

Wrap Technologies, Inc.

1Q '23 Earnings Conference Call

May 10, 2023

Presenters

Kevin Mullins – President, CEO & Director

Christopher DeAlmeida – CFO, Treasurer & Secretary

Operator

Good afternoon, and welcome to Wrap Technologies First Quarter 2023 Earnings Conference Call. Joining me today is our Chief Executive Officer, Kevin Mullins; and our Chief Financial Officer, Chris DeAlmeida. Following their prepared remarks, we will have a few questions submitted from shareholders. I would like to remind everyone that this call will be recorded and made available for replay via link in the Investor Relations section of the company's website at ir.wrap.com. Additionally, the company asked that all interested parties register on the new Investor Relations website at ir.wrap.com to continue to receive alerts and stock information.

As a reminder to listeners, certain statements made during the call today constitute forward-looking statements made pursuant to the safe harbor provision 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 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'd like to turn the call over to our CEO, Kevin Mullins. Kevin?

Kevin Mullins

President, CEO & Director

Good afternoon, everyone, and thank you for joining us today. After the market closed, we issued a press release announcing our results for the first quarter of 2023. A copy of the press release is available on our Investor Relations website at ir.wrap.com, which is also accessible through our corporate side, wrap.com. As an overview of today's discussion, I'll begin by providing a high-level summary of the first quarter and recent developments before handing it over to our CFO, Chris DeAlmeida, to discuss the financial results in more detail. I'll then come back on to provide a larger update on our sales and operations before we move into Q&A. To start, it is a privilege to assume the position of CEO. Having been part of Wrap since early 2022, I have observed the vast market potential that lies ahead of us, and I'm certain that we are laying the foundation for sustained growth. As you are aware, in April, we implemented several organizational changes aimed at aligning our cost structure and prioritizing near-term and long-term sales. While challenging, we believe these changes will yield a positive impact on our profitability and agility going forward.

Our foremost objective is to enable customers in achieving success by providing innovative solutions that can serve as valuable tools for law enforcement officers and Save Life. I would like to express my gratitude to T.J. Kennedy for his leadership and guidance during an important transitional year for the company, and we wish him all the best in his future endeavors. As part of the leadership changes, we have welcomed 2 new members to our Board of Directors, Bruce Bernstein and Marc Savas. Bruce is a senior portfolio manager for 2 alternative finance funds and has over 35 years of experience in the securities industry.

He also brings a wealth of experience in serving on public boards, which will be a great value to wrap. Marc Savas has over 3 decades of experience in accelerating revenue growth for companies. He excels in developing and guiding leadership teams, executing tactical, strategic and technical plans, and he possesses a comprehensive understanding of organizational efficiency. We extend a warm welcome to both Bruce and Marc to the Wrap family, and I look forward to benefiting from their unique perspective and leadership in my role as CEO.

At Wrap, we are more than just a training platform or tool. We are committed to offering solutions that address modern policing problems, which I will elaborate on later. As evidenced by our fiscal 2022 results, we have started to reap the rewards of our long-term investments in marketing, training and research and development. Wrap has established a

robust brand, increased market share of its innovative solutions and forge relationships with numerous law enforcement agencies worldwide. We have a chance to hasten the pace at which we will be closing new sales from our expanding pipeline as we strengthen our relationships with existing customers. We are pursuing several new initiatives to boost the rate at which we source and close deals, and we are confident that taking a more targeted and deliberate approach will enable us to generate business more efficiently.

I intend to establish a well-defined and targeted strategy that aligns with our priorities. To accomplish this, we will adopt a multifaceted approach that entails enhancing collaboration between our inside and outside sales teams, optimizing our sales territories to better target potential customers and streamlining our operating model to improve efficiency and scalability. By implementing a leaner operating model, we will be able to expand our operations when larger orders materialize later in the year. With these measures in place, we are confident that we can stimulate growth and attain our 2023 targets. I have outlined 3 main priorities as we head into the rest of the year. They are: 1, accelerate the rate at which we close deals; 2, expand deployment with existing customers; and 3, reduce our nonessential operating expenses. I will delve deeper into these priorities shortly. But first, I'd like to hand the call over to Chris to discuss our financial results for the quarter. Chris?

Christopher J. DeAlmeida
CFO, Treasurer & Secretary

Thank you, Kevin, and good afternoon, everyone. Moving to our financial results for the first quarter of 2023. In Q1, we generated revenue of \$711,000 compared to \$1.6 million in the prior year period. The decrease in our Q1 2023 revenue was primarily due to a delay in timing of new orders, primarily on the international side. Revenue in the Americas decreased 40% to \$710,000 from \$1.2 million in the prior year period, while international revenue decreased to \$1,000 from \$410,000 in the prior year period.

Gross profit for the first quarter of 2023 decreased to \$350,000 or a 50% gross margin. This gross profit decline is a 48% decrease from \$670,000 or a 42% gross margin in the prior year period. The decrease in gross profit was a result of the decrease in sales, while the increase in gross margin was primarily a result of the increased efficiencies and the costs associated with the production of BolaWrap 150 as compared to the BolaWrap 150 and improved pricing on the Bora 150 products. SG&A expense for the first quarter of 2023 decreased \$1 million or 23% to \$3.5 million from \$4.6 million in the prior year period.

The decrease in SG&A was a result of continued cost containment efforts. Share-based compensation decreased to \$628,000 in the first quarter from \$1 million in the prior year period. R&D expense in Q1 decreased about \$430,000 or 29% to \$1.1 million from \$1.5 million in the prior year period. The decrease in R&D expense for the quarter was primarily a result of cost management efforts as well as improving development costs associated with the Bora. Operating expenses for the first quarter decreased \$1.5 million or 24% to \$4.6 million or from \$6.1 million in the prior year period. The decrease in operating expense was a result of a decrease in SG&A and R&D expenses previously mentioned. Net loss for the first quarter of 2023 improved 25% to a loss of \$4 million or \$0.10 or a \$0.10 loss per diluted share from a loss of \$5.4 million or a \$0.13 loss per diluted share in the prior year period. The improvement in net loss for the quarter was a result of stronger margins and cost containment efforts implemented beginning in the second quarter of 2022, offset by lower-than-expected revenue during the first quarter of 2023.

Our balance sheet remains robust with around \$16 million in cash and short-term investments to sustain our growth plan. In the first quarter, we utilized approximately \$3.3 million of that cash. Subsequent to the quarter's close, we implemented various cost containment initiatives, and we are currently looking at additional measures to extend our operating runway utilizing the current cash reserves. Moving to a review of the key performance indicators for the first quarter. Total trained law enforcement agencies grew to more than 1,390 or a 31% increase from the prior year period.

Total certified officer and structures also grew to more than 4,660 or a 26% increase from the prior year period. Although we have suspended guidance as we reassess our outlook for the fiscal 2023, we anticipate that the recent reductions in nonessential expenses will lead to further decreases in our operating expense in the latter half of the year. These changes are expected to result in a minimum quarterly reduction of operating expense by \$1.5 million or a \$6 million reduction on an annual basis. Nonetheless, we anticipate that Q2 will incur onetime extra expenses due to severance and legal fees associated with the recent organizational modifications we made.

To sum it up, we have sustained healthy margins in Q1 and our ongoing improvements in adjusted EBITDA and net loss signals that we are on the right track towards profitability. Our shift to a just-in-time production model aligns with our sales projections and will enable us to enhance our operational efficiency and maintain high quality that our clients expect. Although our Q1 revenue performance is not ideal, we are still pleased to reach our 2023 revenue targets. Although we faced temporary setbacks in receiving early orders, we anticipate closing out opportunities later in the year, and we possess sufficient inventory to support large-scale orders as necessary.

Our inventory is starting, and we have streamlined our resource to optimize operations while maintaining production capacity. Our focus on trimming nonessential operating expenses was significantly lower the cash burn rate going forward, supporting future profitability. We remain confident in our long-term prospects for our business, and we will provide an update to our 2023 forecast after completing our current assessment. With that, I'll turn the call back over to Kevin to discuss sales and operational updates. Kevin?

Kevin Mullins

President, CEO & Director

Thanks, Chris. Although we encountered a subdued macroeconomic landscape in Q1, which led to the deferral numerous deals, particularly in the international market, we are making headway with these opportunities in our strong sales pipeline. We are observing healthy demand for our -- in our domestic market. In Q1, we participated in several events and provided an equal number of quotes.

Nevertheless, we do need to consider the regular budgeting process, which tends to shift orders to the latter part of the year because of budgeting cycles. Nonetheless, we anticipate a significant increase in domestic orders as we move forward in the year. In the international market, while deals do not progress -- did not always progress as expected, we persisted in expanding our global pipeline. This development is encouraging as we advance into Q2 and the remainder of the year. We recognized significant growth prospects in the international market, and it is still nascent stays regarding capturing market share there.

Due to the public safety market and government budget cycle, sales tend to be back-end loaded. However, we are confident that our strategy is well suited to seize the near-term market opportunities. Before we close, I'd like to take a moment to give further context around leadership's updated operating priorities. As a reminder, these are to: 1, accelerate the rate at which we close deals; 2, expand deployment with existing customers; and 3, reduce our nonessential operating expenses. Beginning with accelerating new sales.

As part of our ongoing efforts to enhance our sales strategy and drive growth, we made several organizational changes in April, including the realignment of our sales force, both domestically and internationally. The primary goal of this realignment is to create a more cohesive and unified team with a committed focus on customer success and driving sales results. By consolidating our sales force, we aim to streamline our processes and reduce inefficiency, ultimately resulting in a faster and more efficient sales cycle. This will enable us to bring our innovative solutions to market more quickly and effectively, helping us to capture new business opportunity and expand our customer base.

Our new unified sales team will be responsible for driving results across all regions and markets with a focus on achieving our sales targets and meeting the evolving needs of our customers. We believe that this approach will allow us to better align our sales efforts with our business objectives while also improving our ability to respond to changing market conditions and customer demand. We are implementing a targeted approach to industry conferences as part of our sales strategy. Previously, we had attended a bulk schedule of events to reach as many potential customers as possible. But now we are taking a more data-driven approach to identify the conferences that consistently generate strong leads while also reducing costs. This approach will enable us to focus our efforts more effectively and achieve better results. In addition to targeting new customers, we are also focusing on expanding our deployments with existing customers.

Our customer success teams have been successful to date, and we are positioning our inside sales team to further monetize areas that we have already penetrated. This will be instrumental in driving our growth. When we started as a company, many of the agencies we initially deployed were only small partial deployment. We are now contacting those agencies and exploring opportunities for further expansion. This includes sales of BolaWrap units, additional cassettes and further emphasis on our training and our Wrap Reality offering.

We are also increasing coordination and communication between our inside and outside sales teams to optimize our full sales approach. By focusing on deliberate and targeted sales efforts, we are confident in our ability to achieve our sales goals and drive growth. To maintain profitability, we have prioritized reducing our operating expenses, which has been successful thus far. Moving forward, we will continue to spend prudently as we grow sales. As Chris mentioned earlier, the organizational changes we made in April will have a meaningful impact on reducing our SG&A expenses.

In addition, we have restructured our brand ambassador program to be more performance-based, but they will receive commissions when deals they acquire are closed. As we explore additional ways to reduce our operating expenses, we have decided to outsource the development of Wrap Reality. By outsourcing product development, we can accelerate tech builds and upgrades at a lower cost, allowing us to focus resources on selling the product, which is a crucial part of our go-to-market strategy. This decision will help us achieve our financial goals while maintaining the quality of our product.

In conclusion, we are committed to maintaining our focus on cost management while investing in new sales growth and greater brand awareness in the remaining quarters of 2023. As mentioned earlier, we have implemented various cost containment measures to extend our operating runway and reduce cash burn. This includes our decision to outsource the development of Wrap Reality, which will allow us to accelerate tech builds and upgrades at a reduced cost while freeing up resources to concentrate on selling the product. We will also continue to optimize our sales approach through a more targeted and deliberate approach to industry conferences as well as expanding our customer base through deeper analysis and collaboration between our inside and outside sales teams.

Our recent organizational changes and restructuring of the brand and ambassador program will have a successful outcome in reducing SG&A expenses, and we continue to look for ways to optimize our expenses as we focus on achieving our growth targets. With a unique and improved product offering, a growing customer base and a very strong sales platform, we are confident in our ability to achieve our targets and improve our profitability metrics. We will keep you updated on our progress in future quarters, and we appreciate your continued support as we work towards long-term sustainable growth. I will now turn the call back over to Kelcie to facilitate the Q&A and preselected questions we have received from investors.

Question and Answer

Operator

Thank you, Kevin. The following questions were submitted from shareholders and interested parties. For the first question, how has the introduction of the reduction in force guarantee been received thus far? And are you seeing additional sales traction?

Kevin Mullins

President, CEO & Director

Thank you, Kelcie. The short answer to that question is yes. I'll recap the program for anyone on the call that might not fully understand it. Our reduction in force guarantee is that if an agency implements BolaWrap and they implement the program enterprise-wide, so to the majority of sworn officers, we guarantee that, that agency will see a significant reduction in use of force over a 12-month period.

There are caveats to this, but it's a program where we put our money where our mouth is that we feel strong in our technology and then what we're seeing and understanding that every agency domestically and internationally, you are looking to reduce use of the force. And that has been heightened by tragic events such as Tyre Nichols at what's happened in Venice. It's heightened by the average cost to defend the use of force claim is \$2.2 million. Interesting that over half the use of force incidents that happened in the United States result in bodily harmed individual. 1/5 of those involve a firearm discharge.

And so we're also seeing an officer injury rates from somewhere in the neighborhood of 15% based on each use of force. And when you break down what the cost is of a use of force. It's over 150,000 workdays that we're seeing that. So the total hours work lost, it's \$1.5 million. And the cost for those hours lost is \$31 million to replace that \$47 million. So again, every agency is looking to reduce those uses of force. We feel so strong in our BolaWrap technology, and we have the data to back it up that again, we put our money where our mouth is, and we are seeing a traction coming from agencies that want to take us up on this program.

Operator

Thank you, Kevin. Chris, when do you plan to complete your reassessment and reissue guidance?

Christopher J. DeAlmeida

CFO, Treasurer & Secretary

Great question. Given kind of some of the recent changes in management, we're taking the time to kind of reassess and re-evaluate our current guidance. While we don't have a specific time line right at this moment, I would like to emphasize that our outlook remains positive. We're confident about our ability to navigate any potential challenges and capitalize on opportunities for the future. We will provide an update on as we have completed our reassessment or in a better position to provide revised guidance. But with that, we appreciate kind of everybody's understanding and patience during this time.

Operator

Thank you, Chris. Also, can you provide more details about how the just-in-time production model will work?

Christopher J. DeAlmeida
CFO, Treasurer & Secretary

Yes, certainly, I'd be happy to do that. What we're trying to focus on with our just-in-time production model is really designing something that optimize the efficiency and minimize waste by producing goods when they're needed, when the demand is there, so to speak. This means that going forward, we'll maintain a leaner inventory and production will be triggered by customer demand. This approach will enable us to reduce our inventory holding costs to minimize the risk of excess or obsolete inventory and improve our cash flow. However, all that being said, we have sufficient inventory today. We can meet the demands of our customers, and we're excited about doing that, and we're comfortable that we can quickly fill orders both today and into the future.

Operator

Thank you. Kevin, is the outsourcing of Wrap Reality of permanent plan? Or is it temporarily based on current business conditions? We'd like to understand the updated long-term vision of this business.

Kevin Mullins
President, CEO & Director

Absolutely. It's a good question. And the answer is yes. This is a permanent plan. We believe that our VR training platform Wrap Reality is one of the best solutions on the market. We received that same feedback from our customer base. So we see this solution as the most productive and efficient way to be able to train on enforcement. It's not only our platform that we're offering the law enforcement directly, but it's to corrections. We also have our Societal Re-entry platform. Outsourcing will allow us to expand with highly trained teams to grow content and grow content effectively and efficiently.

And this is very important when we're looking at expanding into the international market, where we need to localize scenarios for that particular market. Again, it's about creating and building new content as quickly as we can. There's a huge demand in the market right now for a more effective way to train. We are also seeing grant dollars coming in for different training solutions based on different events that have happened over the last several months. So our goal is to be able to take advantage of not only creating content for our law enforcement partners but being able to really rationalize and understand where the budget dollars are coming and then direct our content toward what would be the highest priority there.

Operator

Thank you, Kevin. Also, can you provide more information on any new products or features that you plan to launch in the coming quarters and how these will contribute to revenue growth and customer acquisition?

Kevin Mullins
President, CEO & Director

Yes. We are looking -- we're always looking. We're looking to consider what new solutions are out there. What other ancillary product sets are out there that would allow us for us to expand, expand existing and or potentially new customer bases? So, there are opportunities for large-scale bundled product sets, and so being able to build on those economies of scale, being able to add potential products in that would be a nice bolt-on a nice add-on to our product sets that we have now. So we absolutely are looking for those new revenue sources and how we build on efficiency. So that's going to be a priority in the next coming months.

Operator

Thank you. That concludes our Q&A portion of the call. Thank you for joining us today for Wrap Technologies First Quarter 2023 Earnings Conference Call. If you have any additional questions, please reach out to us via our website at ir.wrap.com. You may now disconnect