WRAP

Wrap Technologies Third Quarter 2022 Earnings Call Transcript

[BEGIN]

Kelcie Brady: Good afternoon. Welcome to Wrap Technologies' third quarter 2022 earnings conference call.

Joining me today is our CEO TJ Kennedy, our CFO Chris DeAlmeida, and our President Kevin Mullins. Following their prepared remarks, we will open the call for your questions.

I would like to remind everyone that this call will be recorded and made available for replay via a link in the investor relations section of the Company's website at wrap.com/investors.

[1]As a reminder to listeners, certain statements made during the call today constitute forward-looking statements made pursuant to the Safe Harbor Provisions of the Private Securities Litigation Act of 1995 as amended. Such forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. These risks and uncertainties are described in our earnings press release and more fully in our filings with the SEC. The forward-looking statements today are made as of the date of this call, and we do not undertake any obligation to update the forward-looking statements.

Now, I would like to turn the call over to our CEO TJ Kennedy.

TJ Kennedy: Good afternoon, everyone, and thank you for joining us today.

After the market closed, we issued a press release announcing our results for the third quarter ended September 30, 2022. A copy of the press release is available in the Investor Relations section of our website. I encourage all listeners to view our release for additional information regarding the quarter.

As an overview of today's discussion, I'll begin by providing a high-level summary of the third quarter activities and results. Then, I will hand it over to our CFO Chris DeAlmeida to discuss the financial results. Our President Kevin Mullins will then come on to provide an update on the effectiveness of our updated go-to-market strategy within our strategic roadmap. I'll then close out our discussion before we move into Q&A.

With that, let's begin.

As I mentioned during our last update, in my first 90 days as CEO, I, along with other members of the board and senior leadership team, worked to develop a multi-year strategic road map targeting growth, profitability, and immense value creation as top priorities. After another 90 days, we've now begun to implement programs, hire new leaders, and develop systems designed to execute on our plans. Six months is not a long period of time, but in that window, I believe we've set significant goals and put in place a process that will ultimately enable us to achieve them.

During the third quarter, we released and started to execute against our new strategic roadmap, making meaningful strides toward re-accelerating growth, achieving sustainable profitability, and ultimately enhancing value for shareholders. 2022 has thus far been a successful transition year for the Company, and our third quarter results demonstrate that we are on track with our plan.

This quarter we improved substantially all key profitability metrics, highlighted by a record gross margin performance and a nearly $2 million reduction in operating expenses. The initial momentum we've generated is a clear indication that our strategy is working.

Driving new sales growth remains a top priority as well. During the period, we generated a 36% increase in domestic revenue as compared to the prior year period, aided by continued deployment and orders across multiple police agencies and departments. Internationally, we just announced the largest BolaWrap 150 deal in our history, an initial $1.5 million agreement with a very large police agency in the EMEA region, as well as, a new sale of the BolaWrap 150 product to a large police agency in South America. These new sales support our thesis that international opportunities, despite longer sales cycles, have the potential to generate outsized returns that justify our investment in these regions.

In August, we announced the extension of the LAPD BolaWrap Pilot Program, entering large-scale field deployment with 500 BolaWrap 150 devices in two key divisions in the City of Los Angeles. Kevin will have more updates on that initiative shortly.

Additionally, this past month we launched Wrap Reality ADAPT, a capability that enables more customization and options to our Wrap Reality virtual training software platform. This capability has been designed to deliver a customizable instructional experience with over 6,000 possible scenario variations to better address in-the-field situations for law enforcement officers and first responders. Providing law enforcement with the highest quality, cost-effective, and in-the-moment adaptable training to better protect them and their community is Wrap Reality's mission. This enhancement to our world-class platform will provide an even higher level of engagement for agency customers and a substantial return on their investment, financially and operationally. We are proud to be a leader in the market of virtual reality training for law enforcement, corrections, and societal reentry.

Most recently, at the end of October, we had over a dozen team members in attendance the annual International Association of Chiefs of Police Conference, or IACP, at this conference we exhibited the BolaWrap 150 and Wrap Reality. Our booth was one of the most trafficked at the event, giving us hundreds of new leads, which we are pursuing. Law enforcement officers are seeing how our holistic offering of public safety tools can truly help agencies achieve safer outcomes, and it is our aim to further develop cross-selling opportunities going forward. Interest in BolaWrap and Wrap Reality was even higher than expected.

Before going any further, and I'd now like to turn the call over to Chris to go over our financials.

Chris DeAlmeida: Thank you TJ, and good afternoon everyone.

Moving to our financial results for the third quarter.

In Q3, we generated net revenues of $1.7 million compared to $1.8 million in the prior year period, representing a 6% decrease year-over-year driven by the timing of certain international sales. However, we saw sequential sales growth from Q2 in both the domestic and international markets, and Q3 2022 was a company record for quarterly domestic sales. Our Third Quarter 2022 revenue performance also includes $240 thousand of promotional discounts and incentives, primarily related to converting customers to BolaWrap 150 from our legacy BolaWrap 100. During Q3, we started phasing out the promotional pricing, which is customary in our industry during a product transition, so those impacts to revenue should decline going forward. Gross revenues before such discounts and incentives were $1.9 million.

Gross profit improved to a record $900 thousand, or 54% of net revenue, a 28% year-over-year increase from $700 thousand, or 39% of net revenue, in the prior year period. Our gross margin performance was a company record and reflects this year’s cost containment efforts as well as our shift to a higher margin product offering mix. To reiterate, we started phasing out promotional pricing in Q3 2022, and we expect our margins to benefit from this action in future periods. As a reminder, our goal has been achieved to attain a 50% blended quarterly gross margin in quarter before the end of this year. Additionally, we are on track to be above 50% again next quarter as well.

Continued focus on keeping expenses low has allowed SG&A expenses to decrease $1.1 million, or 23%, to $3.6 million from $4.7 million in the prior year period. Share-based compensation decreased to $700 thousand from $1.1 million in the prior year period. We also expect SG&A expense for the balance of 2022 to remain below the prior year.

R&D expenses for the third quarter decreased $800 thousand, or 40%, to $1.2 million from $2.1 million in the prior year period. The decline is largely attributable to cost control efforts implemented during the second quarter 2022 as well as higher development costs associated with the BolaWrap 150 in the prior year period.

Operating expenses decreased $1.9 million, or 28%, to $4.8 million from $6.7 million in the prior year period. The decrease in operating expense was the result of the decreases in both SG&A and R&D expenses previously noted and our strategic roadmap focus on an improved operating model. Our goal is to keep total expenses below $5 million for the foreseeable future.

Net loss for the third quarter improved 35% to $(3.9) million, or $(0.09) loss per share, from $(6) million, or $(0.15) loss per share, in the prior year period. The improvement in net loss was the result of an increased sales focus and cost containment efforts implemented since the second quarter 2022.

Our balance sheet remains strong with approximately $24 million of cash and short-term investments to support the growth plan we have in place. During the third quarter, we leveraged $4.8 million of net cash. We believe we have ample working capital to support our operations for at least the next 12-months.

Moving to a review of our key performance indicators.

In Q3, our total trained law enforcement agencies grew to more than 1,300, or a 39% increase from the prior year period.

Total certified officer instructors also grew to more than nearly 4,400, or a 36% increase from the prior year period.

During the first nine months of 2022, we had a 72% increase in device sales as compared to the first nine months of last year.   Additionally, cassette sales grew to 25% of total revenue for the first nine months of 2022, as compared to 15% in the prior year period.

Now I'll spend a minute discussing our current outlook.

Based on our financial performance to date, as well as information available as of today's call, we are reiterating our expectation for sales to grow year-over-year in 2022. As supply chain disruptions ease and the transition from the BolaWrap 100 to the BolaWrap 150 accelerates, we also anticipate sequential increased sales in the fourth quarter and into 2023. New sales are expected to come from a combination of domestic and international expansion with existing customers, as well as new contract signings in from new products in both regions.

Additionally, based on progress achieved as part of the Company's updated strategic roadmap, expected sales growth, and continued cost savings, we are also reiterating our expectation that cash burn should decrease going forward. The Company is currently targeting a quarterly cash flow break-even point by the fourth quarter 2023 and with the potential for profitability by the end of 2024. More importantly, we believe this level of increased BolaWrap uses with dramatically help save lives and save careers.

In summary, the third quarter was defined by substantial improvement across our key profitability metrics, including record gross margin and meaningful cost reductions across R&D, SG&A and other areas. Our topline results reflect ongoing transition from the BolaWrap 100 to BolaWrap 150 as well as the timing of some international sales, however, we recorded our best quarter of the year and a meaningful quarter-to-quarter improvement, which should continue to ramp in Q4 and into 2023. While we invest for new sales growth and greater brand awareness, we remain focused on diligent cost management, which has us comfortably on pace to hit our goal of 50% gross profit margin again in the fourth quarter.

With that, I will turn the call over to Kevin to discuss the early results from our new go-to-market strategy.

Kevin Mullins: Thanks, Chris.

As TJ noted at the beginning of the call, we have already begun to see encouraging results from our revamped sales approach that we put in place last quarter. Building our go-to-market strategy is a fundamental component of our strategic roadmap, and we have given focus to maximizing processes for our future sales success. The goal for the BolaWrap 150 is to achieve repeatable and predictable sales across domestic and international markets. As a reminder, in the second quarter we instituted several major changes to the way we approach our sales process. I'll briefly illuminate those changes once more as well as provide an update on our progress.

First, we looked inwardly at how we can drive more success with existing customers. In response, we created a new customer success team in mid Q3 focused on retaining and expanding existing customer relationships. During our initial assessment, we determined only a marginal percentage of existing partner agencies who are at full deployment. Expansion sales in the public safety vertical, especially with our existing law enforcement agencies, are more efficient, predictable and occur faster in landing new customers. We now have a dedicated team and a clear plan to growing our existing customer base while maintaining focus on expansion. During the third quarter, we saw success in this new effort. As a result of the hard work and dedication of the customer success team, we were able to help drive additional sales through direct discussions with over 220 of our customers.

Second, we looked outwardly at our new customers sales process and implemented a dedicated inside sales team function for new leads with a regionalized approach. By shifting to a regionalized approach, we have created a more regimented system to ensure leads are logged and tracked properly. This process has already resulted in improved lead flow and customer conversion. We've also improved how we implement quotas and have developed commission incentives that is better aligned with our overall results. Additionally, we've initiated weekly pipeline management and sales commit calls. This level of structure has created new transparency and accountability throughout our sales operation. During the quarter, this led to a monumental effort to focus on smaller agencies across the US. During the quarter, we increased our outbound sales calls to over 1,000 calls in just two months that resulted in several new sales from smaller agencies in the quarter, as well as substantial increase in our future pipeline.

Most importantly in Q3 we implemented a review of all domestic and international distributors to ensure they were aligned with our new strategic roadmap. This resulted in key changes to our team to manage these distributors to ensure our mutual success. Existing distributors are now performing even better and some additional distributors have been added and brought onboard. Additional changes to our international distributors are also now underway. The improvements in domestic sales are attributable to the changes to inside sales and our distributors.

Lastly, we analyzed our training programs as part of our strategic review and consider the immense value each provides to our agencies and partners. Based on our review, we decided to begin charging for training services similar to other companies in our space. This decision is consistent with industry standards and has been further validated in discussion with our agency partners who did not raise concerns about this charge. We have also implemented changes to how we sell Wrap Reality, resulting in new wins, and solidified our go-forward virtual reality offering as a Software-as-a-Service model. So far, we have seen acceptance of our new training methodology, and the feedback and interest in Wrap Reality has increased substantially during the quarter.

To that point, in October we announced the launch of Wrap Reality ADAPT, a new major upgrade to our virtual training software platform. ADAPT allows variable real-world scenarios to be customized and conducted with the trainer acting as the voice of the subject through VR headsets. Users will be able to experience variable real-world scenarios where the situation is customized, and the subject's voice is transmitted to create an immersive training experience. This formatting provides the highest level of engagement for trainees and allows for almost unlimited scripting and up-to-the-moment training possibilities, eliminating costly setup and teardown of older, traditional style scenarios created with live actors or hardware-built, two-dimensional sets. This enhancement to our platform will provide a higher level of engagement for agency customers and a substantial return on their investment, financially and operationally.

I’ll now provide a brief update on sales during the quarter.

Both domestic and international sales grew over Q2 of this year.

Moving to our ongoing pilot program with the LAPD, our trial remains underway. In this quarter we extended the pilot to large scale field deployment. We now have 500 BolaWrap devices in two divisions in the City of Los Angeles. The early feedback is encouraging, and we will continue to provide updates as the program moves forward over the next year.

In discussing this program, it likely also makes sense to review our product strategy and how that also relates to our typical sales cycle. As mentioned previously, we have made the decision to deliver the BolaWrap 150 to the marketplace for the next 5 to 10 years to give certainty to our customers and our distributors. We will be innovating new products through our R&D efforts, but these will be additive to the BolaWrap 150 and not replace it to avoid getting into any revenue or longevity issues that occurred with the BolaWrap 100 to 150 transition. The sales cycle for both of our products also takes time as most law enforcement agencies must train on how to use the device, write policy around it, and field test it before it goes to full agency deployment. Internationally, this process can take much longer, as we are typically working with larger customers where we are essentially working with a new product in a new jurisdiction with its own rules and regulations to follow. As evidenced by the recent EMEA and South American orders, we believe our efforts in this area are justified by the large and untapped sales opportunities represented in these geographies.

In summary, we believe our improved go-to-market changes will help drive more consistent sales moving forward over the long term. The tremendous amount of interest we received during our attendance at last month's IACP conference was an eye-opening experience for many members of the team, and we have a healthy pipeline of opportunities to show for it.

While we are building success in our domestic repeatable sales this year for BolaWrap 150, we are also implementing changes in our international approach to sales of BolaWrap 150 that will generate momentum to carry current sales into Q4 and 2023.

I'll now turn it back over to TJ.

TJ Kennedy: Thanks, Kevin.

In closing, I am proud of the progress we have made thus far to execute against our new strategic roadmap. We remain focused on expanding sales in the United States, ramping internationally, and expanding within existing agencies. I am confident that we have the right plan and are building the right team to continue to grow recurring revenue, drive stronger margins, and support long-run profitability.

Looking ahead, we are in a strong position to meet our year-end goals to complete this transition and expect another meaningful step function improvement in sequential revenue growth as we fully transition to our next generation product lines. We also remain committed to delivering on our cash flow and profitability outlook for 2023 and 2024, respectively.

Law enforcement agencies across the globe are continuing to look for alternatives to pain compliance. BolaWrap is now considered by many departments as not elevating to the level of a higher level of use of force, and usage is rewarded as forced avoidance or prevention. As those departments deal with and increasing number of mental health calls and also deal with expensive settlements, it is clear that the BolaWrap 150 is gaining traction, and our sales show that. There are also increasing opportunities for police departments in the US to secure funding from government grants to acquire our product. We are now seeing agencies using multiple grants to purchase BolaWrap and Wrap Reality. We are also seeing agencies dedicate budget to these important investments and are convinced that it will reduce use of force payouts on a yearly basis. We plan to explore these options as they are presented.

Wrap Reality, with the new addition of Wrap Reality ADAPT, is a powerful tool that we see as a successful step forward toward the future of training. We saw an increased interest in the product at IACP last month and, with its new capabilities, we believe it can become a meaningful tool in law enforcement and corrections department training regiments. Our efforts are all part of a continuous push to improve the way law enforcement and corrections departments train their staff.

This also highlights Wrap's own mission to change the way law enforcement save lives. We want to create change moving forward. We are achieving this by working not just with the agencies, but with community groups and leadership as well.

Kevin and I are almost at the six-month mark since joining, and I can tell you I continue to be more optimistic and excited about the enormous market opportunity for Wrap than I've been to date. With the team now executing our strategic roadmap, I am determined to lead us through this transformative period and establish a foundation for long-term success.

I will now turn the call back over to the operator to facilitate the Q&A.

Kelcie Brady: Thank you TJ. We'll now open the line for questions from the Company's publishing analysts as well as pre-selected questions submitted from investors.

Now our first question will come from Greg Gibas with Northland Capital Markets.

Please proceed…

Greg Gibas: Thanks for taking the questions. T. J. Chris Kevin and Kelcie congrats on the record work. Well, I was just wondering. You know it sounds like pipeline is building. Are you seeing changing interest levels from departments, either domestically or internationally? Or would you kind of attribute that more to You know your new go to months, right?

TJ Kennedy: I think it's a little bit of both. I think No. First off we definitely had a shift in change in the way Chiefs and decision makers were coming to the Wrap booth and talking to us as an example in the past. It seemed to be more about. You know we haven't seen it, show it to us uh this particular IACP. It was very much about. We've seen it. We would like to have it, someone on my staff actually said, You know we should come and check it out and learn more and make sure that we get it into our department. So a lot more awareness. A lot of people have seen our videos have talked to other agencies who already use Ballarat or rap reality, and that referral business is certainly, for I do think our new approaches are definitely helping us close deals faster uh than we had before in some cases, and certainly uh, having more follow up and even outbound um approaches to our sales approach, but definitely, uh increasing interest in increasing desire to leverage bullet, wrap, and reality.

Greg Gibas: Great good to hear uh, if I could follow up on the led. Um, you know. Nice to see that trial extended. I think you said five hundred and twelve rep devices with them. Um was just kind of wondering, you know, when you expect to maybe get more definitive results, or when that trial ends, or you know just anything more conclusively.

TJ Kennedy: Yeah, the trial started um in late August, and it was expected to last for twelve months, and this phase part of that is so that they can gather data over time. So you know we're a couple of months into that now. Uh we are um getting some positive feedback. I've been out there uh to listen to the officers in the field, and they expect to continue it, you know, throughout the next year, so I think we'll have a lot more over time. They're looking at a little more longitudinally, and we'll share that as we get more data,

Greg Gibas: Okay, sounds good. Um, regarding the new record order the one point five million, and then you also mentioned a pre-sizeful order in South America. Um we're wondering maybe relative the relative size. I guess that that were um. And then kind of would you expect both of those to be recognized in the queue for time? Right?

TJ Kennedy: Yeah. So the South America order came in uh, actually late in Q3 But we were already in a blackout period, which is why we didn't announce that sooner, and that's a six figure deal, and that's included in Q3 results. The one point five million order was in October, and so that will be a part of Q4 results.

Greg Gibas: great, I guess. Just last one for me. Um, Just regarding your liquidity position. You do you think you have sufficient liquidity to bridge that gap to generating cash based on your output.

Chris DeAlmeida: Yeah, based on our results. Now, we do feel that given where we project sales growth to be, and the current cash we have on hand that that would be sufficient for us going forward.

Greg Gibas: Okay, great. I'll pass it on.

Kelcie Brady: Thank you, Greg. Our next question comes from Alan klee with maximum group. Please go ahead.

Alan Klee: Okay, Thank you. Um. Just following up on the question on the the two big orders. Is it reasonable to assume that both of them you'd recognize all the revenue in the quarter that you received it.

Chris DeAlmeida: Yeah, that that that's correct, Allen. So uh, you did the South America, or, like Tj. Mentioned, actually happened in the third quarter, so that was fully recognized in the third quarter. The larger order we received it, and it occurred in October. So that would be part of Q4 revenue and fully recognized in the fourth Quarter.

Allen Klee: Okay, great, I think I heard you say your goal is to keep operated expenses below five million dollars. Is that still a a goal? Once we get into next year, where you kind of normally at the beginning of the year. Expenses kind of go up, and Sales commission might increase, just sales related costs tend to be a little more variable. So just trying to understand how long of a goal is that? Thank you.

Chris DeAlmeida: Yeah, Absolutely that that is our stated goal that we would keep opex cost below five million in the foreseeable future. You know, we that will grow over time as sales grow, But we're going to be very conscious about how we do that. So at this point we want to keep costs low. We do really going into next year. Uh, we will be able to achieve that. I mean, there's some seasonality, as we mentioned. Uh, just in cost structure overall, but at least on an average basis, we think we'll be below the five out of below the five million mark in 2023, and then look I mean we'll see how sales take off. Clearly, we are being very aggressive in our sales, approach. Uh, we want to see sales grow and build, but I and so that could lead to some additional costs. But we will keep a very tight tight lid on that, and very conscious about how we expand our cost going forward?

Allen Klee: Great! And my last question is, Are you still dealing with travel, um restrictions, or international to try to um accelerate on international sales. Or have you found that that's gotten better?

TJ Kennedy: We have found that it has improved. Uh, there are some regions of the world where there's still more restrictions, but they are much better uh here in in Q. Four of this year versus even, you know, four to six months ago. So we've seen a major improvement, and we expect that to stay fairly open, based upon the knowledge we have right now.

Allen Klee: Thank you very much.

Kelcie Brady: Thank you, Alan. We now have a few questions that we've received from investors. I will read those now. Question number one when made, professional security agencies be allowed to work with this technology currently right now.

TJ Kennedy: In the Us. Uh law enforcement agencies are able to leverage BolaWrap, and those that have different departments that work for those law enforcement agencies, but not private or professional security. Today. Um, we're working on ways to improve that in the future, and um have engaged a number of avenues long term, but try to improve that and allow that to open up much broader, but as of right now, it's still focused on law enforcement in the Us.

Kelcie Brady: And question number two: What factors is wrap looking at, to drive revenue growth?

TJ Kennedy: The main factors for us is really building that repeatable domestic and international sales. And we're continuing to do that through our improvements in the strategic roadmap. Another element for us is building a customer success organization that is focused on our existing Uh agencies today, and really making sure we're supporting them as they grow to more full deployment across the agencies and help grow with them uh every step of that way. And so we believe that that supported and actually implementing a customer, success organization will help us grow uh more intrinsically from our existing basic customers, while we're continuing to add both new domestic and international customers.

Kelcie Brady: Thank you. Tj: At this time that concludes our question and answer session. Thank you for joining us today for our third quarter two thousand and twenty-two earnings. Conference. Call you may now disconnect.

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