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CORPORATE PARTICIPANTS

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Kiva A. Allgood  Sarcos Technology and Robotics Corporation - President, CEO & Director

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Robert W. Mason  Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst
Stephen Edward Volkmann  Jefferies LLC, Research Division - Equity Analyst
Moriah Shilton  Financial Profiles, Inc. - SVP

PRESENTATION

Operator
Good day, and thank you for standing by. Welcome to the Sarcos First Quarter 2023 Conference Call. At this time, all participants are in a listen-only mode. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker Moriah Shilton.

Moriah Shilton  Financial Profiles, Inc. - SVP
Thank you, operator. Good afternoon, everyone, and welcome to the Sarcos Technology and Robotics Corporation First Quarter 2023 Earnings Call.

Joining us on the call this afternoon are Sarcos President and Chief Executive Officer, Kiva Allgood; and Chief Financial Officer, Drew Hamer. Kiva will start the call with a discussion of business highlights from the First quarter and recent events and Drew will then talk in more detail about the financial results, before management takes questions from analysts.

Before we begin, we must state that today's call will contain forward-looking statements, including statements concerning future commercial production and availability of our products, product features and capabilities, target markets and market trends, size and expectations, customer demand and future financial results, condition and cash flows, including revenues, costs and liquidity.

In addition, any statements about future performance related to our acquisition of RE2, including our expectations regarding the benefits to be achieved, the financial performance of the combined company integration plans and other statements regarding the combination of the 2 companies are forward-looking statements. These statements represent management's beliefs and expectations as to future events as of today.

But there are many risks and uncertainties that could cause actual results to differ from what we have projected. Among those risks and uncertainties are those described in our form -- Our report on Form 10-Q filed today with the SEC and those mentioned in today's earnings press release.

We encourage you to review the risks and uncertainties described in this press release and in our filings with the SEC for further information regarding these actual and potential risks and uncertainties. We also encourage you to review the special notes regarding forward-looking statements, including in our earnings release and 10-Q for the First Quarter 2023 filed with the SEC this afternoon in which we posted in the Investors section of our website at sarcos.com and on the SEC's website.

In addition, we will be discussing certain non-GAAP financial measures on our call today. Throughout this call, all financial measures will be GAAP, unless otherwise noted. A reconciliation of any GAAP -- non-GAAP measures to the most directly comparable GAAP measures as well as the description, limitations and rationale for such measures, are included in the earnings release filed with the SEC this afternoon and which is available on our website and on the SEC's website. A recording of this call will also be available on our website until June 9, 2023. The information that we're giving on this call is as of today's date, and we undertake no obligation to update the
At this point, I’d like to turn the call over to Kiva Allgood, President and CEO of Sarcos.

Kiva A. Allgood  
Sarcos Technology and Robotics Corporation - President, CEO & Director

Thank you, Moriah. Good afternoon, and welcome to everyone joining us on the call today. As you saw in our press release, we are gaining revenue momentum from our product development contracts as we push toward initial commercial production sales in the coming quarters. Now that some of the Guardian family of products are available for sale, we have been able to get products working out in the real world, and we expect commercial product sales to ramp up in the second half of the year and grow from there.

We’re excited about our recent manufacturing agreement with Jabil. And as demand for the Guardian family of products grows, this relationship will allow us to grow beyond our initial production capacity of 300 to 500 units per year. In March, we attended ConExpo, the largest construction equipment trade show in North America.

There was tremendous interest and traction at ARPU as we began engagement with more than 70 companies who are speaking with us about how our robotic solutions could help improve their productivity and safety. And they could see firsthand how impactful our Guardian products can be as we perform demos of the XM and XT doing semiautonomous and teleoperated work at height such as laser ablation, grinding and cutting, all tasks required in surface preparation, ship building and construction, which we believe represents a large market opportunity for Sarcos.

Over the week-long event, we demonstrated how our solutions, which include hardware, software and components, improved productivity while keeping workers safe from dangerous working conditions, seeing is believing when it comes to surface solutions and even in the rain, the team executed and performed well.

Now that our products have come to life, we have been actively on the road at industry shows and events in our focused verticals. In April, Sarcos took part in the Aviation and Robotics Summit, a 3-day invitation-only series of workshops, site tours, networking that brought together aviation and robotics industry professionals and experts from around the world. The goal of the summit was to solve aviation business and operational challenges with robotic solutions and advance the industry's focus on improving the travel experience.

Jorgen Pedersen, our Chief Operating Officer, participated in a panel with Delta Airlines and the CEO of Pittsburgh International Airport to discuss how robotics are critical for the growth of the aviation industry. And we were thrilled to host more than 60 summit attendees at our Pittsburgh headquarters, where we conducted demonstrations of our robotic systems and solutions and spoke about the many aviation specific solutions we have to offer.

All attendees were able to see our baggage handling solution as well as the Guardian XT inspecting and airplane fuse launch, and we received very positive feedback from the aviation industry leaders. We had another opportunity to demonstrate our robotic solutions last week in Houston at the Offshore Technology Conference and Exhibition were energy professionals exchange ideas on offshore resources and environmental matters.

We formally announced our partnership with VideoRay at the OTC show, and we demonstrated how our Guardian C class can be retrofitted onto their underwater remote-operated vehicle. We bring human-like dexterity to VideoRay market inspection class ROV by adding arms and hands -- now it can do complex subsea jobs such as ship maintenance and salvage. It was a great opportunity to
promote the Guardian C class as well as our important new agreement with VideoRay. The underwater robotics market is growing 13% a year and is expected to be $2.4 billion serviceable addressable market globally in 2024.

In addition to industry events, we have been doing on-site customer testing to ensure our system performs as intended, are durable and that our software solutions meet the customers' specific needs, putting us at a critical step closer to product sales. And as I mentioned on our last call, we completed the final validation in our product development contract for our robotic solar field construction solution to help an industry facing labor shortages, increased productivity while reducing installation costs.

We're also on track to achieve ISO 9001 compliance by the end of the year, which will put us on our way to achieving certification in early 2024. We are proactively applying quality standards throughout the business to ensure that we meet the reliability and quality requirements our customers demand. These events I talked about today are important steps toward commercialization as we introduce Sarco's robotic solutions to potential customers and generate sales momentum. The excitement that comes from witnessing in person, how revolutionary our technologies are, can't be duplicated without a sales -- with a sales pursue or even a video.

The Guardian family of products are bringing advanced technologies such as machine learning, artificial intelligence, physics-based modeling and simulation to unstructured spaces. This is groundbreaking work and sets a solid foundation for surface to leverage our IP as we launch into industry-specific solutions like the ones we are developing for Solar panel installation and baggage handling. These foundational technologies are available now and will enable Sarcos to bring new solutions to market with greater speed at a lower development cost.

With this strategy and the market momentum we created at ConExpo, the Aviation and Robotics Summit and the Offshore Technology Conference, we're confident in our ability to achieve our $23 million to $25 million revenue target this year as we commercialize our existing lineup, gain sales momentum and develop new technologies for the future. Our participation in these events reinforces our commitment to the opportunities we continue to pursue in the aerospace, construction and underwater industries, which collectively represent a global TAM opportunity of approximately $185 billion in 2025.

After only recently announcing the commercial availability of product, we are proactively increasing sales while working to reduce operating expenses by refining our business model and reducing third-party R&D costs, all with the goal to be on pace to be cash flow positive in 2025 when we exit 2024. And now I'll turn it over to Drew to report on the financials.

Andrew Dunn Hamer Sarco's Technology and Robotics Corporation - CFO

Thank you, Kiva. To everyone on the line, it is a pleasure to be here today speaking with you. Please note that our results for last year include the financial performance of RE2 from the close of the transaction on April 25, 2022. Also, please note that as we discussed on our last earnings call, what was formerly called research and development services revenue is now called product development contract revenue.

Product development contract revenue comes from the different types of contractual research and development agreements, primarily relating to the development and commercialization of our products, including cost type and fixed price agreements. Now turning to the financial results. All comparisons I will use are year-over-year. For the first quarter of 2023, revenue was $2.3 million compared to $700,000 during the first quarter of 2022. The increase was due to increased revenue from product development contracts. Cost of revenue increased by $1.3 million to $1.8 million in the first quarter, mainly due to the costs associated with the product development contracts I just mentioned.

First quarter 2023 total operating expenses, including cost of revenues, were $25.5 million, a decrease from the first quarter 2022 operating expenses of $26.4 million. I'll now discuss the operating expenses in more detail. Research and development expenses increased by $3.5 million to $9.4 million in the first quarter. This increase was driven primarily by increased headcount from the acquisition of RE2. Part of this increase was also related to increased direct material charges.

General and administrative expenses were down $8.1 million to $9.7 million in the first quarter, primarily due to decreased stock-based compensation expense. Sales and marketing expenses were $3.7 million, an increase of $1.5 million compared to the first quarter of 2022.
due to increased costs from a third-party data management platform and increased costs from our attendant to ConExpo, the largest construction equipment trade show in North America.

First quarter 2023 net loss was $21.5 million or a loss of $0.14 per share compared to a net loss of $19.2 million or a loss of $0.14 per share in the first quarter of the prior year. First quarter non-GAAP net loss was $19.4 million or a loss of $0.13 per share compared to a net loss of $13.3 million or a loss of $0.10 per share in 2022.

We ended the quarter with $94.7 million in unrestricted cash, cash equivalents and marketable securities. I'm now going to turn to our financial guidance. For the second quarter of 2023, we expect total revenue to be approximately $2.1 million. Approximately $400,000 of the revenue in the quarter will be revenue from product sales. Reflecting our work to reduce operating expenses, we estimate cash used in the operating activities will average approximately $5 million per month.

As of March 31, 2023, we had an unconditional purchase commitment of $4 million, which is related to operational expenses and all of which is expected to be settled during the year ended December 31, 2023. We expect to pay this amount in 2 equal installments, one during each of the second and third quarters of 2023. Now for the full year 2023, we are reaffirming our full year 2023 financial guidance. Full year total revenue guidance is expected to range between $23 million and $25 million.

Product development contract revenue is expected to be approximately 80% of the mix and will be weighted toward the second half of the year. Product sales are expected to be approximately 20% of our full year 2023 sales and will ramp up in the second half of the year. Turning to our operating expenses. Research and development expenses are expected to decrease in 2023 as compared to 2022 as we reduce our engagement with third-party service providers as we continue to develop and refine our existing products and further enhance efforts on our future products and software.

With the exception of stock-based compensation expense, we expect our general and administrative expenses in 2023 to increase slightly as the company works on a commercialization pathway and maintains public company compliance requirements. Sales and marketing will increase slightly in 2023, in line with the expected revenue growth in the future.

Looking at our balance sheet, we are satisfied with our liquidity and currently have no plans to do an equity financing in 2023. Furthermore, we have taken numerous steps to manage our use of cash and believe we have sufficient capital to fund our business for at least the next 12 months without seeking additional capital.

As Kiva previously mentioned, we are proactively increasing sales while working to reduce operating expenses, all with the goal to be on a pace to be cash flow positive in 2025 when we exit 2024. Operator, that is the end of my prepared remarks. I'd like to turn the call over to you now. Would you kindly repeat the instructions to ask a question.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from the line of Stephen Volkmann with Jefferies.

Stephen Edward Volkmann Jefferies LLC, Research Division - Equity Analyst

Yes, can you hear me now? All right. It's only been, what, 4 years of COVID and we still can't -- I still can't figure out to unmute myself.

Kiva A. Allgood Sarcos Technology and Robotics Corporation - President, CEO & Director

Yes. Join the club...

Stephen Edward Volkmann Jefferies LLC, Research Division - Equity Analyst

Slow, slow learner. Sorry about that. So Drew, can I just start with you with a quick one. You talked about the cash use rate that you expected in the second quarter, is that a reasonable rate as the year sort of for the rest of the year as well? Or is there any sort of inflection there that we should know about?
Andrew Dunn Hamer Sarcos Technology and Robotics Corporation - CFO

Yes. So for me, it's really kind of 2 things. The -- I think the rate -- the $5 million a month, which we talk about here, which ends up being $15 million for the quarter includes these $2 million other adjustments that I mentioned in my prepared remarks, we honestly think that if you're looking at it in 2 layers, there's this kind of exceptional charge $2 million that has to be paid out this quarter in Q3 or Q4. But if you take that out, that is probably an adjustable run rate for us for the rest of the year. So it ends up...

Stephen Edward Volkmann Jefferies LLC, Research Division - Equity Analyst

Good. Can you just say that again because I stepped on you. I think...

Andrew Dunn Hamer Sarcos Technology and Robotics Corporation - CFO

We think that $2 million is up being about $666,000 a month. So we take that out to bring the run rate down to about $430,000

Stephen Edward Volkmann Jefferies LLC, Research Division - Equity Analyst

And then maybe kiva question, but obviously, you have customers sort of funding the development here. Is there anything more you can tell us about what it is you're spending your time developing, which types of applications we should expect to be kind of first out of the gate here?

Kiva A. Allgood Sarcos Technology and Robotics Corporation - President, CEO & Director

Yes. Great question. I think for us, this quarter has been super exciting in part because getting our products in the field and getting customers utilizing. This is the first time we can say it's available for sale, and here you go. So the fact that we've been able to really hit the segments that we're super focused on. If you remember, this last year, it's been all about really figuring out where can we scale the fastest. We are doubling down on the aviation side of the house that's work at height that from a de-icing to cleaning, think of anything where you've got a person in a basket or you're doing something at height.

So that's an area, again, doubling down on aviation underwater. So we were just at the OTC events, which is the Offshore Technology Event in Texas. And again, those are all use cases where currently you have a dive team that goes down and performs a task. Now you don't have to put a diver in dangerous spaces and places -- our products can perform that task now. So I'd say those are the areas where aviation underwater and then on the construction side, it's work at height. So we're definitely focused there. And then on construction, solar construction, we executed the demos. So those -- we're taking that foundational technology, and then we're really creating these solutions to solve these very critical pain points in each of those segments.

Stephen Edward Volkmann Jefferies LLC, Research Division - Equity Analyst

And is it -- should we expect those applications to be sort of remotely operated at first? Or are you working on sort of fully automated solutions already?

Kiva A. Allgood Sarcos Technology and Robotics Corporation - President, CEO & Director

We call it Semi-economy. So again, you've got a human in the loop, the first go around. It can train the robot and then it can perform. In some cases, it can perform that in a semi-autonomous way. So you say, "Hey, I need you to clean this side of a -- of an airplane, it says from point A to -- what human says from point A to point B and then the robot actually performs a pass upwards. So if you remember, last time we had a conversation around use cases and where we're getting a lot of that pool is the fact that we can perform in a semi-autonomous way and actually take the human as the trainer, but then they could be managing a fleet of robots based of the labor shortage at almost every industry we're talking to is seeing.

Operator

Our next question comes from the line of Guy Hardwick at Credit Suisse Securities Research.

Guy Drummond Hardwick Crédit Suisse AG, Research Division - Research Analyst

So it looks like your Q2 guidance includes $400,000 of product sales. I guess that's anywhere between 1 and 3 robotic systems. So can you tell if that's the case, which products and who is the customer?
Andrew Dunn Hamer  Sarcos Technology and Robotics Corporation - CFO

Yes. So we can't go into the details of the customer. The use case, now that we're producing units that are available for sale for factories, there are people who are kind of anxiously waiting in line to get them so that they can start evaluating these units and providing them with the potential customers to get an initial units.

So in some cases, they're evaluating the robots for additional lines where they'd like to use robots to support existing employees or (inaudible) created by worker shortages or in other instances, there's a scenario where we've talked about and they're really just testing it for its various strengths to make sure it's meeting the requirements, which we've previously discussed with them.

So by just kind of buying that initial unit. And as we go out here in the second half of the year, we're looking for robust sales to expand. In this particular instance, it's just one unit. So it's a full system. So it's not just -- again, I just want to remind you, we're selling kind of the arms and the old software and everything related to it and it's an initial sale to a team that's testing out the unit. I believe they are planning...

Guy Drummond Hardwick  Crédit Suisse AG, Research Division - Research Analyst

So, (inaudible) XM or XT?

Andrew Dunn Hamer  Sarcos Technology and Robotics Corporation - CFO

Kiva, want to disclose out a little detail to your color.

Kiva A. Allgood  Sarcos Technology and Robotics Corporation - President, CEO & Director

Yes. No, we're not disclosing a level of detail at this point. What our focus now is as we've transitioned from really R&D to having product sales, the revenue number, to your point, I know you have to update your modeling is really going to speak to where we're getting traction. So in this specific area, it's likely to be in one of the use cases that I just outlined and highlighted.

Guy Drummond Hardwick  Crédit Suisse AG, Research Division - Research Analyst

Okay. And do you have an order book which is going to be materialized over the second half? Or not yet.

Andrew Dunn Hamer  Sarcos Technology and Robotics Corporation - CFO

We have seen an order book that's been materializing as a result of the OTC conferences as well as ConExpo in addition to the orders that we'd already been in discussions with the customers previously. So there is an order book for me. It's very exciting for us right now.

Guy Drummond Hardwick  Crédit Suisse AG, Research Division - Research Analyst

And these are contracted orders with a purchase order.

Andrew Dunn Hamer  Sarcos Technology and Robotics Corporation - CFO

Sorry. It's more pipeline right now, they should convert as we get these units bill. -- as you go from this transition where you've never manufactured anything before it's manufacturing them. People want to buy those first units and just test them out and make sure that the durability and everything else is there and the software works and it meets the specific needs and then they'll move to that larger order. So we're really getting these first orders in place as a first step. And then as we get bigger deals double, we'll excited to announce them for sure.

Guy Drummond Hardwick  Crédit Suisse AG, Research Division - Research Analyst

Just a final one for me. On the inventory stepped up by $2.5 million, $3 million sequentially. Is that finished product? Or is it components mainly?

Andrew Dunn Hamer  Sarcos Technology and Robotics Corporation - CFO

It's a combination of raw materials and finished products. So we do have both in place now.
Guy Drummond Hardwick Credit Suisse AG, Research Division - Research Analyst

I think you said in the previous quarter, you had 10 XM in inventory. Have you built any additional inventory of units?

Andrew Dunn Hamer Sarcos Technology and Robotics Corporation - CFO

So in Q2 -- sorry, in Q1 here, we were focused on just -- there's a completion. So the arms are the first big step for us in XMls and then also building these first preproduction units for XTls were also being produced in Q1. And then so the full systems for XMls are kind of done. The XTls are moving to stage where they're in evaluation. And as it is, I think we also talked previously the C class units have also started into a preproduction phase where we're building them out and testing them and making sure that we have all the steps in place so that we can move to more of a post-production stage as we get further out in the year.

Operator

Our next question comes from the line of Rob Mason at Baird.

Robert W. Mason Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Maybe just a follow up on the last topic there around your inventory. Do you have the raw material -- I'm just curious how your supply chain has been trending for you around components. Do you have the raw material components in inventory today to be able to support the product sales that your forecast for '23 or in the back half of the year? Or is there still components that you need to acquire?

Kiva A. Allgood Sarcos Technology and Robotics Corporation - President, CEO & Director

Yes. As we had communicated in earlier calls, Lisa Johnson, who's the VP of Supply Chain for Sarcos has done a tremendous job securing and making sure that we've got the components to be able to meet the build schedule. So yes, as you know, we have communicated around a $3 billion prepurchase throughout last year to ensure that we had the key components in hand to be able to meet our orders.

Robert W. Mason Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst

Great. So to reference your press release that you issued during the quarter around the VideoRay agreement. Could you just give us a little background there working with VideoRay -- my impression was there -- there's been some work there in the past, maybe with RE2. So to the extent you're starting off -- starting to sell those units, how readily can they be integrated into video raised product. And there was also a reference to a Navy contracted VideoRay had won, I guess, have been awarded. Just what's the relationship with that Navy contract in Sarcos is current but, I guess, current status or potential there?

Kiva A. Allgood Sarcos Technology and Robotics Corporation - President, CEO & Director

Yes. Great, great question. So you are 100% correct. Our Jorgen and team has been working with VideoRay on Mine Neutralization Work for many, many years, really tight relationship. I had the pleasure actually to see it in action here in San Diego about 1 month, 1.5 months ago and talk firsthand with the folks leveraging the defenders.

So we're excited about the VideoRay partnership in part because they are the best of the best, the best vehicle out there. They have a very strong relationship and contract with the Navy. And we're basically in a very short period of time, you can retrofit the current installed base and all new units with the Sarcos technology. And that also includes the ability to do things in a semi-autonomous way, so grabbing a piece of equipment off the ROV so that you can cut something.

All of those things now because it's hard to navigate underwater, we've really been partnering with them to make those semi-autonomous as well to make that an easier task for the people that are above water. And we strongly believe in the undersea space. It's a large target market. We've also seen good momentum on the commercial side outside of the Navy.

Again, this is where you currently today, there's a lot of tasks, whether that's inspection, whether that's line maintenance or people are getting in the water, and now they don't have to. So -- but the partnership, and we're just building on that, and we're excited OTC went really well for us last week. And it was nice to see the first flash of the product as well, and it working the team a really tight team, too. So it's fun to celebrate with them. But VideoRay is a good partner. We're looking forward to a lot of growth with them.
Andrew Dunn Hamer  
*Sarcos Technology and Robotics Corporation - CFO*

And so Rob, if I could just end to that and add on the nature of the relationship is such that it can -- we can be selling -- they can be selling our system. They could -- so that the arms can be added to existing systems that are in the field, and they could take it on the -- if they have a customer that comes to them and wants to do that, they could do that sale or alternatively, we can also be reaching out to their existing customers and selling to them to sell our arms that can be cash through existing systems or if we individually identify somebody who wants a full system, both the ROV and our arms, we're trying to structure it so that it's kind of a one-stop shop for the customers.

So on either side, we could sell the whole solution, even though our real focus is just selling the technology we've developed and have to make it available to. So it's a really nicely structured relationship, it's a good relationship there and it looks like we will sell on both sides.

Operator

Thank you very much. At this time, I would like to turn the call back to Kiva Allgood for closing remarks.

Kiva A. Allgood  
*Sarcos Technology and Robotics Corporation - President, CEO & Director*

Well, thank you. Great question. Really appreciate you guys joining us today. We're super excited and optimistic about where the company is headed, especially as we gain market momentum and customer feedback. We're on track to achieve our targets for the year as we push onward and towards commercialization. So thank you for joining us, keep the questions coming, and have a great evening.

Operator

Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.