Transcript of DarioHealth
Third Quarter 2018 Earnings Call
November 13, 2018

Participants
Erez Raphael - Chief Executive Officer
Olivier Jarry – President and Chief Commercial Officer
Zvi Ben-David - Chief Financial Officer

Analysts
Steven Wardell - Chardan Capital
Micah Noff - Barrett Capital

Presentation

Operator
Greetings and welcome to the DarioHealth Third Quarter 2018 Earnings Conference Call. At this time, all participants are in a listen-only mode. A question and answer session will follow the formal presentation. [Operator instructions].

Hosting the call today are Erez Raphael, Chief Executive Officer; Olivier Jarry, President and Chief Commercial Officer, and Zvi Ben-David, Chief Financial Officer.

Before we turn the call over to management, I would like to remind everyone that this conference may contain projections or other forward-looking statements regarding future events or future performance of the company. DarioHealth does not assume any obligation to update the information or actual events or result may differ materially from those projected as a result of the change in 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 management to make strategic decisions, forecast future results, and evaluate the company's current performance. Management believes that 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 Erez Raphael, Chief Executive Officer of DarioHealth. Thank you. You may begin.

Erez Raphael - Chief Executive Officer
Thank you. Good morning, everyone and welcome to the third quarter highlights. As a leading digital health company, and perhaps one of the only digital health companies out there in the public market, we were pleased to see our revenue mix shift further into recurring revenues from digital services and the sale of memberships during the third quarter. This shift into service revenues increased our deferred revenues. Eighty-two percent of the DarioHealth revenues are now generated in the U.S. market, and more than 50% of the revenues are recurring revenue. This gives us a gradually improving predictability into the future quarters.

During the third quarter, we continued growing all key parameters of the business, which is including the total number of patients that are operating on the platform, the average revenue per patient per month, what is called ARPU, the number of CDEs, the Certified Diabetes Educators that are coaching patients on the platform.

Now for a few financial highlights. Revenues in the first nine months of 2018 grew to $5.7 million, a 58% increase year-over-year. Third quarter revenues grew to $1.88 million, an increase of 37% compared to the third quarter of 2017. On top of that, we need to add an additional $335,000 recorded in deferred revenues in the third quarter, mainly from services included in our membership offering compared to non-deferred revenues in the third quarter of 2017.

Third quarter gross profit increased 70% to $468,000 compared to third quarter of 2017. We fortified our balance sheet with approximately $10 million in equity fundraising. Our value Engage Suite of products is now distributed through multiple verticals and currently is in use by more than 30 clinics and by nearly 100 certified diabetes educators.

Yesterday, we were happy to announce an agreement with Giant Eagle, one of the largest food retailers in the United States, for the rollout of Digital Diabetes Education and Reward Program followed by DarioHealth, which will be offered to 4.6 million Giant Eagle customers through 240 retail locations. This marks our largest product rollout agreement to the U.S. retailer to date.

A few words about the launch of our membership in the plan. By June end, we launched our annual membership offering, which has been very well received. The data we presented to the American Diabetes Association of people who use the Dario product showed that Dario created long-term sustainable clinical benefits. Seeing these positive clinical outcomes, we wanted to incentivize people to be more engaged with the long-term use. That's why we launched the membership plan, which integrated our Dario Engage platform services, including relevant content, in both digital and physical coaching that is being provided to our members.

With the membership business model, Dario users gain a digital healthcare experience. They are not just buying disposables and medical devices, like other products in the market. We believe that the digital services experience will further improve clinical outcomes. Overall, the membership and the new business model not just helps us improve the ARPU, the average revenue per user per month that we are generating, it also helps improve the margins of the business.

A few words about the U.S. team and the growth. During the third quarter we were very pleased to see two top-notch healthcare executives join our DarioHealth team. Olivier Jarry, a highly regarded healthcare executive formerly with Bayer, Novartis and Bristol-Myers, joined DarioHealth as the President and Chief Commercial Officer. We also welcomed Glen Moller, a healthcare executive who has built and led multi-billion dollar driven businesses in insurance and managed care, to our Board of Directors. We are building a stellar team and executing on the multi-billion dollar opportunity in digital health.

Now I would like to turn the call over to Olivier so he can present more information about our commercialization in the United States.

Olivier Jarry – President and Chief Commercial Officer

Thank you, Erez. During the third quarter we had negotiations with major business-to-business accounts in the U.S. and in Canada, including retail chains, clinic networks, and distributors. These are expected to translate into signed agreements and revenues in the fourth quarter.

One example of such an account that's been mentioned is Giant Eagle. We were very happy to announce our largest product rollout agreement through a U.S. retailer to date with Giant Eagle. This grocery food chain has pharmacies in 214 of its retail locations, and serves 4.6 million customers. They will roll out a Digital Diabetes Education and Rewards Program powered by Dario. Giant Eagle customers who enroll in and use the Dario system will receive diabetes education content through the app as well as rewards related to better management of their diabetes. We are excited about this partnership, and expect it to begin contributing to revenues in the fourth quarter.

Currently, there are more than 30 clinics and other healthcare providers using the Dario suite of products. Additionally, there are close to 135 diabetes educators, CDEs, currently using our platform. One example of such a clinic with CDEs now using Dario Engage is Attain Health, which specializes in cystic fibrosis-related diabetes, CFRD. We announced an agreement with Attain Health during the third quarter, whereby the clinic will use Dario Engage for a pilot study to improve cystic fibrosis-related diabetes management. We plan to publish data from this study in the coming months.

The Dario suite of products now includes our Dario blood glucose monitoring system, our Dario mobile app, Dario Engage, and data analytics through different verticals.

With that, I would like to turn the call over to Zvi for a more detailed review of our financial results. Zvi, please go ahead.

Zvi Ben-David - Chief Financial Officer
Thank you, Olivier. Revenue for the third quarter ended September 30, 2018 were $1.88 million, a 37% increase on $1.37 million in the third quarter ended September 2017. Revenue for the third quarter of 2018 included direct-to-consumer sales in the United States and Australia, as well as in Germany, and product sales to distributors in the United Kingdom and Canada. We recorded an additional $335,000 of deferred revenues from revenues generated from our new membership offering to our customers in the U.S.

Gross profit increased by $192,000, a 70% increase to a gross profit of $468,000 in the third quarter of 2018 as compared to a gross profit of $276,000 in the third quarter of 2017.

Operating loss for the third quarter ended September 30, 2018 increased by $952,000 to $3.93 million as compared to nearly $3 million operating loss in the third quarter ended September 30, 2017. This increase was mainly due to an increase in sales and marketing expenses.

Net loss attributable to holders of common stock increased by $1.1 million to $4.6 million in the third quarter of 2018, as compared to about $3 million in the third quarter of 2017. As of September 30, our cash and cash equivalents totaled $11.4 million.

Now to the nine month results. Revenue for the nine months ended September 30, 2018 was $5.7 million, a 58% increase over $3.6 million in the nine months ended September 30, 2017. We recorded an additional $385,000 of deferred revenues from revenues generated from our new membership offering to our customers in the U.S. Gross profit of $1.5 million was recorded in the nine months ended September 30, 2018, an increase of 108% or $800,000 compared to a gross profit of $742,000 in the nine months ended September 30, 2017.

Operating loss for the nine months ended September 30, 2018 increased by $1.2 million to $2.5 million, compared to $11.3 million operating loss in the nine months ended September 30, 2017. Net loss was $12.8 million for the nine months ended September 30, 2018 compared to a net loss of $12.5 million for the nine months ended September 30, 2017. The increase in the net loss for the nine months ended September 30, 2018 compared to the nine months ended September 30, 2017 was mainly due to the increase in our operating expenses partially offset by the increase in our gross profit and the reduction in our financing expenses related to the revaluation of warrants.

I will now turn the call back over to Erez for some concluding remarks.

Erez Raphael - Chief Executive Officer
Thanks, Zvi. There is increasing recognition in healthcare that digital health will be the key contributor to better patient outcomes while increasing efficiencies across the healthcare ecosystem and reducing costs. Data is going to be a key element implementing this vision. DarioHealth is one of the few companies in the market which has a lot of data to show the clinical and cost benefits are a reality. What's more, our data is from more than 17,000 users that we submitted to the American Diabetes Association. The data is very helpful for our commercial team, who is currently in an advanced stage of negotiation with several large potential accounts. Our agreement with Giant Eagle is just one example of those accounts.

As our revenue mix moves further into higher margin digital service recurring revenue, we are very excited about DarioHealth's future performance.

Thank you all for your interest. I'll open the call now for questions. Operator?

Operator
Thank you. At this time we will be conducting a question and answer session. [Operator instructions].

Our first question is from Steven Wardell from Chardan Capital. Please go ahead.

Q: Thanks for the question. My question is just around the revenue you're reporting for the quarter, it's coming in a little below my own expectations, and I'm wondering, can you go into either why this may be the case. Is this due to the shift towards recurring revenue, which means less revenue upfront? Is this affecting the guidance for the year that you gave on the last call? I would appreciate more detail on that.

Erez Raphael - Chief Executive Officer
Thanks for the question, Steve. I think it's an important one. One of the things that we need to educate investors is how to look into our financial results and the guidance that we gave. Because we are moving into digital services and because we are moving our business from not just selling devices and strips, we are moving into PMPM and membership and services, and part of the revenue that we are generating or part of the money that we are collecting is recognized only as deferred revenue, so I think that investors will have to understand how to read these reports.

Specifically about your question, yes, the revenue that we recognized was only $1.88 million. However, you need to count on top of that another $335,000 that hit our bank account, which means that we have users that are paying for these services in advance and there is a matter of revenue recognition of what can be recognized now and what can be recognized in the future.

What I would advise investors to look at is how we are securing future revenue by having this deferred revenue, that's number one. Number two, the fact that we are stating that we keep growing the user base and keep growing the ARPU, the average revenue per user per month, means that this business is becoming more and more healthy, and we do see the growth. But when we need to look from an accounting standpoint, we see these two numbers broken into two different buckets: one is the revenue and the other one is the deferred revenue. This is something that we did while we were reporting our financials and while we were writing our press release, we were following all the SEC guidance on how to reflect these numbers in our financial reports. That's number one.

Number two that I wanted to say is that investors that will look into financial reports of companies that are more SaaS oriented will be able to see the same way of revenue recognition, and I would advise also to look at it from this angle. At the end of the day, this quarter is the first quarter that we started the full transition into what we are calling digital health services, and this is why the reporting has been changed.

With regard to your specific questions about the guidance, given the fact that the way that we are recognizing revenue is being changed to reflect our business, we do have the confidence that the business will keep growing. But we invite investors to take into account the new way on how we are reporting our revenues in order to adjust the recent changes that we did for our business model into our financial records. So that's a change that will have to be done while reviewing our financial reports.

Q: Okay, thank you.

Erez Raphael - Chief Executive Officer
Thanks, Steve.

Operator
[Operator instructions]. Our next question is from Micah Noff [ph] from Barrett Capital. Please go ahead.

Q: Hi, Erez. Thanks for the call. I have a few questions. The first is regarding the increase in marketing costs, if you can explain why it increased by nearly a million dollars, and whether you think you can increase sales going forward according with your guidance without increasing sales costs and marketing costs like you did in this quarter.

The second thing is if you can walk us through a bit of guidance regarding the path towards balancing up profitability towards the end of this year or—sorry, towards the end of 2019 versus cash you have on hand. Thanks.

Erez Raphael - Chief Executive Officer
Thank you, Micah. With regard to the first question, yes, we did increase the sales and marketing expenses. As investors probably remember, this company started selling direct to consumer in what we are calling B2C, and as we improved the platform and we got more regulation clearances—the last one was in April, the last clearance that we got from the FDA—this is where we started to establish our U.S. office and U.S. team. Once we decided to go into more channels, we had to open the office and to invest into expanding the team and opening more channels.

So obviously once we are there, we increased the expenses in sales and marketing year-over-year. Then with the amount of money that we are investing now into sales and marketing, we believe that this kind of investment should stay relatively stable, and with that we're going to see an increased pipeline that will generate for us revenue.

The Giant Eagle is just one example of an account, and I believe that already in Q4 we're going to see a few more signed accounts, and I believe that next year for the same amount of expenses in sales and marketing we're going to see an increased pipeline with 10 to 15 accounts that will be signed with Dario. And from these accounts we should generate more revenue that will contribute to the additional investment that we did into the sales and marketing.

So as we move forward, I don't see a linear increase in the sales and marketing in order to keep generating higher revenue, because that's kind of a fixed investment that we are doing. Once the accounts will be up and running like Giant Eagle, we're going to see the sales going up relatively with the same amount of investment into sales and marketing. So that's with regards to your first question.

What was the second one, if you don't mind reminding me?

Q: The second question was about if you could walk us through--well, it's a direct link to the first question, with cash on hand that you have, which is a bit more than $11 million, how you go through 2019 if your growth projections pan out, how you get to a balanced cash flow.

Erez Raphael - Chief Executive Officer
The profitability is something that we are looking carefully into the numbers and how we are structuring our business model. One very important point that investors should look at is how much money we are generating from a single user and what are the margins that we are generating from single user. This is something that is improving over time, especially in this quarter, and as we move into Q4 and Q1 next year, investors will be able to see, I believe, that the gross margins keep improving because we are not selling just devices and test strips, we are selling also digital services or physical services, and the overall membership of the PMPM becomes more and more profitable. So this is something that as we move forward will enable us to reduce the burn rate and eventually take the business to profitability.

According to the plans that we have now in hand, we believe that the amount of cash that we have will take us out to 2020. Given the fact that we have B2B in accounts that will generate revenue, and given the fact that we have already tens of thousands of users that are operating on the platform and keep generating revenue, we believe that getting the business to cash flow positive, this is something that we can see not in the too far horizon.

Practically, the margins are improving, the number of users on the platform, this is something that is growing, we made a few fixed investments that will help us generate more revenue while keeping the fixed budget of the organization stable and not increasing it too much. All these elements together with the technology that is already cleared by the regulation bodies, we believe that investors will be able to see in the next few quarters the extrapolation that might take this business to cash flow positive.

Q: Okay, thanks. Keep up the good work.

Erez Raphael - Chief Executive Officer
Thank you, Micah. I appreciate your questions.

Operator
Thank you. This concludes the question and answer session. I would like to turn the floor back to management for any closing comments.

Erez Raphael - Chief Executive Officer
Thanks, everyone, for joining us for the earnings call. We are looking forward to the next earnings call and to keep showing how we are growing this business and creating a real digital health company, a leading worldwide company. Thank you, everyone.

Operator
This concludes today's teleconference. You may disconnect your lines at this time. Thank you for your participation.