Good day, and thank you for standing by. Welcome to the Fourth Quarter 2022 Sarcos Technology & Robotics Corporation Earnings 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 today, Moriah Shilton from Financial Profiles.

Moriah Shilton Financial Profiles, Inc. - SVP

Thank you, operator. Good afternoon, everyone, and welcome to the Sarcos Technology and Robotics Corporation Fourth Quarter and Full Year 2022 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 2022 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 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 annual report on Form 10-K 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-K for the full year 2022 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 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 April 16, 2023. The information that we're giving on this call today is as of today's date, and we undertake no obligation to update the information subsequently.

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

Thanks, Moriah. Good afternoon, and welcome to everyone joining us on the call today. As you saw in our press release earlier, we had a strong fourth quarter and full year with revenue coming in on the high end of our guidance range. In addition, increasing revenue, it was a productive year and a giant leap forward.

Sarcos is a recognized technology and software company developing the latest innovations in robotics and software technology. And the RE2 acquisition we made in 2022 is playing a key role in that recognition. By combining our 2 companies, Sarcos is now able to offer a much wider range of robotic systems and solutions to meet our customers' needs and expand it even more industries. Most importantly, we gained the RE2 team and their deep expertise in robotics, machine learning and AI.

We have integrated RE2 Sapien products into our portfolio and incorporated them into our Guardian product lineup, which now encompasses the Guardian XM Intelligent Robotic System, a Guardian Sea Class robotic system and the Guardian XT Dexterous Robotic System. We are commercializing these systems first because of the expected strong demand that the products are capable of real-world use, and we are managing supply chain risk associated with these products.

Although we continue to develop the Guardian XO, we don't believe production of the initial commercial version will be ready until sometime after 2023. We have a customer pipeline that is ready now for the XM, XT and Sea Class and we see the power and utilities, aviation, defense, maritime and construction industries as the end markets where our technologies can make the biggest, fastest impact.

We're seeing a strong customer preference to buy our systems outright rather than lease them in a robotic as-a-service model. We are also seeing strong customer demand in our software solutions. Our systems include software to enable basic control, teleoperation, semi-autonomous capabilities. We will provide additional software options such as supervised autonomy as an incremental service.

Our supervised autonomy framework uses multi-modal sensor data to perceive, interact and conceptualize unstructured environment. Combined with our success-based learning AI approach, the supervised autonomy framework harnesses the power of real-time and learned behavior data input. That enables our robots to execute task-specific autonomy in unstructured environment. Our advanced success-based AI enables human workers flexibility, creativity and improvisational skills to deliver improved workflow performance and safer interactions between humans and machines for jobs in unstructured environment.

Our success-based reinforcement learning functionality uses advanced AI and machine learning to improve the overall dexterity, mobility, safety and autonomy of a robot so that it can learn new skills to enhance its abilities autonomously. Our AR approach is supervised autonomy to be leveraged not only in the Guardian line but also in robots that aren't our own products. By licensing our software to others, we have recurring revenue opportunities that don't require the capital of a RaaS model.

We began production of the Guardian XM and met our goal of producing 10 units in Q4 but we need to move bigger and faster. And to do that, we recently signed an agreement with a major contract manufacturer that will allow us to scale production.

We achieved technical milestones this year through several field trials, including those with the U.S. Navy for the Maritime line utilization system, which is the foundation for the Guardian Sea Class. After 2 years of field trials, we successfully integrated our STARFISH and end effectors to demonstrate complex tasks requiring grasping movements and touch somewhat as those as the human hands. A remote operator command the robot system to operate in real-world situations. It's a prime example of how we're developing robotic technologies to take humans out of harm's way and dangerous job. We are now commercializing the Sea Class system and providing the most value to our customers by optimizing the user experience.

As I mentioned on the Q3 call, we executed demanding field trials in the Navy's repair technology exercise where several Sarcos robotic systems were put to the test, including the Guardian XM, the Guardian Sea Class and the Guardian DX, which is our defense teleoperated Dexterous Robotic System, and the Guardian S, our remote visual inspection robotic system. These technologies can be used at height or, in the case of the Sea Class, at great depth that are unsafe for our workers.
We conducted a demonstration of our outdoor-based autonomous baggage loading system developed in conjunction with Changi Airport Group. This system automates loading and unloading bags from passenger planes, which is obviously a physically demanding job. Deploying robotic systems in this way has the potential to transport airport, improving worker safety and reducing passenger delays, especially in bad weather. Additionally, autonomy technologies are a potential solution for the growing need for labor in the aviation industry. Baggage loading is just one of those many ways our technologies could address these in aviation, and there will be more to come in this market.

And I hope you saw last week’s press release announcing that we had completed the final validation in our Outdoor Autonomous Manipulation of Photovoltaic Panels, known as O-AMPP project robotic solar field construction solutions. We worked with the industry leaders such as Mortenson, JLG Industries, Array Technologies and Pratt Miller at a Mortenson product site to validate the solution. The solar energy is facing labor shortages, and we expect our solution to significantly increase productivity, thus, reducing crew sizes and greatly reducing installation costs. This validation process was a critical step towards commercialization.

And beyond the physical hardware development, we have developed AI-based algorithms for semi-autonomous detection, tracking and classification of objects, whether they are stationary or moving. We are advanced and fully immersive operation technology for extended reality interactions between humans and robots that combines virtual reality and augmented reality, affordable motion capture technology to provide a greater sense of realism, increased performance, safety and control.

We launched 2 industry-sponsored research efforts with leading universities in the field of AI-based control technologies for robotics to advance dexterity, maneuverability and robustness and dynamic and unstructured environment. And we continued to expand our simulations and mixed reality solutions that use augmented reality, virtual reality, digital twins and AI-enablement simulation techniques to create simulation environment in which we can train, optimize robot operations. Simulations are important when conditions are too expensive, risky or time-consuming to do in the physical world.

As you can tell, we’ve accomplished this great deal in 2022 and years prior, and those accomplishments will serve us as the springboard for growth going forward.

In 2023, we anticipate increasing both our product and product development contract sales to $23 million to $25 million as we commercialize our existing lineup while developing new technologies for the future. Customers are paying us to be first in line for the first production unit and paying us to deliver them faster than anyone else. We've been working for years to be in this position. We are ready.

And finally, I'd be remiss if I didn't mention one more key event in 2022, and that's the appointment of Drew Hamer, as our Chief Financial Officer, who quickly became a valued member of our strategic leadership team.

And now I’ll turn it over to Drew to report on the financials.

Andrew Dunn Hamer Saros 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 this year include the financial performance of RE2 from the close of the transaction last year on April 25. The 2021 results do not include results from RE2. Also, please note, what was formerly called research and development services revenue is now called product development contract revenue.

Product development contract revenue comes from different types of contractual research and development agreements, primarily related to the development and commercialization of our products, including cost pipe and fixed price agreements.

Now turning to the actual results. All comparisons I will use are year-over-year. For the fourth quarter of 2022, revenue was $6.1 million compared to $1 million during the fourth quarter of 2021. The increase was primarily due to increased revenue from product development contract revenues. Cost of revenue increased by $3.3 million to $4.4 million as compared to $1.1 million in 2021, mainly due to the costs associated with the product development contracts I just mentioned.
Fourth quarter 2022 total operating expenses included cost of revenues, were $101.3 million, an increase from the fourth quarter of 2021 operating expenses of $28.6 million. The increase was mainly due to a noncash goodwill impairment charge of $70.2 million, which was primarily driven by the sustained decrease in the company's publicly quoted share price and market capitalization during the fourth quarter.

Research and development expenses increased by $4.1 million to $10.2 million in the fourth quarter. This increase was driven primarily by increased headcount from the acquisition of RE2. Part of this increase was also related to increased third-party service provider costs focused on the development of our Guardian XT, Guardian XM and Guardian XO products. General and administrative expenses were down $6.1 million to $12.9 million in the fourth quarter primarily due to decreased stock-based compensation expenses. Sales and marketing expenses were $2.7 million, which was slightly up compared to $2.5 million in the fourth quarter of 2021.

Fourth quarter 2022 net loss was $92.3 million or a loss of $0.61 per share compared to a net loss of $34.1 million or a loss of $0.25 per share in the fourth quarter of the prior year.

Fourth quarter non-GAAP net loss was $18 million or a loss of $0.12 per share compared to a net loss of $14.7 million or a loss of $0.11 per share in 2021.

Moving on to the full year 2022. Revenue increased to $14.6 million from $5.1 million for the full year of 2021, primarily due to increased revenue from product development contract revenues. We also had $330,000 in sales of our legacy products in 2022 as compared to $1.5 million in such sales in the prior year.

Cost of revenue increased by $7.7 million to $11.6 million in 2022 as compared to $3.9 million in 2021. Mainly due to the costs associated with the increase in product development contract revenues I just mentioned. 2022 total operating expenses, including cost of revenues, were $191.6 million, up $105.5 million from 2021 due mainly to the goodwill impairment charge I previously discussed. Research and development expenses increased by $16.6 million as compared to the prior year due to increased labor and overhead expenses as a result of increased head count due in part to the RE2 acquisition and third-party service provider costs as the company focused on the development and commercialization of its Guardian XT, XM, Sea Class and XO products.

For the full year 2022, net loss was $157.1 million or a loss of $1.07 per share compared to $81.5 million or a loss of $0.72 per share in the prior year, $70 million of which was due to the goodwill impairment charge I mentioned earlier. Full year non-GAAP net loss for 2022 was $67.4 million or a loss of $0.46 per share compared to a non-GAAP net loss for 2021 of $35.5 million or a loss of $0.31 per share. We ended the year with $114.5 million in unrestricted cash, cash equivalents and marketable securities.

I'm now going to turn to our outlook. First, I'd like to discuss our production capabilities in ramp. The production of our Guardian XM and Guardian XT systems is progressing on schedule. Initial commercial versions of both systems will be ready for customer delivery in the first half of 2023. Going forward, we will be providing a weighted average ASP in giving unit counts for a total number of systems perspective. As we get closer to the ramp expected in the second half of 2023, we will begin to provide these metrics in our guidance.

The initial manufacturing of our commercial products is already ramping in our facilities in Salt Lake City and Pittsburgh. We do not anticipate high-volume production by a contract manufacturing partner to be in place until at least the end of 2023. We estimate that we have the capability to manufacture between 300 and 500 units of our Guardian XT Robotic System, Guardian XM Robotic System, Guardian Sea class units and our existing commercial products depending on the mix. We continue to expect that we will not use all of the capacity in 2023.

Now to our financial guidance. For the first quarter of 2023, we expect total revenue to approximate $2.3 million and all will be product development contract revenue. We estimate cash used in operating activities will average approximately $6 million per month. Now for the full year 2023 guidance. Total revenue is expected to range between $23 million and $25 million. Product development contract revenue is expected to be approximately 80% of the mix with product revenue, the remainder. Product sales are expected to begin to ramp up in the second half of 2023.
Turning to our operating expenses. Research and development expenses are expected to decrease slightly in 2023 as compared to 2022 due to our focus on product development and as the company continues to leverage third-party service providers in its development activities. 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 its commercialization pathway that maintains public company compliance requirements. Sales and marketing will increase slightly in 2023, in line with the expected revenue growth in the future.

Now looking at our balance sheet. We are satisfied with our liquidity and currently have no plans to do an equity financing in 2023. We will continue monitoring our liquidity, financial and business results, outlook and market conditions and could change our plans if we determine it to be necessary or advisable.

Operator, that is the end of my prepared remarks. I'd like to turn over the call to you now. Would you please repeat the instructions to ask a question?

**QUESTIONS AND ANSWERS**

**Operator**

(Operator Instructions) Our first question comes from Rob Mason with Baird.

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

Yes, Kiva, Drew. My question, starting out, just can you just walk through what the gating factors are before we start to recognize commercial revenue starting from now until, I guess, midyear, what else needs to happen along the 2 products that would be most likely to recognize revenue?

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

Yes. Great question. So actually, hopefully, you saw our announced that we've got 3 products that we're really focused on, the Sea Class the XM and the XT. Sea Class has been in field and underwater for over 2 years and highly tested and is in production now. So very excited there. On XT and XM, we also produced a good 10 units of the XM at the end of last year. And XT is in production right now. I had a chance to go down and check out the new face and smile. So it's coming to life as we speak.

As far as gating factors, again, it continues to -- spending money to get the long-lead items in time. We still have some pieces and parts that are 42 to 52 weeks. But again, I think the supply chain team did a fantastic job of purchasing those long-lead items that also shows up on the balance sheet from last year. So I think from my perspective, right now, it's just penciled down and moving forward.

**Andrew Dunn Hamer Sarcos Technology and Robotics Corporation - CFO**

Right. And then we'll continue to ramp that production, Rob, so that we can get to the volume units to be able to sell them. However, they are available now for our sales force to go out and start negotiating with customers and closing contracts.

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

Well, that was maybe my next question is, I think you are open now, the order book is now open, you're taking orders or your ability to take orders is here.

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

That is correct.

**Andrew Dunn Hamer Sarcos Technology and Robotics Corporation - CFO**

Key milestone for us is these units could be produced in ever-increasing volumes now.
Robert W. Mason  
**Robert W. Baird & Co. Incorporated, Research Division - Senior Research Analyst**

Very good. And it's good to see that you've got the contract manufacturer arrangement lined up. How do you see that playing out here over the next year or 2? Is it -- should I think that there will be subassemblies and both subassemblies, I guess, and final assembly at the contract manufacturer? But I'm just -- just maybe speak to the interplay between your own capabilities and the contract manufacturer over the next year or 2.

Andrew Dunn Hamer  
**Sarcos Technology and Robotics Corporation - CFO**

Yes. So there are 2 stages to this. I'll start and then Kiva can finish on this. But the first stage as we go -- as we start to ramp manufacturing this year is that they are working with this and understanding how we manufacture our products. However, we're still doing end-to-end manufacturing as we refine the process. And then as the year progresses and volumes start to increase, then we could transfer some of the subassemblies to them. We will always do some -- we will do final assembly test, packaging and shipping from here.

But by moving the subassembly work to them, that will offset a bunch of the work that needs to be done to produce the units. And then as we get further out a couple of years, then we can start talking about having them do everything. So it's just a natural phasing stage that takes place in transferring things to your contract manufacturer. Mostly this year that we'll be doing most of the manufacturing towards the end of the year. Then we can start to explore having them do some of that subassembly and ramping that up in 2024.

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

Nothing more to be said.

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

Very good. Maybe just one last question, and I'll jump back in the queue. How -- can you give us any initial thoughts for the second half of the year as we do start the scale deployments, how to think about initial gross margins?

Andrew Dunn Hamer  
**Sarcos Technology and Robotics Corporation - CFO**

Yes. So I think for this year, we've always talked about having kind of target gross margins in the 20% to 35% range over time. We'll probably be at the low end of that range for this year. So around 20% in this year, and it will be a combination of both the product development contract revenues and the product revenues. The product revenues have slightly lower margins this year because their initial production units.

But as volumes start to scale, then we'll start to get economies of scale in those production. So the combination of those things will allow us to get to around 20% this year and so you start to scale up next year as manufacturing increases. And then we expect as we get into the outyears, we are going to have access to a software platform that people have to get access into. And as that starts to scale in the coming years, that will also provide an incremental gross margin improvement.

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

Very good, and good luck this year.

Operator

Our next question comes from Guy Hardwick with Credit Suisse.

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

Hi Kiva, hi Drew. So since you have -- appears you have -- you manufactured 10 XMs in Q4. Are you manufacturing now? I think you said XTs and XMs and Sea Class. So what sort of inventory would you have at the end, say for the sake of argument, June 30, because you're not anticipating any sales in the first half, it sounds like? So what kind of -- what sort of inventories will you have in the midyear? And can you marry that in terms of cash burn? Or what does the cash burn imply you have in terms of inventories in the middle of the year?

Andrew Dunn Hamer  
**Sarcos Technology and Robotics Corporation - CFO**

Yes. So the cash burn that we've talked about is mostly going to be focused here in the beginning of the year. We're expecting that we should see that decline as we get further into the year. The company did make some smart moves last year in trying to accelerate
products and bringing them to market by bringing in consultants to assist in some of the development work, and they will roll off as the year progresses here. So as it relates to cash burn, we expect that we'll see that kind of sort of trail down a bit as we get further out into the year in the coming quarters. So high in Q1 and starting to ease off in Q2, 3 and 4.

As it relates to the inventories, we're really doing a little bit of - we're not over-manufacturing here beginning of the year. So we're just producing enough to meet the anticipated demand as well as we need to have some just for getting out and just kind of demo-ing them and getting around the organization and other further testing on the units. So as we progress into the year, we'll consider advancing on and manufacturing more units, but we should be just producing enough to meet the current year demand.

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

All right. So in terms of what is ready now to actually go straight to a customer and be used, do you still thought you need to have more testing in terms of -- although you have manufactured units for commercialization, do you still feel you're not actually ready to sell any products to the customer today for use in the field?

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

Well, no, we're definitely ready. So again, with any new variant or full solutions, so a great example is on the Sea class, right, we're making some additional changes that we have the hardware development kit to go onto the -- with the Array unit. So again, our focus now is continuing to develop where the spaces and places the product can go. So we've got the channel partners, like I've mentioned, with Array. But each solution is a combination of hardware, software and some form of a platform. So every time we attach to a new platform, we do have to make sure that we have that hardware development kit and can execute effectively.

Right now, we've got an arm -- last time I check, I think it had 600 hours on it in a cage testing and running and going. So we're doing all that tough validation in both locations in Pittsburgh and Salt Lake City as part of the design process. So once we say it's commercially ready, it's commercially ready.

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

And just lastly for me. If you have a new customer, who -- potential customer you meet with today for the first time, how do you anticipate the sales cycle to look like now that you have the product available?

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

Yes, great question. So definitely, robotics lead time is -- I think that's one of the key questions we get all the time, how long does it take to do a custom solution? I'd say the advances that we've made there and definitely the controls team and the simulation team, we've really reduced, as we've talked about before via our physics-based models, that development time. We're not having to iterate as much hardware and software together. We can take a current product, we can test it in simulation and then really understand whether or not we can perform that task. So we greatly reduced the cycle time.

The focus for us right now, the aviation use cases, the subsea use cases, the instruction of tight use cases, those are full solutions that we're testing. So for us, the development time and the sales cycle time goes way down because we know what the -- how the product has to perform in the field. Every time we get a new one, you have to go to that process again. But from where we're targeted and the [psalm and song] that we're really focused on right now in those segments, the product that we have today can fit and meet the needs without redeveloping it.

Operator

And this concludes the Q&A session. I'd now like to turn the call back over to Kiva Allgood for any closing remarks.

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

Yes, great questions, and thank you for joining us today. After hearing from us, I hope you understand our optimism and enthusiasm for the future of Sarcos. We are enabling the more important portion of the future by combining human intelligence and judgment with the strength, endurance and precision of machines to create dexterous robots that operate in unstructured real-world situations.
I would also like to thank the entire Sarcos team for their commitment to our mission and our values. It's exciting work, and Drew and I look forward to telling you more about it in the future. Thank you for joining us today. Have a great evening.

Operator

This concludes today’s conference call. Thank you for participating. You may now disconnect.