioning and have issues with not ongoing persistent gun violence, but more intermediate gun violence that they have to be concerned about. We're hopeful that we're going to see some traction on the security front.

Hilary Cauley

Then just higher level. I know you just did this LEEDS acquisition, getting a couple of other initiatives up and running. Just when you look at the portfolio of potential skill sets that you might look to add, just any thoughts on what potential M&A opportunities might be interesting to you? That's all I had. Thank you.

Alan Stewart

Sure. This is Alan. I would say, having just acquired LEEDS, we're very excited about what they're doing and what they bring to us in terms of adding our product portfolio, especially in the case management. It helps in numerous areas. It helps us in terms of looking at different potential customers, it helps us from expanding the TAM. I would say at this point we're not necessarily looking for adding any other companies right now, from an M&A perspective, until we're finally working well with what we've done with LEEDS.

Operator

The next question is from Richard Baldry from ROTH Capital.

Richard Baldry

When I look at, I guess, you'd call your backlog, the difference between contracted and deployed, the 34-mile delta. That's about half of what you deployed for all of 2020. I'm curious what gates that deployment? Are there factors at the city level or COVID restrictions that will measure how fast that comes out or is that just a matter of you getting to it, so it could start the year on a faster pace than maybe we would otherwise expect?

Alan Stewart

Yes. This is Alan. Go ahead, Ralph.

Ralph Clark

Go ahead, Alan.

Alan Stewart

No, go ahead.

Ralph Clark

No, I was going to say, during our last quarter we talked about there being 50 miles going live in the next period of time. We're probably halfway there. In Q4, we would expect some of that in terms of the stuff that's under contract right now will happen in Q1, but I think it's definitely true to say, Rich, like you said, in terms of versus 2020, we feel better about where we are and where we're positioned from a pipeline and go-live miles in 2021 than we thought at the beginning of 2020.

Richard Baldry

When you talk about churn was obviously very low this year, but could be back up to something like 3% or 4% next year, is that something you see and you have awareness of spots inside of the renewals that are unlikely or is that just generic caution entering any year with uncertainties?

Ralph Clark

This is Ralph. I think it's much more the latter. We're just trying to be cautious. COVID-19 was not a nine-month or 12-month event. We're viewing it much more as an 18- to 24-month event. I think it's probably, to use a maybe poor analogy, we're really in the fifth inning on this thing. As good as we did in 2020 with respect to attrition management, we don't think that we're necessarily out of the woods yet. That's why we thought it to be appropriate to estimate a 3% to 4% attrition number, hopefully with the idea that we can do much better than that. It's encouraging, I think. Like I said, we did a great job last year, and I'm hoping we'll be able to do a really good job this year as well, but I think we do understand that it's still very much a challenged environment from a municipal budget point of view.

Richard Baldry

Lastly, when we look into your Opex, how much of that reflects LEEDS now or maybe as a new baseline to look at going forward or are there any fourth quarter onetime things that we should back out, maybe related to year-end bonuses, et cetera? Just getting a baseline for spending starting 2021. Thanks.

Alan Stewart

This is Alan. Great question. Look, we do have some revenue in Q4, but it's less than half the quarter from LEEDS. We also had, that went along with the revenue, some expenses that would be included as well. You can also expect that we're going to have some amortization costs related to the actual transaction itself, that will be adding throughout 2021. I would say, if you think about in terms of where our expense line items are going to be, we'll probably have a little more percentage spent in sales and marketing. R&D will be very similar. G&A will be similar to what it's been in the past and probably even lower than Q4 because Q4 had all the M&A expenses associated with it.

Operator

The next question is from Ryan Kimbrel from Craig-Hallum.

Ryan Kimbrel

Ryan on for Jeremy Hamblin here today. Congrats on the nice quarter. You guys highlighted and made a lot of smaller deals over the past few months. Does this mark a broader change in strategy in terms of letting some smaller cities try out the product on a trial basis or how is your overall viewpoint on that change in the last three or so quarters?

Ralph Clark

This is Ralph. I think we've been pretty intentional around developing a sales and marketing—targeted sales and marketing program going after the Tier 4, Tier 5 market vertical for us. We're finding that we're really demonstrating some success in that market. They're smaller deals to be sure. It's really hitting more singles and doubles versus maybe triples and home runs. But we like it a lot because it appears at least our early experience is that the sales cycles don't feel as long and complicated as what you might find in a larger city environment. Again, we're seeing from our work across a number of cities and agencies that there really is something interesting going on with respect to the uptick in violent crime. Violent crime, again, I'll just double down in the comments I made during our review, is that it's not limited to large urban cities. Those get reported a lot, but I mean, we're seeing some very strong uptick in gun violence in smaller cities that are having this one, two, three square mile challenges within their cities that we think we speak to pretty effectively.

It'll probably be more of that going forward. We're investing in it. We're getting some momentum going on there. As we bring on Tier 4 and Tier 5 cities, again, we can bring that agency to become a net promoter, they then help us sell that next agency over because now the heart of the possible becomes a lot clearer when cities like Kankakee, as an example, are just showing success. Other smaller cities can say, "Hey, you know what, that might work for me, too." We're pretty excited about it.

Ryan Kimbrel

Great. As it pertains to LEEDS, can you give us an indication of what the cadence on that $10 million contribution will look like next year? Is it still too early to dig into the overall, just on a high level, the LEEDS margin profile and how that compares to the ShotSpotter business?

Alan Stewart

Sure. This is Alan. I'd say we talked about $10 million in LEEDS right now. It's really a couple of buckets there. There's about, as you heard, from around $6.7 million in annual recurring revenue. The balance would be somewhere in the professional services. For example, if you look in 2020, they had some professional services, which were a little higher than that, that they were able to get in 2019 and perform in 2020. For us, when you look at that $10 million, we're trying to be reasonable in terms of where we think the professional services will be. There's always a possibility it might be a little higher. We don't expect it would be lower than that. That's how we get to the $10 million for our current guidance.

Ralph Clark

Then the margin profile. He asked about the margin profile, too. It's probably too early for us to get into details about the margin profile. Just to answer your second question, secondary part of your question.

Operator

The next question is from Mike Latimore from Northland Capital Markets.

Michael Latimore

Very nice quarter there. I guess you talked a little bit about the shorter sales cycles for Tier 4, Tier 5 cities. I guess, how are the sales cycles generally for your average customer now versus, say, six to nine months ago?

Ralph Clark

This is Ralph. I don't think we're—I don't think we would change from our traditional view of sales cadence of it being 12 to 18 months. I think as we entered into the pandemic and then saw the municipal budget pressures and then defund the police, we had this really interesting—we had categories of two customers—I mean, two categories of customers, I would say. Some would say, "Hey, look, I'm really busy now kind of dealing with the social unrest and protest. I might have budgetary issues. I'm interested, but I'm going to be a little bit slower in kind of turning my attention to this." Then that's a little bit of the, I would say, wind in the face, so to speak.

Then the wind at our back were a number of agencies that saw the uptick in gun violence, and that was enough to compel them to act. We saw a couple of deals that had much shorter sales cycles than our traditional 12- to 18-month sales cycles, I would say. I think there are some other ones that are going to be a little bit farther because—or a little bit longer because of all the things that are going on in that particular agency environment. It's really been a mix of both. I don't know, Alan, would you see anything different or you want to add to that?

Alan Stewart

No. I think you covered it pretty well.

Michael Latimore

Great. Then on attrition, I guess we've had two months of 2021 so far, I guess. Have you seen an uptick in churn and things so far or no major change yet?

Alan Stewart

This is Alan. I think we'll talk about the attrition that we would see at the end of Q1, but I would say, right now, we feel pretty good about how things are going. As Ralph mentioned earlier, we are counting on or at least expecting as high as 3% to 4%. Last year, only a little over 1% was fantastic. It would be our goal and our efforts to try to keep it as low to that as we can.

Michael Latimore

Got it. Then just last on LEEDS. So, $10 million to reiterate that. That's all from one customer. You're not building any new customer sales in this year, right?

Ralph Clark

Yes, that's correct.

Michael Latimore

Okay. Are there prospects for landing and recognizing revenue under this year or is that really just going to happen later?

Ralph Clark

We don't have it in our guidance, I would say. We are planning to launch ShotSpotter Investigate later this year, say, early Q3. It could be the case, and this would be upside, if we were able to generate some revenues from some early adopters jumping on that platform sooner versus later. We're not planning on it, though. We're looking more to that from a planning point of view, really generating measurable revenues in 2022, but it is potential that it could happen late this year.

Operator

At this time, this concludes our question-and-answer session. If your question was not taken, you may contact ShotSpotter's Investor Relations team by e-mailing ssti@gatewayir.com. I'd now like to turn the call back over to Mr. Clark for his closing comments.

Ralph Clark

Thank you very much. I want to thank everyone for joining the call. We're looking forward to seeing many of you over the next month or so, one at our Investor Analyst Day, which will be at the end of March, and we're also planning to participate in the ROTH conference mid-March as well. Thanks, again. I hope everyone continues to stay safe and be well. Thank you.

Operator

Thank you for joining us today for today's call. You may disconnect your lines now.