

***Transcript of
DarioHealth
First Quarter 2017 Earnings Call
May 15, 2017***

Participants

Rob Fink – Hayden Investor Relations
Erez Raphael – CEO
Zvi Ben-David – CFO

Analyst

Mark Lanier – Pegasus

Presentation

Operator

Good day, ladies and gentlemen, and welcome to the DarioHealth First Quarter 2017 Earnings Call. All lines have been placed on a listen-only mode. [Operator instructions].

At this time it is my pleasure to turn the floor over to your host, Rob Fink of Hayden Investor Relations. The floor is yours.

Rob Fink – Hayden Investor Relations

Thank you. Good morning, everyone. I'd like to welcome everyone to DarioHealth's First Quarter 2017 Earnings Call. Hosting the call today are Erez Raphael, Chief Executive 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 other forward-looking statements regarding 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 and documents that are filed 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 the presentation of these non-GAAP financial measures is useful to investors understanding and assessment of the company's ongoing core operations and their prospects for the future. Unless it is otherwise stated it should be assumed that any financials discussed in this conference call will be on a non-GAAP basis. Full reconciliations of non-GAAP to GAAP financial measures are included in the earnings press release that was issued earlier today.

With all that said, I'd now like to turn the call over to and introduce Erez Raphael, Chief Executive Officer. Erez, the call is yours.

Erez Raphael – CEO

Thanks, Rob. Good morning and welcome to DarioHealth First Quarter 2017 Earnings Call. Thank you all for joining us today, this morning. We are very proud and excited from the first quarter results. In fact this is a record

for our company in terms of the revenues that we managed to grow. We did, this morning, \$1 million in revenue in this quarter and this is something we're very excited about and give us the flow to keep the growth as we're moving forward.

The overall penetration in the US, post the soft launch that started in March and continued into June, proved to be very effective. We managed to sell overall \$25,000 devices so far in the US. The majority of it was done in this nine months since the soft launch. We also managed to enhance our capital structure and to introduce some marketing partnership this quarter.

Overall, as I stated in our previous call we are trying to get more and more access to the market. One of the things that we did also this quarter is creating partnership with a third party in order to get access to more insurance companies in the US. We're getting more and more access to users. At the moment we feel that we have a very good foundation in order to build and a very profitable business based on a very good product and also a very good strategy of direct-to-consumer.

We are very pleased with the way the things have progressed in the US. At the same time we're also working on the rest of the territories where we're building penetration also into UK, into Canada, into Australia. We see that our users are very engaged. This is a very important portion that will help us increase the customer volume in the future. Also at the same time we feel that the go-to-market and the B2C foundation makes it more easier for us to reduce the overall acquisition costs and this is something that will help us take the overall business to profitability.

In the overall numbers we also managed to have more than 67,000 installed worldwide. One of the things that investors should look at is the overall revenue that came from consumables and from test strips. We did 76% from test strips and this is an overall growth of 20% from Q4 2016, which is a very positive number and very positive KPI because when we're looking on the overall business we're expecting that the growth will continue the momentum, but at the same time we want to get the overall burn of the company down so we can show investors that we start to have a trend toward profitability next year.

This kind of improvement in the customer value by having more consumables and at the same time a very effective direct-to-consumer machine that we're improving from quarter to quarter while increasing the customer value, these are two key components that will help us get the business to profitability and this is something that we're going to look carefully, also, in Q2 and Q3 growing the sales but at the same time reducing the overall burn rate of the company.

As you know we're dealing with the digital health. This is how we are positioning our company. It's not a device company. It's a company that is transforming a market from pure monitoring and device to be more disease management. Further than that we are talking about digital therapeutics here. We are engaging with users of our platform and we are helping them improve clinical outcomes. We are doing it in a very, very user-centric approach which is something that traditionally you don't see in traditional medical devices companies.

We are very confident that by the fact that we have users that like the product. By the way, one of them is Dominique Wilkins that used our product for three months and now he's our presenter in the US. We announced it in Q1. So having the users that are engaged that are using the device and the overall platform more and at the same time we are communicating with them directly means that we are starting to be more and more viral. We are starting to get a higher customer value and this is the key point in order to drive the sales forward.

When talking about access to the market obviously we have another very important milestone to hit in the next few months which is the clearance of the Android in the US. This is something that is extremely important for the company. We feel that while having this kind of a milestone as well as other milestones that will give us more

access to the market will enable us not just keep the growth but also to accelerate the growth and to bring the business to profitability.

Another very important milestone is to continue the coverage of our overall solution with insurers in the US. We just started in Q1 but we're going to continue in Q2 and Q3. Having more access to our overall solution from consumers will enable us to keep the growth and to accelerate the growth of the business in a faster way.

Another milestone that we are planning for later this year is the launch of the product in Germany. While it's very important for us to go to business in the US we feel that from a strategic standpoint as well as from valuation standpoint it's extremely important to service another market. We feel that we are mature enough in order to go into an additional market that is not a pure English-speaking market. We decided that the next market is going to be Germany and this is what we are planning to do by September.

Another very important point that investors should look at is the fact that we believe that our product can be implemented for also other applications. We have users that are using our product for prevention. We feel that this is a market that was not touched by the traditional medical device industry. While we have a very digital and very whole solution we feel that we can tap into the prevention market. This is also something that we are planning at least to pilot later this year and also to start to build our revenue channel also into this direction.

Looking at the overall picture we have a lot of ways not just to grow the business but also to do it in a way that we are less sensitive to a specific territory. We are having a very worldwide growth, at the same time also introducing other business lines under the same product and also increase the customer value by having everything more and more digital and more and more communicated directly with our users.

Looking into a more long-term, medium to long-term, I think that we are creating here a very good foundation to deal with other chronic conditions. The patents that we have for the overall turning smartphones [ph] to be a device and monitor can cover [ph] us also for other fluid tests like cholesterol which is something that we're looking at. Also something that we feel should happen and will happen in the medium term is the big data. One of the big reasons why we are doing that is that we believe that eventually we can create a digital coaching, a digital therapeutics where people will improve clinical outcomes. We can achieve that by capturing a lot of data points and by creating a lot of big data analysis and also creating artificial intelligence on top of the platform.

We already started to see the first results when looking into our database. We see that we have users that are improving clinical outcome. We see specific trends that are related to foods and glucose levels. We see specific trends that are related to medication and glucose levels. And, the fact that we are one of the only solutions in the market to capture 100% of the data and doing it in real-time brings us huge advantages in terms of big data and monetization on this data. This is something that we should in the medium and in the long-term will contribute highly to the valuation of this company.

We feel that the overall mindset of investors is about our performance in terms of revenues and profitability. The big data portion we believe will be added to it in the future. This is extremely an important portion of what we do. Overall we are expanding. We are selling at the moment in UK, New Zealand, Netherlands, Australia, Israel, Canada and Italy. Germany is around the corner. Expansion into more platforms in the US is also around the corner.

With that I would like to turn the call to Zvi Ben-David, our CFO, to give some detailed review about our financial results. Zvi, go ahead.

Zvi Ben-David – CFO

Thank you, Erez. As Erez [indiscernible], during the first quarter of 2017 we sold more than 6,900 devices in the US. Revenues for the first quarter ended March 31, 2017 was a \$1,007,000 which is a 77% increase from the \$568,000 in the first quarter ended March 31, 2016 and a 20% increase sequentially from the first quarter of 2016. The increase in the revenues is mainly a result of continued market penetration into the United States and Australia.

Revenues for the first quarter of 2017 included a direct-to-consumer sales in the US as well as direct-to-consumer and businesses partner sales in Australia and product sales to distributors in the US, Italy, Canada and the United Kingdom. Gross profit of \$106,000 was quoted in the first quarter ended March 31, 2017 an increase of \$208,000 compared to a gross loss of \$102,000 in the first quarter of 2016. This represents a gross profit of 10.5% as strips and other consumables made 76% of the quarterly revenues.

Operating loss in the first quarter ended March 31, 2017 increased by \$2.3 million to \$4.2 million compared to \$1.9 million operating loss in the first quarter ended March 31, 2016. This increase is mainly due to the increase in our direct sales and marketing expenses in the US and Australia as well as expenses related to stock-based compensation to management. Note six to the financial statements details the increase in stock-based compensation by \$1.2 million to \$1.6 million in the first quarter ended March 31, 2017 compared to \$324,000 in the first quarter ended March 31, 2016. Net of this increase in stock-based compensation expenses, operating expenses decreased by only \$1.3 million and again this increase is mainly due to the increase in our direct sales and marketing expenses.

Financial income in the quarter was \$7.4 million compared to financial expense of \$445,000 in the first quarter ended March 31, 2016. This change was mainly due to reversing the warrant evaluation expense recorded in the first quarter of 2016 due to the price protection feature included in warrant issued to investors in March and August '16. This price protection feature expires on March 8, 2017 and as a result we cancelled the liability related to these warrants by recording financial income of \$7.4 million.

Net profit attributable to holders of common stock increased by \$5.6 million to \$3.2 million in the first quarter of 2017 compared to a loss of \$2.4 million in the first quarter of 2016. This was mainly attributable to the increase in financial income previously discussed. As of March 31, 2017 cash and cash equivalents totaled \$2.8 million. Such [ph] subsequent to be handled the first quarter on April 5, 2017 the company closed the public offering of 1,450,000 shares at the purchase price of \$3.10 per share for an aggregate consideration of \$3.8 million net of issuance costs.

That's all for me. Now back to you, Erez.

Erez Raphael – CEO

Thanks, Zvi. As you can see we made a meaningful progress against our long-term growth strategy. We feel that we have a very good product. We're getting daily feedback from our users. This is the most important thing. This is something that impact the customer value that is growing every day. We're doing a lot of digital work in order to grow the customer value. At the same time the [indiscernible] acquisition and our ability to penetrate the market becomes also more and more effective. This is the second parameter that is very important for the future profitability of this business.

At the same time we are creating more access to get to more users. Whether it's going to be the Android platform in the states, getting more insurance coverage in the states or increasing the globalization and talking about Germany, expanding the sales also in other markets like UK, all these kinds of actions are being taken. At the same time we see our database growing with a lot of data points.

Remember that we have a very unique solution because we are one of the only solutions in the market that catch 100% of the data in real-time which means that while the digital health is talking about future coaching or digital therapy we have all the foundation in order to implement it which is a huge evolution for the current medical device market. We're turning device into a pure digital therapy which is the something that the market needs and we believe our solution will—it's already proved from our database that we are improving clinical outcomes but we believe that we're going to do it in a more efficient way, which is something that the market needs.

Having all these arguments, all these parameters together gives us the confidence that we can take the business forward to keep the growth in 2017 while reducing intensively the burn rate of the company. We are sure that in medium and the long-term the monetization of the data is another very important element in a lot of internal big data analytics that we're doing we already see the value and we'll have to find a way in the future to monetize on that.

Overall we're very excited in the first quarter with the revenue that is above a million dollars. I'm looking forward to continue the hard job to one of the next milestones in the future to exceed \$2.5 million in the quarter which is \$10 million a year. This is a very good milestone that we want to achieve in the coming future.

With that, I would like to open the call for questions. Operator?

Operator

Thank you. The floor is now open for questions. [Operator instructions.] Please hold while we poll for questions. Our first question comes from Mark Lanier from Pegasus. Mark, state your question.

Q: Congratulations on the quarter, gentlemen. My question has to do with the markets in the UK and Canada that you are opening up. Would you compare and contrast the approaches that you're taking in both territories and give us some more granular update on your progress there? Thank you.

Erez Raphael – CEO

Yes. Absolutely. Hi, Mark. UK was one of the first markets that we started the launch in and much before we went to the states. The history of the company matters here because when we started the overall launch in UK and then in Canada we were approaching the market in a very B2B way. We hired, like the traditional and medical devices company, we hired distributors that were working under exclusivity in the region. The majority of the initial sales was done by the distributors through the clinicians.

Later on we wanted to create something that is more effective. We understood that the nature of our product is very digital and also has all the qualities of a medical device but also can operate as something that feels for users as a semi-gadget. We thought that it's going to be very effective to spend more efforts and more time in order to make it more [indiscernible] to consumer. When we started these efforts in Australia we thought that it's highly effective and we decided to launch in the states in a very direct-to-consumer way.

The two countries that you just mentioned UK and Canada are two markets that we decided to transform from B2B to be more B2C oriented. While we keep the distribution agreements and the distribution partners in Canada and in UK in place, we work together with the two distributors. In Canada we're talking about A&D Medical and in UK we're talking about Advanced Therapeutics. We reached an agreement with these partners based on our performance in Australia and also in the states that we want to launch the B2C as a side-by-side approach. We are operating in Canada, side-by-side I think from Q4 and introducing direct-to-consumer and selling online where we're having the distributors supporting us from the ground with fulfillment. We started like a week or two weeks ago. We announced in that in UK we also reached an agreement with our distributor in the UK Advanced Therapeutics. Now we are starting to sell online also in the UK.

From the number standpoint I think that we should be able to accelerate the sales in the UK as well as in Canada like we did in Australia and also in the states. This is what investors would see in the next few quarters. It's extremely important for us to keep the right balance of users and so between the states to the rest of the territories in order to ensure that we are doing a very balanced growth and keeping the company very global. We think that it's going to be very important for the future.

Q: Turning to the United States and the challenge of dealing with insurance companies could you talk about how long that takes? Roughly, how many critical insurance companies you feel are necessary to gain the majority of exposure to the United States, and, roughly what your expected timeline is to secure insurance coverage in the United States? Thank you.

Erez Raphael – CEO

Yes. This is something that we should look at from a few angles. The glucose monitoring market and the specifically the test strip market is something that was highly reimbursed all over the world, not just in the US, so users used to pay zero for supplies. The market is changing. The market is changing because the commercial insurance or the private insurance companies today are asking for what is called co-pay. The co-pay over the years becomes higher and higher. The sensitivity to whether your test strips or bio test strips are being covered by the insurance as of today or what it's going to be in two years from now is not the same thing that we had five years ago. This is one element that is changing in the market. Also the pricing of Dario that is very competitive when you're signing up for the subscription makes it much more easier to sell out-of-pocket.

Having said that, we do say that for specific insurers the co-pay is relatively still very low and we do want to get more users and we do want to get the opportunity to more and more users to buy the Dario device and enjoy the overall capabilities of the digital therapeutic that we are providing. Therefore we are starting to get the coverage. In terms of the [indiscernible] population we are partnering with third parties that are sort of distributors that have this agreement already with insurers and by signing with them and by providing the lead that we are creating from the digital marketing to these partners we are managing to get users that are approaching our website and want to get our device and tested through these third parties we are doing it in an online way. We are collecting the lead and then we are providing it to the third party to make sure that it's being delivered to the user and the reimbursement.

We believe that in order to cover at least 50% of the insurance we need to have somewhere between three to five agreements with third parties. We already signed with the first one. We are now working with the next three to four partners. In Q2 and also in Q3 we believe that we will be able to execute at least on the next two or three third parties that we've mentioned it would take us to at least 50% coverage of the insurance. At the same time we do think that our pricing strategy should stay competitive to allow users to make it also out-of-pocket.

If you are looking from the US market perspective the Android growing together with these insurance coverage should give us a very good access which is in the range of 50% to 70% of all the people with diabetes in the state that will have access to our product in the next two quarters. This is our hope and this is what we're aiming for. This is not including the other prevention market that we were talking about, which is a total different story, that should also highly contribute to our ability to generate sales.

Q: That's exciting. I wish you all good luck.

Erez Raphael – CEO

Thanks, Mark. I appreciate it.

Operator

There appears to be no further questions in the queue. Thank you. This does conclude today's teleconference.