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Intrusion Inc Q4 2023 Earnings Call

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Q4 2023 Earnings Call

Presentation

Operator:

Welcome to Intrusion Inc.'s Fourth Quarter and Full Year 2023 Earnings Conference Call and Webcast. At this time all participant lines are in a listen-only mode. For those of you participating in the conference, there will be an opportunity for your questions at the end of today's prepared comments. Please note this conference is being recorded. An audio replay of the conference call will be available on the Company's website within a few hours after this call. I will now turn the call over to Josh Carroll with Investor Relations.

Josh Carroll, Investor Relations:

Thank you and welcome. Joining me today are Tony Scott, Chief Executive Officer; and Kimberly Pinson, Chief Financial Officer. This call is being webcast and will be archived on the Investor Relations section of our website. Before I turn the call over to Tony, I'd like to remind everyone that the statements made during this conference call relating to the company's expected future performance, future business prospects, future events or plans may include forward-looking statements as defined under the Private Securities Litigations Reform Act of 1995. Please refer to our SEC filings for more information on the specific risk factors that could cause our actual results to differ materially from the projections described in today's conference call. Any forward-looking statements that we make on this call are based upon information that we believe as of today and we undertake no obligation to update these statements as a result of new information or future events. In addition to US GAAP reporting, we report certain financial measures that do not conform to Generally Accepted Accounting Principles. During the call, we may use non-GAAP measures if we believe it is useful to investors or if we believe it will help investors better understand our performance or business trends. With that, let me now turn the call over to Tony for a few opening remarks.

Anthony E Scott "Tony", President/CEO:

Thank you, Josh, and good afternoon and thank you all for joining us today. To start, I'd like to just take a moment to acknowledge the poor performance of our stock in the marketplace this past year. As an investor and as one who has significantly increased my personal investment in Intrusion over the last year, I want you to know that I feel your pain. Intrusion's performance in 2023 did not live up to anyone's expectations, including mine, and I wanted to address that right up front. But I'd like to share some of the factors which have contributed to that poor performance and also share our plans to overcome those realities or at least compensate for them. We made no secret that we needed to raise capital in 2023, and as it turned out, 2023 was one of the worst years ever for small and micro-cap companies

to raise equity. We made multiple attempts with three different investment banking firms to raise capital and obviously, our stock was severely discounted as a result of these efforts. Additionally, due to unforeseen delays in Shield bookings, we were not able to make the kind of public announcements that could have helped either stabilize the stock price or generate a measure of positive inertia. And finally, as you'll hear later, the loss of the large thin[ph] margin consulting contract in 2022 that we previously talked about, had its full impact on top-line revenue in 2023 and the impact of the federal government's continuing resolution in Q4 2023, which continued into 2024, has had a significant impact on our consulting revenue during the period. At all times, we've reacted to these developments by doing what we could to reduce costs and to conserve cash, and at the same time, preserve and protect our highly talented engineering and consulting teams whose skills are not easily replaced.

In 2023, we did manage to resolve all of the legal issues that were a carryover from 2021 and 2022, including the SEC investigation, the shareholder derivative lawsuit, and the class action lawsuit. Only the derivative action remains technically open with final court approval scheduled shortly after a self-imposed delay by the court of jurisdiction. I'll say it's impossible to fully measure the workload and the distraction that these legal issues have landed on our leadership team, and are only surpassed in magnitude by the workload and distraction associated with the constant fundraising activities we also took on in 2023. I'm happy to have at least some of this workload behind us as we get into 2024.

From a product development perspective, 2023 was a very productive year and one of significant progress in terms of delivering the features and functions that our customers have told us were important. We delivered a cloud-based reporting and management platform that makes it easy to manage a fleet of shield instances, including cloud and endpoint. This is an important development for managed service providers, managed service security providers, and enterprise customers. We've also made significant improvements in overall performance, and we've continued our progress on reliability, quality, and scalability to meet the needs of the most demanding customers. Also, the infrastructure and tooling that supports our product development team and our consulting teams has had a much needed and long delayed upgrade as well. Taken together, these improvements will shorten our product development time as well as continue to deliver high quality products that are relevant to our customers.

Let me talk a bit about our sales activity. We added seven new logos in Q4, 2023, our best quarter ever. Now, revenue for these initial contracts will be small initially as deployments occur in Q1 and Q2. But two of these new customers have already indicated intent to significantly increase their Shield consumption in 2024 with revenue potential in each case of several \$100,000 ARR. In October of 2023, we announced a \$5 million multi-year award with a large telecom provider that we expected to generate revenue beginning in Q4. And due to some unforeseen contracting delays involving our original channel partner and ultimately the need to switch to an alternate channel partner at the request of our customer, we now expect revenue to begin in Q2 and then ramp throughout the year. We expect to be able to make a more definitive announcement of the details of the award in the next few weeks. Finally, in the last two weeks, we've been notified through our partner iOne Resources in the Philippines that were part of a solution that's been down-selected as the number one preference for helping protect the cyber security integrity of National Elections in the Philippines. After an upcoming 30-day to 45-day technical due diligence period, a final award will be made with deployments beginning in Q2 and Q3. And if we are successful along with our iOne partners, the revenue to Intrusion for this will exceed \$1 million ARR.

Now turning to our financials, total revenues for the fourth quarter were

\$1.4 million, representing a 7% decline on a sequential basis. Revenues for fiscal 2023 were \$5.6 million, a 25% decline compared to fiscal year 2022. The decline in revenue in the fourth quarter was driven by the decrease in consulting revenue, mainly associated with the Federal Government's continuing resolution and the absence of an approved federal budget. The decline year-over-year was largely due to the loss of the large low-margin government contract in Q4 2022 that we previously discussed. Shield revenues for the fourth quarter were flat sequentially, primarily due to a delayed final contracting and implementation schedule as I just discussed. We've also been informed by a large and early Shield customer that they will not be renewing their shield contract. The customer was one of the original users of an early version of the Shield product and had implemented a highly customized and non-standard architectural configuration of the product. While the loss of one of our original Intrusion shield customers is both regrettable and will have a short-term impact on our financial results, we believe that the Shield transactions that we booked in the fourth quarter of 2023 and during the first quarter of 2024 and the several transactions that we anticipate will close in the second quarter of this year as well as the promising opportunity from the iOne Resources award will help drive Intrusion Shield revenue growth in 2024.

Turning now to our consulting business, our fourth quarter consulting revenues were down sequentially, driven by the continuing resolution and the absence of an approved federal budget that I mentioned earlier in the call. And while the budget was finally passed over this past weekend, it will take a few days to sort out the total impact on Intrusion and planned renewals as well as prospective new work. Still we continue to remain optimistic about the demand for our products and services and expect growth in the future from both our government and non-government customers. And finally, through some of our recent consulting contract renewals for 2024, we were able to implement rate increases and also make other revenue generating enhancements to existing contracts. As I previously indicated in various Q&A sessions, I informally stay in touch with many former colleagues and notable CIOs and CSOs across a wide spectrum of industries. Among other things, these conversations help me understand the general sentiment and consensus opinion of these important individuals as it relates to trends, spending, and concerns related to cyber security. During the last quarter, I heard that as a result of the current economic environment that we're in, a large majority of companies have been going through some form of flattening or reduction in growth when it comes to their cybersecurity teams and their cybersecurity budgets. Meanwhile, the bad guys continued to proliferate all kinds of new and lethal attacks. This has put a significant amount of pressure on CIOs and CSOs to keep up with both technology and staffing needs with more limited new resources. We continue to believe that this provides Intrusion with a significant opportunity to step in and help fill the gaps these companies currently have in their technology stack and in their cyber security teams and to provide them with the needed capability to identify, deflect, and eliminate any cyber threats that they might encounter.

In November 2023, we closed a private offering pursuant to which we sold an aggregate of 4.4 million shares of our common stock, each of which was coupled with a warrant to purchase 2 shares of common stock at an aggregate offering price of \$0.60 per share above the market price at the time. The private offering resulted in net proceeds to Intrusion of approximately \$2.3 million, which are being used for working capital and general corporate purposes. Members of our Executive team, our Board of Directors, and several existing shareholders participated in the private offering, which we believe demonstrates the confidence that both our organization and our loyal shareholders have in our unique technology. In addition to our private offering on January 2nd of 2024, I personally entered into an accounts receivable invoice financing arrangement via no[ph] purchase agreement in

which I purchased from Intrusion a promissory note in the amount of \$1.1 million in exchange for delivery of \$1.0 million in cash to Intrusion. Not only does this purchase agreement provide favorable terms for intrusion, but this also demonstrates the confidence I have in Intrusion's future. Finally, before I turn the call over to Kim to cover our financial results in greater detail, I would first like to spend a few minutes discussing the recent steps that we've taken to regain compliance with Nasdaq for continued listing on the Nasdaq Capital markets as it relates to the minimum bid price of \$1.00 and the equity standard. On March 18th, we announced our intentions to effectuate a 1-for-20 reverse stock split of our issued and outstanding shares of common stock par value of \$0.01 per share. The reverse split became effective on March 22nd and Intrusion shares began trading on a reverse stock split adjusted basis on March 25th. We also announced last week that we'd entered into an exchange agreement with Streeterville Capital to exchange an aggregate of \$9.3 million of senior debt pursuant to notes issued in March and June of 2022 for newly designated Series A preferred stock. We'd like to thank Streeterville Capital for their continued support of Intrusion as the firm has been a key partner in providing Intrusion with additional flexibility to support our capital needs. As an additional measure, we have offered a warrant exercise inducement to warrant holders from our 2022 registered direct and 2023 pipe offerings, whereby we've reduced the exercise price through March 29th. After which time the inducement period will be over and the exercise price reverts back to the original exercise price. And while there can be no assurance that Intrusion will be able to regain and therefore sustain compliance with Nasdaq's listing requirements, we believe that the measures taken provide Intrusion with the best option to successfully regain compliance with Nasdaq listing requirements. Now I'd like to turn the call over to Kim for a more detailed review of our fourth quarter and fiscal year 2023 financials. Kim?

Kimberly Pinson "Kim", Chief Financial Officer:

Thanks, Tony. Revenues for the fourth quarter of 2023 were \$1.4 million, a decrease of \$0.1 million on both the sequential and year-over-year basis. Revenues for the full year ended December 31, 2023 were \$5.6 million, a decrease of \$1.9 million compared to 2022. Consulting revenue in the fourth quarter totaled \$0.9 million, a decrease of \$0.1 million sequentially and \$0.2 million year-over-year. Consulting revenue for the full year of 2023 was \$4.0 million, a decrease of \$2.3 million compared to 2022. The decline in our consulting revenues is due to the loss of a consulting contract in the fourth quarter of 2022 in which Intrusion's prime sponsor chose not to renew the final option year of a contract. As disclosed in prior quarters, while the loss of this one consulting contract significantly impacted Intrusion's top-line revenue, the gross margin on this contract was 14% and as a result had a marginal impact on profitability. Additionally, as Tony mentioned earlier in the call, our consulting business has also been impacted by the continuing resolution of the federal budget that continues to hinder the clarity of timing for new contract awards. We continue to have a relatively strong consulting pipeline that, once the budget uncertainty is officially resolved, should result in growth.

Shield revenue for the fourth quarter was \$0.4 million, which was relatively flat sequentially and up 37% on a year-over-year basis. For the full year of 2023, Shield revenue was \$1.6 million, an increase of 36% compared to 2022. However, as Tony previously mentioned, we were informed by a large Shield customer that they will not be renewing their contract. As a result, the loss of the Shield customer has the potential to impact our financial results beginning in the second quarter into a greater extent, the deals that we anticipate closing during the second quarter slip into the second-half of the year. As a reminder, many of our new bookings in much of our pipeline consist predominantly of Shield appliance product sales, where revenue recognition is

dependent on an implementation in customer acceptance timeline. Gross profit margin was 79% for the fourth quarter of 2023 compared to 63% in the fourth quarter of 2022. The increase in gross profit margin in the current quarter is a result of our product mix with Shield revenues representing a higher percentage of revenues and the loss of the low margin consulting contract as previously mentioned. Shield sales currently represent 32% of our revenues. Operating expenses in the fourth quarter of 2023 totaled \$3.5 million, a decrease of \$0.4 million sequentially from the third quarter of 2023. We implemented cost reduction measures in late March 2023, which was predominantly in staffing as we eliminated 16 positions and reduced our use of contractors. These measures along with continued reductions in discretionary spend resulted in \$5.2 million in cost savings April through December. As we have noted on previous calls, as we grow our customer base and increase revenues, we may choose to accelerate our product development in future periods, which will result in increased spending. We will and are continuing to evaluate each spend decision while also making prudent investments in our long term profitable growth.

The net loss for the fourth quarter of 2023 was \$2.8 million or \$0.09 per share, a marked improvement from our loss of \$3.2 million or \$0.14 per share for the third quarter of 2023. When compared to the same periods in 2022, earnings per share improved \$0.16 per share from a loss of \$0.25 per share for the 2022 quarter. The net loss per share for the 12 month period 2023 was \$0.57 per share compared to \$0.82 per share for the same period in the prior year. Turning to the balance sheet, on December 31st, we had cash and cash equivalents of \$0.1 million, down \$3 million at the end of 2022. Since December 31st, we have funded our operations through the continued use of our ATM facility and changes in working capital, which consists principally of customer advance payments in the AR financing arrangement, Tony mentioned earlier in the amount of \$1.1 million. More information relating to this arrangement is available on current reports on Form 8-K.

We continue to take active steps towards improving our liquidity and strengthening our balance sheet, which also align with steps we are taking to regain compliance with the Nasdaq Listing requirements. On February 1st we had a Nasdaq Hearings Panel meeting where we presented our plan to regain and sustain compliance. Following this meeting, we were granted an extension until April 23rd in which to meet the Nasdaq Capital Markets Listing criteria. We are executing a plan to gain compliance with the Nasdaq Listing rule 5550(b)(1), which requires a minimum of \$2.5 million in net equity. Pursuant to this plan, in order to increase our equity, we are continuing to utilize our ATM. We closed on a private offering in November 2023 and are anticipating to close on an additional private offering in the near-term. We have sent warrant inducement letters that temporarily reduce the exercise price to warrant holders for our 2022 registered direct and our November 2023 pipe offerings, and through a series of three transactions in the fourth quarter 2023 and two transactions in this March 2024 quarter, we exchanged \$10 million in senior debt or \$0.8 million in common stock and \$9.3 million in Series A Preferred Stock. These exchange agreements with Streeterville Capital are a significant step towards deleveraging our business. Following the exchanges, the remaining outstanding principle on the senior notes is \$0.5 million. I'd like to now turn the call back over to Tony for a few closing comments. Tony?

Anthony E Scott "Tony", President/CEO:

Thanks, Kim. Despite the challenges that we face throughout the year, we've continued to move forward with a clear vision for the future, and we're focused on transforming that vision into action through compelling products and innovative strategies that position us to capitalize on the robust opportunities in our evolving marketplace. I look forward to sharing the next steps in our journey with all of you, and I want to personally thank all of

our employees for all their artwork over the past year, and our investors and financial partners for their continued patience and support as we execute our strategy. This concludes our prepared remarks, and I'll now turn the call over to the operator for Q&A.

Questions And Answers

Operator:

At this time, we will be conducting a question-and-answer session. (Operator Instructions). The first question comes from Scott Buck with HC Wainwright. Please proceed.

Scott Buck, Analyst:

Hi, good afternoon, guys. Thanks for taking my questions. Tony, I'm curious, are you seeing any patterns in the success that you're having selling Shield during the fourth quarter and now the first quarter? I'm just curious if maybe you guys have stumbled onto a seat -- secret sauce or what the recent success can be attributed to?

Anthony E Scott "Tony", President/CEO:

I think there's a couple of things. But first, I would tell you that all of the new work that we talked about the new logos were the result of months of work of doing a proof of concept, and then getting the customer comfortable with the product, and what it could do, and so on. So, in a lot of ways, we've been setting the stage for these for quite a long time. But I think there's a couple of macro things in the environment that also are helping us. One is and you've probably seen in the newspaper, a lot of concern around activities from foreign governments, China and Russia in particular. And our solution is particularly well suited to detect those kinds of threats in a network environment. And I think as people's concerns have continued to rise in that particular dimension it argues for a solution like ours, maybe more than it would have before so, we do see that pattern. And then I mentioned it in my remarks, but one of the things we were missing was the ability to manage a fleet of Shield instances. Prior to our introduction of the Cloud Dashboard, you would have had to log into each instance separately and manage it individually and with the cloud platform, now you can manage a fleet of Shield devices across all the different ways it gets deployed and have consolidated reporting as well as management and that was one of the most asked for features from our bigger clients. And so I think that's helped and will continue to help us in terms of addressing the needs of some of these larger customers.

Scott Buck, Analyst:

Great. I appreciate that. Kim, can you tell us what the dollar amount contributed from the large non-recurring shield customer was during 2023?

Kimberly Pinson "Kim", Chief Financial Officer:

I don't have that number in front of me. I know that -- I mean it is a significant number and I would need to pull that for you, but it does represent -- in 2023 it represented I think roughly 80% of the Shield revenues.

Scott Buck, Analyst:

Okay. I appreciate that. And then last one for me guys. What do you have remaining on the ATM?

Kimberly Pinson "Kim", Chief Financial Officer:

We have roughly \$9 million remaining on the ATM. The ATM is off of our S-3 registration which expires in August of this next year.

Scott Buck, Analyst:

Okay, perfect. I appreciate the added color guys. Thank you.

Operator:

The next question comes from Ed Woo with Ascendant Capital. Please proceed.

Edward Woo, Analyst:

Yeah, thank you for taking my question. You mentioned that some of the cybersecurity budgets are getting cut. How does your sales pipeline look right now versus 3 months ago and a year ago?

Anthony E Scott "Tony", President/CEO:

Yeah, I didn't want to misrepresent they're not so much getting cut, but they're tapering down in terms of the amount of increases that they've been getting. As you can probably imagine, over the last couple of years, one of the biggest increases in IT budgets was for cyber security, could have been 20%, 30%, 40% a year in some cases. And that's been trimmed down pretty significantly in most organizations. So what we're seeing is more like, a single digit increases not double digit increases and so on. And so that's I think the factor that I was referring to there. And what the CIOs and CSOs are starting to demand is a couple of things that I think are relevant to our platform. One is, prove to me that there's value in the technology that it's actually preventing something and we can actually show that, what the value for the money is. And it's not true necessarily of all the cyber tools that a organization may have in its stack. So I think CIOs are looking at what's nice to have and what's critical to have and I think in some cases they're narrowing their choices based on that. And then they also complain about the number of suppliers they have to deal with and that's a trend that's been going on for now a couple of quarters. And so I expect there to be some industry consolidation as a result of that concern, and it's becoming a pretty vocal concern at this particular point.

Operator:

Okay. The next question --

Edward Woo, Analyst:

Great. Thank you and good luck.

Anthony E Scott "Tony", President/CEO:

Thank you.

Operator:

Thank you, Ed. The next question comes from Walter Schenker with MAZ Partners. Please proceed.

Walter Schenker, Analyst:

Thank you. The ability to raise capital from the ATM is somewhat limited given the liquidity in the stock especially, although I realize it's just math, but there are only about 1.5 million shares left or maybe a little more after the Streeterville. What thoughts do you have, Tony, about raising capital beyond that, the ATM?

Anthony E Scott "Tony", President/CEO:

Well, I think as Kim mentioned, we're looking at pipe type transaction similar to what we did in Q4, and I want to note that I'm personally going to participate in that again, and continue my investment in Intrusion. And it's likely small number of investors think of it as friends and family, a mix of tech people, cyber people, retired business people, wealthy individuals, and

myself who believe in what we're doing and think there's a great future ahead of us. So that's our -- that's our plan at the moment.

Walter Schenker, Analyst:

And just the second quick question, you don't know, but you've been in negotiations. On the consulting side, and we've discussed this, given your relationships going back a long way, the budget has now been passed. I realize it takes a little while to work things out, but you would look to the consulting area to be meaningfully higher than it's been running recently i.e., you're picking up new contracts, not just renewals plus price.

Anthony E Scott "Tony", President/CEO:

Yes. So, there's a couple of things to think about in this space. One was, if you remember our business, we have a series of contracts that just renew generally year-after-year-after-year as a budget gets passed, and then we get task orders against those renewals because of the length of this CR, some of those renewals didn't happen when the new budget didn't get passed, and Congress can't or -- agencies can't spend money if it's not appropriated and authorized by Congress. And so we were impacted by those and then on top of it, we had some new opportunities. Some of which we thought could get funded by sort of, I'll call it emergency funding or funding that generally isn't subject to the annual process, but it turned out in the end that was not possible. So, we've got a pipeline of prospective deals that when the dust settles, we think we've got a good opportunity for the remaining six months of the year. And we'll -- it'll -- as I said it'll take a little while for that to sort through, but we feel like we're in pretty good shape there. So, I'm optimistic.

Walter Schenker, Analyst:

Okay. Thanks a lot, Tony.

Operator:

At this time, there are no other questions in queue. I'll turn the call back over to your host, Mr. Tony Scott.

Anthony E Scott "Tony", President/CEO:

Well, thanks. I appreciate the questions. As we find ourselves at the end of -- almost at the end of Q1, I think there's a couple of things to be excited about. As I mentioned on the call, some of the wins that we had in Q4 I think are likely to turn into significantly bigger opportunities in the remaining part of the year and we look forward to that. We're also excited about this 1 opportunity I mentioned with our iOne Resources partner for the Bureau of Elections in the Philippines and I think that's a real positive if we can win that solution. Part of that solution is a new variation of the product that we created to provide additional a layer of security when you have a Starlink terminal and that was one of the winning elements that helped this solution get down selected for the Bureau of Elections. And we're seeing a great level of interest in that in other applications.

As I think many of you know, Starlink terminals are popping up everywhere, but a lot of customers are looking for additional cybersecurity, so we're hoping to take advantage of that growth and make sure that Intrusion is a part of that solution whenever anybody buys a Starlink terminal for their business. So taking together, I'm still optimistic about our future. So I mentioned I'm going to invest additionally over the course of the year and I hope to have some very positive news over the next several months for you. I appreciate everybody's patience, this is obviously taking a lot longer and been a lot harder than any of us imagined a year ago or two years ago. But we're committed, we're working hard, the team is ready and anxious and we're looking forward to showing what we can do. So I want to thank everybody and I

appreciate your participation.

Operator:

Thank you. This concludes today's conference and you may disconnect your lines at this time. Thank you for your participation.

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