CEA Industries Inc.

May 12, 2022

4:15pm ET

Operator: Good afternoon ladies and gentlemen, and welcome to the CEA Industries one, 2022 Earnings Conference Call. At this time all participants have been placed on listen only mode and we will open the floor for your questions at the end. If you'd like to ask a question, you may press *1 to enter the queue at any time. Should your question be answered, and you wish to leave the queue, please press *2. Before we begin, please be advised that this call may contain statements of a forward-looking nature relating to future events. These forward-looking statements are subject to the inherent uncertainties in predicting future results and conditions.

These statements reflect CEA Industries' current beliefs and a number of important factors could cause actual results to differ materially from those expressed in this call, including the risk factors set forth in their Form 10k which was filed with the SEC. Please refer to their SEC filings for a more detailed discussion of the risks and uncertainties associated with their business. It is now my pleasure to turn the floor over to your post, CEA Industries CEO, Tony McDonald. Sir, the floor is yours.

Tony McDonald: Thank you, and good afternoon. Welcome to CEA Industries' first quarter 2022 earnings call. My name is Tony McDonald, I'm the company's Chairman and CEO, and I'm joined today by our Chief Financial Officer, Ian Patel. Please note that we filed our quarterly report on Form 10Q, and issued a press release announcing first-quarter results earlier today. These documents can be found on our website@ceaindustries.com/investor-relations. If you'd like to be on our email distribution list, send an email to info@ceaindustries.com.

While we will highlight some key information contained in the press release, the primary purpose of this call is to provide an update on our recently updated strategic and organic growth plans, and our key operating metrics. We began the year with a focus on two strategic efforts. The first was that of pursuing organic growth through expanded product offerings and new target markets. To that end, we have several new products and services in development. We have proposals that were several other customers and will continue the momentum we have achieved in expanding our product line. We have also identified organic growth opportunities by pursuing markets outside our traditional cannabis end market, including the rapidly growing urban indoor farming market.

We continue to believe our skillset complements that opportunity. During the first quarter we identified several leads with growers in the urban farming market, we are confident that our efforts would lead to opportunities outside of our traditional cannabis market. We have increased our sales and marketing efforts in expanding both our products and markets and we will continue to pursue these opportunities. Our second strategic effort involved identifying partners that could benefit from our platform as we participate in industry consolidation that is accretive to shareholder value. Our industry experience and exposure to various components of the controlled environment build process, provides us with a uniquely well informed view of the value contribution from the various services and products in the marketplace.

All of this experience and industry knowledge will enable us to identify consolidation partners that can create value for our shareholders. To that end, we met with several potential partners during the first quarter 2022, and will continue that effort throughout the year. Central to both of the strategic priorities was a public equity platform. It's just a capital base that provides liquidity to support the company's operations and the currency to pursue strategic acquisitions. I'm pleased to note that during the first quarter we made major progress on both fronts. First, we were able to successfully uplift our common shares and warrants to the NADSAR capital markets. Where we believe our securities will offer a more attractive investment opportunity for our current and future investors.

Second, we succeeded in raising net proceeds of approximately $22 million from the sale of approximately 5.8 million shares of common stock and 6.6 million warrants. This capital provides us with a currency that enables us to execute our strategic plan to create shareholder value. We continue to execute on our strategic plan to expand our business through both organic growth and identifying M&A opportunities and we are confident that these efforts will create strong results throughout the year. Operationally, we experienced some of the same supply chain challenges in the first quarter that we have identified over the last couple of quarters. Our recognized revenue first and third quarter was hampered by production and shipping delays experienced by some of our suppliers.

Reductions in cargo ship by air and sea, container shortages and domestic truck delivery options have all taken a toll on our suppliers, and this resulted in delays to our ability to translate some of our contract backlog to revenue, in accordance with the original timeframe of the contracts. We do not believe this is a permanent issue for business, and we continue to work with our customers, suppliers and shipping partners to manage through this. Nonetheless, this delay in revenue recognition was challenging for our gross margins, especially since a portion of our crossing had been sold or fixed due to the decline in revenue. In addition to supply chain to some related disruptions, we did experience some cost increases well.

First, we recognized higher labor and employment costs as we adjusted salaries to address the current inflationary pressure that we are seeing across the economy. We require our employees to manage our business amid supply disruptions and coordinate among our customers. Suppliers, transporters and other partners who we believe that in order to keep employees focused on these challenges, market level competitive salaries that keep pace with inflation are necessary. Secondly, we invested in future growth through the hiring of certain skilled new employees.

We believe these employees will help support our growth as we venture into new products, services and markets. Finally, we recognize certain non-recurring expenses in the first quarter associated with identifying and hiring certain members of our executive team. Would like to believe these costs were necessary for retaining existing employees and building out the executive skill set necessary to support organic growth in position strategies. At this time, I will ask our CFO, Ian, to cover recent financial highlights from the quarter. Ian.

Ian Patel: Thanks Tony. As mentioned, the first quarter of 2022 was affected by supply chain disruptions that delayed our ability to recognize certain revenue items that we expected to recognize in the first quarter of 2022. On March 31, the 2022 backlog was approximately $11.2 million; an increase of $361,000 or 3% from our December 31, 2021 backlog. The increase in backlog is the result of lower revenue translated from backlog to revenue in the first quarter of 2022. Our Q1 2022 revenue was $1.7 million. Representing a 26% decrease compared to our Q1, 2021 revenue.

Revenue was impacted in the quarter by disruption in our supply chain, which delayed shipments and affected our ability to translate some of our contract backlog to revenue in accordance with the original timeframe of the contracts. Our Q1, 2022 gross profit margin was 5.2%, compared to 14.6% for the first quarter of 2021. The primary driver for this decrease in margin was lower recognized revenue off of a partially fixed cost base. Our operating loss for Q1 2022, was $1.6 million, compared to $686,000 operating loss in Q1 2021. Part of that loss for Q1 2022 was a $1.4 million compared to a net loss of $793,000 in the year ago quarter. Again, the decline in profitability was driven by the lower revenue.

Our Q1 2022 net bookings were approximately $2.1 million. This booking amount representing 61% decrease as compared to our Q1, 2021 net bookings. As of March 31, 2022, our cash position was approximately $22 million compared to $2.2 million as of December 31 December 21. The increase in cash was primarily the result of cash proceeds from the sale of common stock and warrants at approximately $21.7 million, offset by the redemption are a serious need for preferred stock and interest of $2 million. As previously stated, the purpose of this raise was to continue funding our growth strategy and for general corporate purposes. This concludes my prepared remarks; I'll pass it back to you Tony.

Tony McDonald: Thank you Ian. The first quarter of 2022 proved challenging as we managed through timing of revenue inflation and supply chain issues. Nonetheless, we are confident that our organic growth strategy is gaining traction in the market and will continue to bear fruit throughout the rest of the year. The CEA Industries team greatly appreciates all the support from our shareholders. This concludes today's prepared remarks, and we will open the floor for questions.

Operator: Thank you, ladies and gentlemen the floor is now open for questions. If you have any questions or comments, please press *1 on your phone at this time.

We ask that while posing your question you please pick up your handset, as listening on speakerphone to provide optimum sound quality. Again, please press *1 if you have questions at this time. Please hold while we poll for questions.

Tony McDonald: As we wait for people to enter the queue I'll feel some questions received by email and the web cast. First question: "As you mentioned, costs have gone up in response to inflation. Does the company have pricing power to pass those costs onto customers or can we expect a permanent contraction in gross margins?" No, our gross – our margin compression was caused by reduced revenue due to shipping delays combined with the increase in fixed cost we incurred to facilitate growth that we expect to realise later in the year. Next question: "Can you offer an update on what you're seeing in the M&A and consolidation space?"

We obviously can't get into specifics, but there's a lot of opportunity out there and it ranges in terms of business opportunities. Getting scale in the current landscape is difficult, and as capital becomes more expensive, this trend will only continue. Companies that we were talking to understand that and are eager to find ways to work together. We are continuing to evaluate partnerships and remain disciplined in that process. Next question: "Did you lose any contracts you have previously signed due to the inability to ship product?" No, we did not. We have heard that delays in shipping product has been a recurrent theme that is not unique to our company or industry. It's something we are all working through. Do we have any questions operator?

Operator: Yes, we did have a couple of questions from the lines if you're ready to take them now Tony?

Tony McDonald: Mm-hmm.

Operator: OK, first question is coming from Mark Sweiss. Mark, your line is live, please announce your affiliation and pose your question.

Mark Sweiss: Hi, I'm a private shareholder. My question is about bookings and on January 4, there was a press release that indicates that there was a $3.4 million contract with various holdings signed that day. Yet bookings are quite a bit less than that single contract. How is that?

Tony McDonald: Mark, I don't have a quick – I don't have information at the fingertips on that. I think that project was from Q4, but I'm not (cross talk)

Mark Sweiss: (cross talk)– signed on January 4, so I'm not sure – and I don't think it was in the fourth quarter either. So I'm just curious, I thought maybe it got cancelled.

Tony McDonald: No, we've not had a cancellation on that. I don't recall exactly when it was signed. But no, there's not been a cancellation on that contract.

Mark Sweiss: OK, thanks.

Operator: OK, we did have another question from Andrew, your line is life please announce your affiliation and pose your question.

Andrew Scott: Hi Tony, how are you, it's Andrew Scott from Think Equity. Just out of curiosity, I understand a lot of guys got hit with supply chain issues in Q1, midway through Q2 are you seeing any bounce back in those orders or are you still seeing delays and disruptions in supply chain?

Tony McDonald: Ian, do you want to speak to that?

Ian Patel: Yeah, sure. We are seeing bounce back in the orders. I think obviously this has been a pretty volatile quarter with the Ukrainian conflict, interest rates going up, but that sort of challenge that we saw initially has thawed somewhat. We are looking forward to building backup of pipeline. But obviously is going to have to be something we have to continue to work harder moving forward. Some of the projects we are remaining cautious as recent interest rate decisions change the cost of capital, but the working through it and we continue to be confident that will get through that.

Andrew Scott: All right, but you are seeing bounce back in Q2 or…

Ian Patel: Correct.

Andrew Scott: All tight, that's good. How about –

Tony McDonald: Of course, at the end of the quarter we had a strong backlog position as well.

Andrew Scott: Yes, that's what I wanted to ask and I think this will help, especially with the prior question. Backlog in bookings are different. I missed a little bit, can you give us an idea of what the backlog was at the end of Q1?

Tony McDonald: It was 11.2 million, is that right, Ian?

Ian Patel: Correct, yes, it was 11.2 million at the end of Q1.

Andrew Scott: So it sounds like some of the things just slipped into Q2? OK. And then, how much cash did you have at the end of Q1 and then if you could just let me know what there is cash value per share? I'm just trying to get an idea on intrinsic value.

Ian Patel: Yes, the end of quarter cash balance was $22 million. That implies a cash value per share of about $2.83.

Andrew Scott: OK, all right. I know you're looking for M&A, all right, I know I don't have anything else. I'm good, thank you.

Tony McDonald: Thank you Andrew.

Andrew Scott: Thank you.

Operator: Thank you, and there were no other questions from the lines at this time.

Tony McDonald: Thank you operator, this will conclude today's conference call and we look forward to presenting our second quarter results later in the year. Thank you for your continued interest in CEA Industries.

Operator: An audio replay of this call will be available on ceaindustries.com/investors, beginning on May 13 at 4 PM Eastern. And will remain available until June 2, 2022. You may disconnect your phone lines at this time and have a wonderful day. Thank you for your participation.