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Transcript of DarioHealth
Fourth Quarter 2018 Earnings Call
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Participants

Erez Raphael - CEO
Olivier Jarry - President and Chief Commercial Officer
Zvi Ben-David - CFO

Analysts

Ben Haynor - Alliance Global Partners

Presentation

Operator
Good day, ladies and gentlemen, and welcome to the DarioHealth Fourth Quarter and Year-End 2018 Conference Call. Hosting the call today, are Erez Raphael, the Chief Executive Officer; Olivier Jarry; President and Chief Commercial Officer; and Zvi Ben-David, Chief Financial Officer.

Before I turn the call over to management, I'd like to remind everyone that this conference call may contain projections or forward-looking statements regarding the future events or the future performance of the Company. DarioHealth does not assume any obligation to update that information. Actual events or results may differ materially from those projected as a result of the changing market trends, reduced demand, and the competitive nature of DarioHealth's industry, as well as other risks identified in the documents filed by the Company with the Securities and Exchange Commission.

In addition, certain non-GAAP financial measures will be discussed during this call. These non-GAAP measures are used by the management to make strategic decisions, forecast future results, and evaluate the Company's current performance. Management believes the presentation of these non-GAAP financial measures is useful to investors' understanding and assessment of the Company's ongoing core operations and prospects for the future.

With that, I would like to now introduce Mr. Erez Raphael, Chief Executive Officer of DarioHealth. Mr. Raphael, Please go ahead.

Erez Raphael - CEO
Thank you. Welcome and thank you for joining our call today. I would like to congratulate the team for extraordinary work in delivering record growth and pioneering innovation in 2018 and thank all stake holders including vendors, strategic partners, shareholders and our Board of Directors for their contribution for this successful effort.

2018 was a transformative period not only for our Company and its continued leadership in the field of digital therapeutics, but for the field itself that continues to be embraced by the healthcare industry as an answer to the epidemic chronic illness that plagues the U.S. and the globe.

DarioHealth continues to lead in improving clinical outcomes with value-driven services that reward measurable health improvement, engage the patients with tech-enabled diabetic management features and deliver real time data for evidence-based preventions and provider intervention.

In the past, treatment of chronic illness was brokered by doctors and the software used in treating chronic illness was very provider centered, diminishing the pivotal role that [ph] patient lifestyle choices play in managing chronic conditions like diabetes, hypertension, and obesity. With the advent of digital health and, more specifically, digital therapeutics, the ongoing patient data is made available through technology to the provider to make real time evidence-based care decisions, payers are able to pay for measurable results in a form of improved medical outcomes that directly lower healthcare cost.

Delivery of meaningful, improved clinical outcomes depends on continual access to patient data, which is enabled by digital health technologies which cannot be achieved on an output basis without active participation of the users, which is why our focus was always and will be on providing tool to the users, which means that our software and products are really user centered and extremely easy user experience. This is something that we are doing in two ways. One, we deliver data access required for real time prevention treatment and performance measurement; and two, we empower the patient with tech-based tools to easily produce the lifestyle changes that drive improved health measures.

In response to this clear healthcare trend, DarioHealth in 2018 has undertaken to transform our model from one of the medical device-enabled glucose measures application [ph] to higher margin, higher value recurring membership service that incorporates our acclaimed top selling glucose monitoring system into comprehensive lifestyle change empowering solution that combines technology, artificial intelligence, big data, digital coaching and lifestyle enhancing features to intuitively engage with our users into more healthy lifestyle that evidence shows improve medical outcomes and lower health care costs.

The transition of our model we think resembles the transformation of the software industry revenue model for one of the licensed products to software-as-a-service that we see today. Acceleration of our growth in 2019 will be driven by three main market channels: number one is the tens of thousands of users that already operate on the platform where a lot of them are under membership program; the second one is increasingly successful cost per acquisition driven direct-to-consumer campaigns over platforms like Facebook, Google, Amazon, affiliations, influencers and other digital channel; and number three, enhanced B2B efforts to win contract to provide lifestyle enhancing products and services to users of retailers, insurance companies, employers and healthcare providers.

Since it is in production, in the first quarter, we have improved and fine-tuned the service based on customer needs and better digital tools in human support including coaching. Because of the accounting rules requirement to differ a portion of the collected revenue, a key measure of our performance in the new membership service is the level of deferred revenues that recognize [ph], which almost doubled from $385,000 in the third quarter to $736,000 in the fourth quarter of 2018.

In the second half of 2018, we were able to complete our full transition into full digital service under subscription offering, and we are planning to maintain innovation and market leadership through continuously new and improved features and insight that will be added to the platform, enhancing the personalized experience that our users have and also increasing key success indicators like average revenue per user per month.

Since the launch of the membership, in Q3, we witnessed continuous improvement of indicators like the ARPU, average user revenue per month, and also customer engagement, retention and also profit margin per user per month. Those key performance indicators illustrate the success we are having in this transformation in addition to the acceleration, financial results that our CFO will discuss shortly.

Now let's turn into some financial highlights from 2018. 2018, in addition to being transformative for our business strategy, was another period of record financial growth, which we're confident, will continue and even accelerate in 2019 as our revenue base transitions to a higher margin service and our optimized marketing strategy gains further traction from increasing market embrace of digital therapeutics.

First quarter of 2019 is progressing very well and we expect continued growth, a clear indicator of the success in our transformation along 2018. Billing [ph] non-GAAP generated for us in 2018, $8.13 million, a 57% [ph] increase year-over-year. Annual GAAP revenues grew 43% year-over-year to $7.4 million, plus an additional $736,000 deferred revenue, resulting from the different accounting treatments of our annual subscription service. Gross profit for 2018 was $1.77 million versus $1.3 million in the prior year.

Now, I'd like to discuss our commercial strategy and how it has evolved during the second half of 2018. As I mentioned, our 2019 commercial strategy is comprised of three key channels. Channel number one is the recurring revenue of users that already operate on the platform and will keep generating high margin revenue for the Company, also in 2019. The second one is direct-to-consumer sales through the different digital channels such as Amazon, Facebook, Google, digital channels, which continue to grow and add more resources and marketing infrastructure for better cost per acquisition, and digital marketing optimization.

Number three is our B2B channel that we developed in the second half of 2018 that has just begun to bear fruits. We expect the percentage of presentation of these channels in our revenue mix to increase as our investment into sales to healthcare providers, distributors, retailers and payers bears fruit, a topic on which I will allow our Chief Commercial Officer, Olivier Jarry to elaborate shortly.

Another important element is our offering strategy. There are two key factors in our growth strategy that evoke our offering. Number one, continuous expansion of the current offering for people with diabetes that will be able to get more digital services, more content and more offering on top of the platform, which is something that will continue increase our average revenue per user per month, which is something that we showed that we are consistently improving in the last two years. Additional factor of our offering, or additional dimension, is the horizontal move into solutions for other types of chronic illness, one of them is hypertension, another one is obesity. These two are planned for 2019, and this is something that we anticipate that will contribute as a revenue multiplier.

With that, I would like to hand over to Olivier Jarry, Chief Commercial Officer, to expand about the B2B.

Olivier Jarry - President and Chief Commercial Officer
Thank, Erez. The B2B business has indeed continued to expand with new commercial agreements during the last quarter, first with healthcare providers, who are particularly interested in our digital patient access platform for providers, Dario Engage, that allows them to remotely support their patients. Most providers typically start immediately selling Dario to these patients. Second, with retailers like Best Buy, we are actively developing digital marketing and in-store marketing plans to recruit users to Dario and we run joint campaigns with the stores. Third, with payers, like insurance companies, we reach to our healthcare distributors. We are preparing for the various ways of enrollment, typical of a U.S. healthcare market, meanwhile, commercially [indiscernible] progress with major accounts in each channel. Erez?

Erez Raphael - CEO
Thank you, Olivier. Now, I will ask Zvi Ben-David for a few highlights on our fourth quarter in 2018. Zvi?

Zvi Ben-David - CFO
Thank you, Erez. Here are some highlights from the fourth quarter of 2018. Revenue for the fourth quarter ended on December 31, 2018 was $1.7 million, a 9.5% decline from $1.88 million in the third quarter ended September

2018. In addition, we recorded additional $351,000 as deferred revenues from the revenues generated from our membership offering to our customers in the U.S. and also in Australia. Due to delays in collections from our distributors in the United Kingdom and Italy, we have revised during the fourth quarter of 2018, our revenue recognition policy for sales made to these distributors to be recognized upon collection only. As a result, we have reduced our fourth quarter revenues by $257,000. These revenues will be recognized when we collect the outstanding amount. And this policy change explains the decline compared to the previous quarter. Gross profit in the fourth quarter was $223,000 compared to a gross profit of $468,000 in the third quarter and compared to a gross profit of $569,000 in the fourth quarter of 2017.

Operating loss in the fourth quarter increased by $2 million to $5.1 million, compared to $3.1 million operating loss in the fourth quarter of 2017. This increase was mainly due to the increase in sales and marketing expenses. Net loss attributable to holders of common stock increased by $1.7 million to $5 million in the fourth quarter of 2018, compared to $3.3 million in the fourth quarter of 2017. As of December 31, 2018, cash and cash equivalents totaled $11 million.

And now, I would like to present you highlights about our sales performance during 2018. The average sale to the customer during the fourth quarter 2018 was 45% higher than in the fourth quarter of 2017, 52% of our sales transactions in the fourth quarter of 2018 were of returning customer compared to only 42% in the fourth quarter of 2017. The average recurring sales to customers in the fourth quarter of 2018 were 20% higher than in Q4 of 2017. Recurring sales in the fourth quarter of 2018 were 50.5% of the quarterly sales compared to only 33.1% [ph] in the fourth quarter of 2017.

I'll now turn the call back to Erez.

Erez Raphael - CEO
Thank you, Zvi. I'd like to take you now to some conclusions, to conclude there are a number of factors that we expect to accelerate our growth in 2019. Number one is the market. Continued market embrace and red hot value growth within digital health and digital therapeutics is demonstrated by $20 billion investment that was done in this segment in 2018. So, there is no doubt that we are living in a very hot space, and it seems like we're going to see this continuous trend also in 2019.

Number two is the product excellence. I think, this is one of the most important points, our continually update product and service offering that lead the field innovation is FDA cleared, and is moving quickly to the top medical downloads in Amazon's popularity list. In other words, just one example, last week, we were hitting number two best sellers on Amazon. If you're going to go to the application store from the United States, you're going to see that we are ranked very high in terms of reviews. There is no doubt that we've built a very good product that is evolving very-fast and becoming better and better, and we hear it every day from users and customers. And this is a very good foundation for building a successful business.

Number three is the business model, our new and powerful business model that is higher margin and of greater value to the patients, providers and payers. This is something that, according to a lot parameters, some of them were stated by Zvi, shows that we are creating a business model that is more and more profitable.

Number four is our three-fold growth channels consisting of revenue, recurring revenue that is generated from existing users that keep operating on the platform, a successful growing direct-to-consumer channel, and also growing B2B channel with more than ten signed agreements recently in a place of number which is expected to multiply in the coming quarters.

All these four elements together market development, product excellence, business model and multiple channels to growth, we think that all these elements together will ensure that we're going to grow in 2019 and even accelerate the current growth that we have.

To conclude our prepared remarks, I would like open it now for questions. Operator?

Operator
Thank you. [Operator instructions]. We'll go first to Ben Haynor, Alliance Global Partners.

Q: Good morning, gentlemen. Thanks for taking my questions. First off for me, the new channels that you've gotten into, the Amazons, the Best Buys of the world, how big of a driver were those in Q4 and how do you see those impacting results in the future?

Erez Raphael - CEO
Thanks, Ben, for the question. When we are looking on the big picture of the main three elements, existing users, direct-to-consumer digital channel and then B2B big accounts, we are considering Amazon as a digital channel, which is something that can go hand-in-hand with other retailers for marketplaces like Best Buy, Giant Eagle and others. We think that this kind of channel can help us scale up our direct-to-consumer revenue. So, it's something that we think that will grow more and more. And I'm sure that you are aware to all the activities that are being done also by Amazon and by other marketplaces in order to consumerize the health care industry, and we feel that we're right in the place making sure that our Company is a very user-centric and very direct-to-consumer oriented with knowhow to leverage on this kind of opportunities. So, in short, we think that it's going to be a very big contributor to our growth in our sales, and this is not including the other elements that we have, like big B2B accounts.

Olivier Jarry - President and Chief Commercial Officer
Maybe just one element to add to that quickly is B2B is competing in medicated release [ph] channels. And they see us as an expert in digital marketing, which helps them be more competitive in the field and this facilitates the conversations we have with these B2B accounts.

Q: Thanks Olivier. That's very helpful. And then, looking at kind of the deferred revenue, it looks like that's increasing nicely. Do you expect kind of a similar growth in deferred revenue in Q1, now that we have less than a week left, as you saw in Q4 or how should we expect that to track over time?

Erez Raphael - CEO
Yes. So, thanks for this question. Actually, this is one of the important messages, that we'd like investors to understand about reading our numbers. The more we are closing agreements or subscriptions with our customers that are buying something that is more than medical device and, in some cases, also committing one year in advance, the higher the deferred revenue is, and this is a very good indicator to look into this number when it's growing. So, I think that we should expect continuous growth of the deferred revenue as we move forward, which is something that will provide a good sign. And as I stated earlier in this call, we were comparing this kind of transition that we are doing now into digital therapeutics to the transition that was done in the software industry from licensing to software-as-a-service. There are a lot of similarities. And I think that this is one of the indicators that investors can analyze our business and the focus of the business.

Operator
[Operator instructions]. We'll go next to [indiscernible] who's an investor. Your line is open. Please go ahead.

Q: My question is more on the expenses side, not on the growth of revenue. I see, your operating loss went up considerably in Q4, if you could explain the reasons behind that, and how you see the burn rate, how you see the evolution of eventually getting to a more balanced P&L. Thanks.

Erez Raphael - CEO
Yes. So, indeed, we invested more into sales and marketing. Actually, we accelerated the establishment of our direct-to-consumer team and strategy, as well as investing into a team that is operating in United States under the management of Olivier. These two investments made an increase in our burn, which is something that we believe will pay off in 2019 in a way that will help us accelerate the growth. So, this is something that we planned and this is something that we are dealing with and we are managing it in a very responsible way, considering the amount of cash that we have in the bank.

Operator
[Operator instructions]. Mr. Raphael, we have no other questions holding, I will turn the conference back to you.

Erez Raphael - CEO
I would like to thank everyone for joining us today, and looking forward for our next conference call that will be probably second week of May. Thank you everyone.