

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549**

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2019

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from _____ to _____

Commission File Number: 001-38107

ShotSpotter, Inc.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
7979 Gateway Blvd., Suite 210
Newark, California
(Address of principal executive offices)

47-0949915
(I.R.S. Employer
Identification No.)

94560
(Zip Code)

Registrant's telephone number, including area code: (510) 794-3100

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|-------------------------------------|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input checked="" type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> | Smaller reporting company | <input type="checkbox"/> |
| Emerging growth company | <input checked="" type="checkbox"/> | | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

| Title of each class | Trading Symbol(s) | Name of each exchange on which registered |
|---|-------------------|---|
| Common stock, par value \$0.005 per share | SSTI | The Nasdaq Capital Market |

As of May 7, 2019, the registrant had 11,320,983 shares of common stock, \$0.005 par value per share, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

ShotSpotter, Inc.
Condensed Consolidated Balance Sheets
(In thousands)

| | March 31, 2019 (Unaudited) | December 31, 2018 |
|--|----------------------------------|----------------------|
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 29,524 | \$ 10,218 |
| Accounts receivable and unbilled revenue | 7,375 | 15,267 |
| Prepaid expenses and other current assets | 1,332 | 1,527 |
| Restricted cash | 60 | 60 |
| Total current assets | 38,291 | 27,072 |
| Property and equipment, net | 16,688 | 16,504 |
| Operating lease right-of-use asset | 765 | — |
| Goodwill | 1,379 | 1,379 |
| Intangible assets, net | 255 | 242 |
| Other assets | 1,638 | 1,922 |
| Total assets | <u>\$ 59,016</u> | <u>\$ 47,119</u> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 1,698 | \$ 1,307 |
| Deferred revenue, short-term | 23,415 | 23,102 |
| Accrued expenses and other current liabilities | 3,960 | 4,427 |
| Total current liabilities | 29,073 | 28,836 |
| Deferred revenue, long-term | 1,095 | 1,060 |
| Other liabilities | 549 | 76 |
| Total liabilities | 30,717 | 29,972 |
| Stockholders' equity: | | |
| Common stock | 57 | 55 |
| Additional paid-in capital | 126,143 | 114,618 |
| Accumulated deficit | (97,739) | (97,377) |
| Accumulated other comprehensive loss | (162) | (149) |
| Total stockholders' equity | 28,299 | 17,147 |
| Total liabilities and stockholders' equity | <u>\$ 59,016</u> | <u>\$ 47,119</u> |

See accompanying notes to condensed consolidated financial statements.

ShotSpotter, Inc.
Condensed Consolidated Statements of Operations
(In thousands, except share and per share data)
(Unaudited)

| | Three Months Ended March 31, | |
|---|------------------------------|------------|
| | 2019 | 2018 |
| Revenues | \$ 9,593 | \$ 6,907 |
| Cost of revenues | 4,004 | 3,308 |
| Gross profit | 5,589 | 3,599 |
| Operating expenses | | |
| Sales and marketing | 2,629 | 1,554 |
| Research and development | 1,294 | 1,236 |
| General and administrative | 1,986 | 2,028 |
| Total operating expenses | 5,909 | 4,818 |
| Operating loss | (320) | (1,219) |
| Other income (expense), net | | |
| Interest income, net | 33 | 27 |
| Other income (expense), net | (57) | 1 |
| Total other income (expense), net | (24) | 28 |
| Loss before income taxes | (344) | (1,191) |
| Provision for income taxes | 18 | 26 |
| Net loss | \$ (362) | \$ (1,217) |
| Net loss per share, basic and diluted | \$ (0.03) | \$ (0.12) |
| Weighted average shares used in computing net loss per share, basic and diluted | 11,005,781 | 10,067,830 |

See accompanying notes to condensed consolidated financial statements.

ShotSpotter, Inc.
Condensed Consolidated Statements of Comprehensive Loss
(In thousands)
(Unaudited)

| | Three Months Ended | |
|--|---------------------------|-------------------|
| | March 31, | |
| | 2019 | 2018 |
| Net loss | \$ (362) | \$ (1,217) |
| Other comprehensive income (loss): | | |
| Change in foreign currency translation adjustment, net | (13) | 29 |
| Comprehensive loss | <u>\$ (375)</u> | <u>\$ (1,188)</u> |

See accompanying notes to condensed consolidated financial statements.

ShotSpotter, Inc.
Condensed Consolidated Statements of Stockholders' Equity
(In thousands, except share data)
(Unaudited)

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|---|-------------------|--------------|----------------------------------|------------------------|---|----------------------------------|
| | Shares | Par Value | | | | |
| Balance at December 31, 2018 | 10,864,722 | \$ 55 | \$ 114,618 | \$ (97,377) | \$ (149) | \$ 17,147 |
| Exercise of stock options | 177,408 | 1 | 218 | | | 219 |
| Issuance of common stock upon secondary offering, net of costs | 250,000 | 1 | 10,553 | | | 10,554 |
| Issuance of common stock from RSUs vested | 28,790 | — | — | | | — |
| Stock-based compensation | | | 754 | | | 754 |
| Other comprehensive loss | | | | | (13) | (13) |
| Net loss | | | | (362) | | (362) |
| Balance at March 31, 2019 | <u>11,320,920</u> | <u>\$ 57</u> | <u>\$ 126,143</u> | <u>\$ (97,739)</u> | <u>\$ (162)</u> | <u>\$ 28,299</u> |

| | Common Stock | | Additional Paid-in Capital | Accumulated Deficit | Accumulated Other Comprehensive Income | Total Stockholders' Equity |
|---|-------------------|--------------|----------------------------------|------------------------|---|----------------------------------|
| | Shares | Par Value | | | | |
| Balance at December 31, 2017 | 9,827,129 | \$ 48 | \$ 109,708 | \$ (97,595) | \$ 1 | \$ 12,162 |
| Exercise of stock options | 486,588 | 3 | 340 | | | 343 |
| Issuance of common stock in connection with exercise of warrants | 16,129 | — | — | | | — |
| Stock-based compensation | | | 427 | | | 427 |
| Other comprehensive income | | | | | 29 | 29 |
| Cumulative effect of change in accounting principle | | | | 3,025 | | 3,025 |
| Net loss | | | | (1,217) | | (1,217) |
| Balance at March 31, 2018 | <u>10,329,846</u> | <u>\$ 51</u> | <u>\$ 110,475</u> | <u>\$ (95,787)</u> | <u>\$ 30</u> | <u>\$ 14,769</u> |

See accompanying notes to condensed consolidated financial statements.

ShotSpotter, Inc.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

| | Three Months Ended March 31, | |
|---|------------------------------|------------|
| | 2019 | 2018 |
| Cash flows from operating activities: | | |
| Net loss | \$ (362) | \$ (1,217) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 1,238 | 817 |
| Stock-based compensation | 754 | 427 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 7,892 | (2,439) |
| Prepaid expenses and other assets | 195 | 11 |
| Accounts payable | (346) | 305 |
| Accrued expenses and other current liabilities | (810) | (834) |
| Deferred revenue | 344 | 706 |
| Net cash provided by (used in) operating activities | 8,905 | (2,224) |
| Cash flows from investing activities: | | |
| Purchase of property and equipment | (896) | (2,985) |
| Investment in intangible and other assets | (34) | (10) |
| Net cash used in investing activities | (930) | (2,995) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock upon secondary offering | 11,247 | — |
| Payments of offering costs | (127) | — |
| Proceeds from exercise of stock options | 219 | 342 |
| Net cash provided by financing activities | 11,339 | 342 |
| Increase (decrease) in cash, cash equivalents and restricted cash | 19,314 | (4,877) |
| Effect of exchange rate on cash and cash equivalents | (8) | 42 |
| Cash, cash equivalents and restricted cash at beginning of year | 10,278 | 19,597 |
| Cash, cash equivalents and restricted cash at end of period | \$ 29,584 | \$ 14,762 |
| Supplemental cash flow disclosures: | | |
| Offering costs included in accounts payable | \$ 317 | \$ — |

See accompanying notes to condensed consolidated financial statements.

ShotSpotter, Inc.
Notes to Condensed Consolidated Financial Statements

Note 1. Organization and Description of Business

ShotSpotter, Inc. (the “Company”) provides precision-policing solutions for law enforcement to help deter gun violence and make cities, campuses and facilities safer. The company’s flagship product, ShotSpotter Flex, is the leading outdoor gunshot detection, location and forensic system trusted by approximately 100 cities. ShotSpotter Missions uses artificial intelligence-driven analysis to help strategically plan patrol missions and tactics for maximum crime deterrence. The Company offers its solutions on a SaaS-based subscription model to its customers.

The Company’s principal executive offices are located in Newark, California. The Company has two wholly-owned subsidiaries, ShotSpotter (Pty) Ltd. formed in South Africa and ShotSpotter Colombia S.A.S. which was formed in Colombia in March 2019.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (“U.S. GAAP”) and applicable rules and regulations of the Securities and Exchange Commission (“SEC”) regarding interim financial reporting. Certain information and note disclosures normally included in the consolidated financial statements prepared in accordance with U.S. GAAP have been condensed or omitted pursuant to such rules and regulations. The condensed consolidated financial statements include the results of the Company and its wholly-owned subsidiaries. All significant intercompany transactions have been eliminated during consolidation.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements reflect all normal recurring adjustments necessary to present fairly the financial position, results of operations, comprehensive loss, stockholder’s equity and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for the full year 2019 or any future period.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and reported amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its significant estimates including the valuation of accounts receivable, the lives of tangible and intangible assets, stock-based compensation expense, and accounting for revenue recognition and income taxes. Management bases its estimates on historical experience and on various other market-specific and relevant assumptions it believes to be reasonable under the circumstances. Actual results could differ from those estimates and such differences could be material to the Company’s financial position and results of operations.

Concentrations of Risk

Credit Risk – Financial instruments that potentially subject the Company to concentration of credit risk consisted primarily of restricted cash, cash and cash equivalents and accounts receivable from trade customers. The Company maintains its cash deposits at three domestic and one international financial institutions. The Company is exposed to credit risk in the event of default by a financial institution to the extent that cash and cash equivalents are in excess of the amount insured by the Federal Deposit Insurance Corporation. The Company generally places its cash and cash equivalents with high-credit quality financial institutions. To date, the Company has not experienced any losses on its cash and cash equivalents.

Concentration of Accounts Receivable –As of March 31, 2019, two customers accounted for 27% and 11% of the Company’s accounts receivable. Fluctuations in accounts receivable result from timing of the Company’s execution of contracts and collection of related payments. As of December 31, 2018, one customer accounted for 77% of the Company’s accounts receivable.

Concentration of Revenues –For the three months ended March 31, 2019, two customers accounted for 21% and 14% of the Company’s total revenues. For the three months ended March 31, 2018, two customers each accounted for 18% of the Company’s total revenues.

Concentration of Suppliers — The Company relies on a limited number of suppliers and contract manufacturers. In particular, a single supplier is currently the sole manufacturer of the Company’s proprietary sensors.

Accounting Pronouncements Recently Adopted

In February 2016, the FASB issued ASU 2016-02, *Leases* (Topic 842). There have been further amendments, including practical expedients, with the issuance of ASU 2018-01 in January 2018, ASU 2018-11 in July 2018 and ASU 2018-20 in December 2018. The amended guidance requires the recognition of lease assets and lease liabilities on the balance sheet for those leases with terms in excess of 12 months and currently classified as operating leases. Disclosure of key information about leasing arrangements is required. Effective January 1, 2019, the Company adopted Topic 842. The Company elected the optional transition method which allows entities to continue to apply historical accounting guidance in the comparative periods presented in the year of adoption.

At transition, lessees and lessors may elect to apply a package of practical expedients permitting entities not to reassess: (i) whether any expired or existing contracts are or contain leases; (ii) lease classification for any expired or existing leases and (iii) whether initial direct costs for any expired or existing leases qualify for capitalization under the amended guidance. These practical expedients must be elected as a package and consistently applied. The Company has elected to apply the package of practical expedients upon adoption.

The Company’s operating lease for its corporate headquarters office is impacted by the new standard and upon adoption, the Company recognized a right-of-use asset of \$0.9 million and related lease liabilities totaling \$0.9 million. See Note 10, *Leases*.

In July 2017, the FASB issued ASU 2017-11, *Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815)*. The amendments in Part I of ASU 2017-11 change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity’s own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments. The amendments in Part I of this ASU are effective for the Company as of January 1, 2019. The amendments in Part II of ASU 2017-11 replace the indefinite deferral of certain guidance in Topic 480 with a scope exception. The amendments in Part II of ASU 2017-11 do not require any transition guidance. The Company adopted Part I of this ASU as of January 1, 2019 and the adoption did not have any impact on the consolidated financial statements.

Note 3. Revenue Related Disclosures

As of December 31, 2018, the Company had total short-term and long-term deferred revenue of \$24.2 million. During the three months ended March 31, 2019, the Company recognized \$8.4 million in revenue from the beginning deferred revenue balance and \$1.1 million from new billings, and added \$9.8 million to total short-term and long-term deferred revenue from new billings.

As of January 1, 2018, upon the adoption of Accounting Standards Codification (“ASC”) Topic 606, *Revenue from Contracts with Customers* (“Topic 606”) the Company had total short-term and long-term deferred revenue of \$17.3 million. During the three months ended March 31, 2018, the Company recognized \$5.7 million in revenue from the beginning deferred revenue balance and \$1.2 million from new billings, and added \$7.7 million to total short-term and long-term deferred revenue from new billings.

As of March 31, 2019, the Company has estimated remaining performance obligations for contractually committed revenues of \$24.0 million, \$12.0 million, \$7.1 million, and \$0.7 million that will be recognized during the remainder of the year ending December 31, 2019, and years ended December 31, 2020, 2021, and 2022 through 2024, respectively. The timing of revenue recognition includes estimates of go live dates for contracts not yet live. Contractually committed revenue includes deferred revenue as of March 31, 2019 and amounts under contract that will be invoiced after March 31, 2019.

During the three months ended March 31, 2019, the Company recognized revenues of \$9.4 million from customers in the United States and \$0.2 million from a customer in South Africa.

During the three months ended March 31, 2018, the Company recognized revenues of \$6.7 million from customers in the United States and \$0.2 million from a customer in South Africa.

Accounts Receivable, net and Unbilled Revenue

Accounts receivable, net consist of trade accounts receivables from the Company's customers, net of allowance for doubtful accounts if deemed necessary. Accounts receivable are recorded as the invoiced amount. The Company does not require collateral or other security for accounts receivable. Unbilled revenue consists of revenue recognized in advance of invoicing the customer.

Note 4. Fair Value Measurements

In October 2018, upon the acquisition of certain technology, referred to as HunchLab, from Azavea, Inc., the Company recognized a contingent consideration liability classified within Level III of the fair value hierarchy because some of the inputs used in its measurement were neither directly or indirectly observable. The Company estimates the fair value of the contingent consideration based on management's estimates of (i) the probability of achieving the relevant revenue targets and (ii) the timing of achieving such targets. There were no changes in fair value of contingent consideration for the three months ended March 31, 2019.

Level III balances (in thousands):

| | As of March 31, 2019 | As of December 31, 2018 |
|--|-------------------------|----------------------------|
| Fair value of contingent consideration | \$ 750 | \$ 750 |

Note 5. Details of Certain Condensed Consolidated Balance Sheet Accounts

Prepaid expenses and other current assets (in thousands):

| | March 31, 2019 | December 31, 2018 |
|----------------------|-------------------|----------------------|
| Prepaid expenses | \$ 595 | \$ 832 |
| Deferred commissions | 655 | 629 |
| Other | 82 | 66 |
| | <u>\$ 1,332</u> | <u>\$ 1,527</u> |

Other assets (in thousands):

| | March 31, 2019 | December 31, 2018 |
|----------------------|-------------------|----------------------|
| Deferred commissions | \$ 1,541 | \$ 1,560 |
| Other | 97 | 362 |
| | <u>\$ 1,638</u> | <u>\$ 1,922</u> |

Accrued expenses and other current liabilities (in thousands):

| | March 31, 2019 | December 31, 2018 |
|----------------------------|-------------------|----------------------|
| Personnel-related accruals | \$ 1,967 | \$ 2,603 |
| Royalties payable | 114 | 130 |
| Professional fees | 122 | 396 |
| Sales/ use tax payable | 249 | 273 |
| Contingent consideration | 750 | 750 |
| Operating lease liability | 282 | — |
| Deferred rent | — | 24 |
| Other | 476 | 251 |
| | <u>\$ 3,960</u> | <u>\$ 4,427</u> |

Other liabilities (in thousands):

| | March 31, 2019 | December 31, 2018 |
|---------------------------|-------------------|----------------------|
| Operating lease liability | \$ 545 | \$ — |
| Deferred rent | — | 71 |
| Other | 4 | 5 |
| | <u>\$ 549</u> | <u>\$ 76</u> |

Note 6. Capital Stock*Common Stock*

The Company is authorized to issue 500,000,000 shares of common stock, with a par value of \$0.005 and each outstanding share of common stock is entitled to one vote.

At March 31, 2019, there were 11,320,920 shares of common stock issued and outstanding. At December 31, 2018, there were 10,864,722 shares of common stock issued and outstanding.

Preferred Stock

The Company is authorized to issue 20,000,000 shares of preferred stock, with a par value of \$0.005. As of March 31, 2019, there were no shares of preferred stock issued and outstanding.

Note 7. Net Loss per Share

The following table summarizes the computation of basic and diluted net loss per share (in thousands, except share and per share data):

| | Three Months Ended March 31, | |
|--|------------------------------|------------|
| | 2019 | 2018 |
| Numerator: | | |
| Net loss | \$ (362) | \$ (1,217) |
| Denominator: | | |
| Weighted-average shares outstanding, basic and diluted | 11,005,781 | 10,067,830 |
| Net loss per share | \$ (0.03) | \$ (0.12) |

The following potentially dilutive shares outstanding at the end of the periods presented were excluded in the calculation of diluted net loss per share as the effect would have been anti-dilutive:

| | As of March 31, | |
|-----------------------------------|-----------------|-----------|
| | 2019 | 2018 |
| Options to purchase common stock | 706,472 | 801,397 |
| Unvested restricted stock units | 121,571 | 129,575 |
| Warrants to purchase common stock | 163,713 | 445,611 |
| Total | 991,756 | 1,376,583 |

Note 8. Common Stock Warrants

As of March 31, 2019, the Company had the following common stock warrants issued and outstanding (in thousands, except share and per share data):

| Warrant Class | Shares | Issuance Date | Price per Share | Expiration Date |
|--------------------------|---------|---------------|-----------------|-----------------|
| Common stock warrant | 3,766 | July 2012 | \$ 5.8667 | July 2019 |
| Common stock warrant | 25,231 | August 2012 | \$ 5.8667 | August 2019 |
| Common stock warrant | 50,716 | February 2014 | \$ 0.1700 | February 2021 |
| Common stock warrant (1) | 84,000 | June 2017 | \$ 13.2000 | June 2020 |
| | 163,713 | | | |

(1) This warrant was issued to the Company's lead underwriter in connection with the Company's initial public offering.

Note 9. Equity Incentive Plans

2017 Equity Incentive Plan

In May 2017, the Board and the Company's stockholders approved the 2017 Equity Incentive Plan (the "2017 Plan"), which became effective in connection with the IPO. The 2017 Plan provides for the issuance of stock options, restricted stock units and other awards to employees, directors and consultants of the Company. A total of 2,413,659 shares of the Company's common stock were initially reserved for issuance under the 2017 Plan, which is the sum of (1) 900,000 shares, (2) the number of shares reserved for issuance under the 2005 Plan at the time the 2017 Plan became effective and (3) shares subject to stock options or other stock awards under the 2005 Plan that would have otherwise been returned to the 2005 Plan (up to a maximum of 1,314,752 shares). Under an "evergreen" provision, the number of shares of common stock reserved for issuance under the 2017 Plan will automatically increase on January 1 of each year, beginning on January 1, 2018 and ending on and including January 1, 2027, by of 5% of the total number of shares of our capital stock outstanding on December 31 of the preceding calendar year or a lesser number of shares determined by our Board of Directors. In accordance with the evergreen provision, the number of shares of common stock reserved for issuance under our 2017 Plan was automatically increased on January 1, 2019 by 543,236 shares, which was equal to 5% of the total number of shares of capital stock outstanding on December 31, 2018.

2005 Stock Plan

In February 2005, the Company adopted the 2005 Stock Plan, as amended in January 2010 and November 2012 (the "2005 Plan"). Under the 2005 Plan provisions, the Company was authorized to grant incentive stock options, non-qualified stock options, stock appreciation rights, restricted stock units, and shares of restricted stock.

Following the effectiveness of the 2017 Plan in connection with the IPO, no further grants were made under the 2005 Plan.

A summary of option activities under the 2005 Plan and 2017 Plan during the three months ended March 31, 2019 is as follows:

| | Number of Options Outstanding | Weighted Average Exercise Price |
|-------------------------------------|-------------------------------------|--|
| Outstanding as of December 31, 2018 | 820,186 | \$ 8.44 |
| Granted | 73,280 | \$ 44.95 |
| Exercised | (177,408) | \$ 1.23 |
| Canceled | (9,586) | \$ 4.91 |
| Outstanding as of March 31, 2019 | <u>706,472</u> | <u>\$ 14.09</u> |

During the three months ended March 31, 2019, the company granted executive management restricted stock unit (“RSU”) awards totaling 39,597 shares of common stock, with quarterly vesting over the next four years. The weighted average fair value of \$44.95 per unit was calculated using the closing stock price on the grant date.

The number of shares available for grant under the 2017 Plan was 1,688,369 as of March 31, 2019.

2017 Employee Stock Purchase Plan

In May 2017, the Board and the Company’s stockholders adopted the 2017 Employee Stock Purchase Plan (“2017 ESPP”), which became effective in connection with the Company’s IPO. The 2017 ESPP allows eligible employees to purchase shares of the Company’s common stock in an offering at a discount of the then-current trading price, up to the lesser of (1) 85% of the fair market value of the common stock on the first day of the IPO or (2) 85% of the fair market value of the common stock on the purchase date. The 2017 ESPP permits the maximum discounted purchase price permitted under U.S. tax rules, including a “lookback.”

The 2017 ESPP initial offering period runs for approximately 24 months in length, and contains four 6-month purchase periods. An employee’s purchase rights terminate immediately upon termination of employment or other withdrawal from the 2017 ESPP. No participant will have the right to purchase shares of common stock in an amount that has a fair market value of more than \$25,000 determined as of the first day of the applicable purchase period, for each calendar year.

There are 200,000 shares of common stock reserved for issuance under the 2017 ESPP. In addition, the 2017 ESPP contains an “evergreen” provision which provides for an automatic annual share increase on January 1 of each year, in an amount equal to the lesser of (1) 2% of the total number of shares of common stock outstanding on December 31st of the preceding calendar year, (2) 150,000 shares or (3) such number of shares as determined by the Board. In accordance with the evergreen provision, the number of shares of common stock reserved for issuance under our 2017 ESPP was automatically increased on January 1, 2019 by 150,000 shares.

The Company accounts for employee stock purchases made under its 2017 ESPP using the estimate grant date fair value of accounting in accordance with ASC 718, *Stock Compensation*. The Company values ESPP shares using the Black-Scholes model.

There were no shares issued under the 2017 ESPP during the three months ended March 31, 2019.

Total stock-based compensation expense associated with the 2005 Plan, 2017 Plan and 2017 ESPP is recorded in the condensed consolidated statements of operations and was allocated as follows (in thousands):

| | Three Months Ended March 31, | |
|----------------------------|------------------------------|---------------|
| | 2019 | 2018 |
| Cost of revenues | \$ 133 | \$ 57 |
| Sales and marketing | 266 | 66 |
| Research and development | 87 | 40 |
| General and administrative | 268 | 264 |
| Total | <u>\$ 754</u> | <u>\$ 427</u> |

Note 10. Leases*Operating Lease*

The Company leases its principal executive offices in Newark, California, under a non-cancelable operating lease which expires in October 2021. This lease does not have significant rent escalation holidays, concessions, leasehold improvement incentives, or other build-out clauses. Further, the lease does not contain contingent rent provisions or renewal options. Our lease includes both lease (e.g., fixed payments including rent, taxes, and insurance costs) and non-lease components (e.g., common-area or other maintenance costs) which are accounted for as a single lease component as we have elected the practical expedient to group lease and non-lease components for all leases. Upon adoption of ASC 842 on January 1, 2019, the Company recognized an operating lease right-of-use asset of \$0.9 million and a corresponding lease liability of \$0.9 million, using a discount rate of 6% which reflects the Company's incremental borrowing rate for a similar asset and similar term as of the date of adoption. The operating lease cost recognized for the three months ended March 31, 2019 was \$0.1 million. Rent expense recognized for the three months ended March 31, 2018 was \$0.1 million.

Supplemental information related to the operating lease as follows (in thousands):

| | <u>As of March 31, 2019</u> |
|--|--|
| Assets | |
| Operating lease right-of-use asset | \$ 765 |
| Liabilities | |
| Lease liability (short-term) <i>(presented within Accrued expenses and other current liabilities)</i> | \$ 282 |
| Lease liability (long-term) <i>(presented within Other liabilities)</i> | 545 |
| Total operating lease liability | <u>\$ 827</u> |
| | <u>Three months ended March 31, 2019</u> |
| Cash paid for amounts included in the measurement of lease liabilities <i>(presented within Operating cash flows)</i> | \$ 86 |

Maturities of the lease liability at March 31, 2019 are as follows (in thousands):

| | |
|------------------------------------|---------------|
| 2019 (remainder of year) | \$ 232 |
| 2020 | 357 |
| 2021 | 304 |
| Total lease payments, undiscounted | 893 |
| Less: imputed interest | (66) |
| Total | <u>\$ 827</u> |

The Company does not have any finance leases.

The following table is shown for comparative purposes only. The future minimum lease payments under the non-cancelable lease at December 31, 2018 are as follows (in thousands):

| | |
|-------|-----------------|
| 2019 | \$ 352 |
| 2020 | 357 |
| 2021 | 304 |
| Total | <u>\$ 1,013</u> |

Note 11. Commitments and Contingencies

The Company has data center non-cancelable contracts that exceed one year.

The following is a schedule of future minimum data center arrangements under the non-cancelable operating commitments at March 31, 2019 (in thousands):

| | Data Center Arrangements |
|--------------------------|-------------------------------------|
| 2019 (remainder of year) | \$ 160 |
| 2020 | 71 |
| Total | <u>\$ 231</u> |

Contingencies

On August 28, 2018, Silvon S. Simmons (the "Plaintiff") amended a complaint against the City of Rochester, New York and various city employees, filed in the United States District Court, Western District of New York, to add the Company and employees as a defendant. The amended complaint alleges conspiracy to violate plaintiff's civil rights, denial of the right to a fair trial, and malicious prosecution. The Plaintiff claims that ShotSpotter colluded with the City of Rochester to fabricate and create gunshot alert evidence to secure Plaintiff's conviction. On the basis of the allegations, the Plaintiff has petitioned for compensatory and punitive damages and other costs and expenses, including attorney's fees. The Company believes that the Plaintiff's claims are without merit and are disputing them vigorously.

The Company may become subject to legal proceedings, as well as demands and claims that arise in the normal course of business. Such claims, even if not meritorious, could result in the expenditure of significant financial and management resources. The Company makes a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed and adjusted to include the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel, and other information and events pertaining to a particular matter.

An unfavorable outcome on any litigation matters could require payment of substantial damages, or, in connection with any intellectual property infringement claims, could require the Company to pay ongoing royalty payments or could prevent the Company from selling certain of our products. As a result, a settlement of, or an unfavorable outcome on, any of the matters referenced above or other litigation matters could have a material adverse effect on the Company's business, operating results, financial condition and cash flows.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

You should read the following discussion and analysis of our financial condition and results of operations together with our unaudited condensed consolidated financial statements and accompanying notes included in this Quarterly Report on Form 10-Q and the financial statements and accompanying notes and other financial information in the Management's Discussion and Analysis of Financial Condition and Results of Operations included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018, filed with the Securities and Exchange Commission ("SEC") on March 4, 2019 ("Annual Report"). This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. These statements are often identified by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may," "plan," "project," "will," "would" or the negative or plural of these words or similar expressions or variations. Such forward-looking statements are subject to a number of risks, uncertainties, assumptions and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified herein, and those discussed in the section titled "Risk Factors", set forth in Part II, Item 1A of this Quarterly Report on Form 10-Q and in our other SEC filings. You should not rely upon forward-looking statements as predictions of future events. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.

Overview

We provide precision-policing and security solutions for law enforcement and security personnel to help deter gun violence and make cities, campuses and facilities safer. Our flagship public safety solution, ShotSpotter Flex, is the leading outdoor gunshot detection, location and alerting system. Our newly-acquired patrol management software, ShotSpotter Missions (formerly HunchLab), creates crime forecasts designed to enable more precise and effective use of patrol resources to deter crime. Recently we created a new technology innovation unit – ShotSpotter Labs – to expand our efforts supporting innovative uses of our technology to help protect wildlife and the environment. Our security solutions, ShotSpotter SecureCampus and ShotSpotter SiteSecure, are designed to help law enforcement and security personnel serving universities, corporate campuses and key infrastructure or transportation centers mitigate risk and enhance security by notifying authorities of a potential outdoor gunfire incident, saving critical minutes for first responders to arrive. Our gunshot detection solutions are trusted in approximately 100 cities as of March 31, 2019.

Our gunshot detection solutions consist of highly-specialized, cloud-based software integrated with proprietary, internet-enabled sensors designed to detect outdoor gunfire. The speed and accuracy of our gunfire alerts enable law enforcement and security personnel to reduce their response times to shooting events, which can increase the chances of apprehending the shooter, providing timely aid to victims, and identifying witnesses before they scatter, as well as aid in evidentiary collection and serve as an overall deterrent. When a potential gunfire incident is detected by our sensors, our system applies machine learning combined with human review to analyze and validate the incident and precisely locate where the incident occurred. An alert containing a location on a map and critical information about the incident is transmitted directly to subscribing law enforcement or security personnel through any internet-connected computer and to iPhone or Android mobile devices.

Our software transmits validated gunfire data along with a recorded digital file of the triggering sound to our Incident Review Center ("IRC"), where our trained acoustic experts are on duty 24 hours a day, seven days a week, 365 days a year to screen and confirm actual gunfire incidents. Our acoustic experts can supplement alerts with additional tactical information, such as the potential presence of multiple shooters or the use of high-capacity weapons. Gunshot incidents reviewed by our IRC result in alerts typically sent within 45 seconds of the receipt of the gunfire incident.

We generate annual subscription revenues from the deployment of ShotSpotter Flex on a per-square-mile basis. Our security solutions, ShotSpotter SecureCampus and ShotSpotter SiteSecure, are typically sold on a subscription basis, each with a customized deployment plan. Our ShotSpotter Missions solution pricing is under development, but will also be subscription based. As of March 31, 2019, we had ShotSpotter Flex, ShotSpotter SecureCampus and ShotSpotter SiteSecure coverage areas under contract for approximately 680 square miles, of which 660 square miles had gone live. These coverage areas included 99 cities and 11 campuses/sites across the United States and in South Africa, including three of the ten largest cities in the United States. During the three months ended March 31, 2019, we changed the classification of one customer to be a SiteSecure customer instead of a city customer. For the three months ended March 31, 2019, substantially all of our revenues are attributable to customers based in the United States.

While we intend to continue to devote resources to increase sales of our ShotSpotter SecureCampus, ShotSpotter SiteSecure solutions, and ShotSpotter Missions, we expect that revenues from our ShotSpotter Flex solution will continue to comprise a substantial majority of our revenues going forward.

We enter into subscription agreements on a term basis that typically range from one to five years in duration, with the majority having a contract term of one year. Substantially all of our sales are to governmental agencies and universities, which often undertake a prolonged contract evaluation process that affects the size or the timing of our sales contracts and may likewise increase our customer acquisition costs. For a discussion of the risks associated with our sales cycle, see risks entitled “Our sales cycle can be unpredictable, time-consuming and costly, and our inability to successfully complete sales could harm our business” and “Because we generally recognize our subscription revenues ratably over the term of our contract with a customer, fluctuations in sales will not be fully reflected in our operating results until future periods” in Part II, Item 1A, *Risk Factors*, included in this Quarterly Report on Form 10-Q.

We rely on a limited number of suppliers and contract manufacturers to produce components of our solutions. We have no long-term contracts with these manufacturers and purchase from them on a purchase-order basis. Our outsourced manufacturers generally procure the components directly from third-party suppliers. Although we use a limited number of suppliers and contract manufacturers, we believe that we could find alternate suppliers or manufacturers if circumstances required us to do so, in part because a significant portion of the components required by our solutions is available off the shelf. For a discussion of the risks associated with our limited number of suppliers, see risk entitled “We rely on a limited number of suppliers and contract manufacturers, and our proprietary ShotSpotter sensors are manufactured by a single contract manufacturer” in Part II, Item 1A, *Risk Factors*, included in this Quarterly Report on Form 10-Q.

We generated revenues of \$9.6 million and \$6.9 million for the three months ended March 31, 2019 and 2018, respectively, a year-over-year increase of 39%. Revenues from our ShotSpotter Flex during the three months ended March 31, 2019 and 2018 represented approximately 96% and 99% of total revenues, respectively. Our two current largest customers, the City of Chicago and the City of New York, accounted for 21% and 14%, respectively, of our total revenues for the three months ended March 31, 2019, and each accounted for 18% of our total revenues for the three months ended March 31, 2018.

For the three months ended March 31, 2019 and 2018, revenues generated within the United States accounted for \$9.4 million and \$6.7 million, respectively, or 97% of total revenues for the both periods, and \$0.2 million for both three months ended March 2019 and 2018, and was derived from our customer located in South Africa.

We had net losses of \$0.4 million and \$1.2 million for the three months ended March 31, 2019 and 2018, respectively. Our accumulated deficit was \$97.7 million and \$97.4 million as of March 31, 2019 and December 31, 2018, respectively.

During the three months ended March 31, 2019 and 2018 we went “live” on 12 and 47 net new square miles of coverage, respectively. During the three months ended March 31, 2019, the increase in coverage was achieved through new customers, and is net of miles lost from a customer no longer under contract. During the three months ended March 31, 2018, 31 miles out of 47 were due to expansion from a single customer.

Net New “Go-Live” Miles

Net new “go-live” square miles represent the square miles covered by deployments that were formally approved by customers during the quarter, both from initial and expanded customer deployments, net of square miles that ceased to be “live” during the quarter due to customer cancellations. New square miles include deployed square miles that may have been sold, or booked, in prior quarters. We focus on net new “go-live” miles as a key business metric to measure our operational performance and inform strategic decisions.

This metric, presented below for the three months ended March 31, 2019 and 2018, is calculated on a quarterly basis using internal data and may be calculated in a manner different than similar metrics used by other companies.

| | Three Months Ended | |
|--------------------------------------|--------------------|------|
| | March 31, | |
| | 2019 | 2018 |
| Net new "go-live" square miles added | 12 | 47 |

We have focused on rapidly growing our business and believe that its future growth is dependent on many factors, including our ability to increase our customer base, expand the coverage of our solutions among our existing customers, expand our international presence and increase sales of our security solutions. Our future growth will primarily depend on the market acceptance for outdoor gunshot detection solutions. Challenges we face in this regard include our target customers not having access to adequate funding sources, the fact that contracting with government entities can be complex, expensive, and time-consuming and the fact that our typical sales cycle is often very long and can be costly. To combat these challenges, we invest in research and development, increase awareness of our solutions, and hire additional sales representatives to drive sales in order to continue to maintain our position as a market leader. In addition, we believe that entering into strategic partnerships with other service providers to cities and municipalities offers another potential avenue for expansion, particularly for our ShotSpotter Flex solution.

We will also focus on expanding our business by introducing new products and services to existing customers such as ShotSpotter Missions and ShotSpotter Labs. We believe that developing and acquiring products for law enforcement in adjacent categories is a path for additional growth given our large and growing installed base of police departments who trust ShotSpotter's products, support and way of doing business. The ability to cross-sell new products provides an opportunity to grow revenue per customer and lifetime value. Challenges we face in this area include ensuring our new products are reliable, integrated well with other ShotSpotter solutions and priced and serviced appropriately. In some cases, we will need to bring in new skills sets to properly develop, market, sell or service these new products depending on the categories they represent.

In October 2018, we acquired the HunchLab technology and related assets that underline our ShotSpotter Missions solution. ShotSpotter Missions applies risk modeling and artificial intelligence to help forecast when and where crimes are likely to emerge and recommends specific patrol missions and tactics that can deter these events. The HunchLab technology provides a proven, high-value, and complementary solution we can immediately offer to our existing law enforcement customers. We believe our investment will democratize the sharing of important intelligence with patrol officers who currently have limited direct access to crime analysts.

With respect to international sales, we believe that we have the potential to expand our coverage within South Africa and to pursue opportunities in Europe, South America and other regions of the world. For example, we signed a contract with the Bahamas in early 2019. By adding additional sales resources in strategic locations, we believe we will be better positioned to reach these markets. However, we recognize that we have limited international operational experience and currently operate in a limited number of regions outside of the United States. Operating successfully in international markets will require significant resources and management attention and will subject us to additional regulatory, economic and political risks. Moreover, we anticipate that different political and regulatory considerations that vary across different jurisdictions could extend what is already a lengthy sales cycle.

Components of Results of Operations

Presentation of Financial Statements

Our condensed consolidated financial statements include the accounts of our wholly-owned Colombian and South African subsidiaries, ShotSpotter Colombia S.A.S. and ShotSpotter (Pty) Ltd. All intercompany balances and transactions have been eliminated in consolidation.

Revenues

We derive substantially all of our revenues from subscription services. We recognize subscription fees ratably, on a straight-line basis, over the term of the subscription, which for new customers is typically initially one to three years in length. Customer contracts include one-time set-up fees for the set-up of our sensors in the customer's coverage areas, training and third-party integration licenses. If the set-up fees are deemed to be a material right, they are recognized ratably over three years. Training and third-party integration license fees are recognized upon delivery.

We generally invoice customers for 50% of the total contract value when the contract is fully executed and for the remaining 50% when the subscription service is operational and ready to go live – that is, when the customer has acknowledged the completion of all the deliverables in the signed customer acceptance form. All fees billed in advance of services being delivered are recorded as deferred revenue. The timing of when new miles go live can be uncertain and, as a result, can have a significant impact on the levels of revenue and deferred revenue from quarter to quarter. For our ShotSpotter Flex solution, our pricing model is based on a per-square-mile basis. For our ShotSpotter Missions solution, our final pricing model is still evolving, but is currently based on a percentage of Flex subscription price, for customers using Flex, and on a customized basis for customers not using Flex. For ShotSpotter SecureCampus and ShotSpotter SiteSecure, our pricing model is on a customized-site basis. As a result of our process for invoicing contracts and renewals upon execution, our cash flow from operations and accounts receivable can fluctuate due to timing of contract execution and timing of deployment.

We generally invoice subscription service renewals for 100% of the total contract value when the renewal contract is executed. Renewal fees are recognized ratably over the term of the renewal, which is typically one year. While most of our customers elect to renew their agreements, in some cases, they may not be able to obtain the proper approvals or funding to complete the renewal prior to expiration. For these customers, we stop recognizing subscription revenues at the end of the current contract term, even though we may continue to provide services for a period of time until the renewal process is completed. Once the renewal is complete, we then recognize subscription revenues for the period between the expiration of the term of the agreement and the completion of the renewal process in the month in which the renewal is executed. If a customer declines to renew its subscription prior to the end of three years, then the remaining setup fees are immediately recognized.

It is likely that international deployments may have different payment and billing terms due to their local laws, restrictions or other customary terms and conditions.

Cost of Revenues

Costs include the cost of revenues and charges for impairment of property and equipment. Cost of revenues primarily includes depreciation expense associated with capitalized customer acoustic sensor networks, communication expenses, costs related to hosting our service application, costs related to operating our Incident Review Center (the "IRC"), providing remote and on-site customer support and maintenance and forensic services, certain personnel and related costs of operations, stock-based compensation and allocated overhead, which includes IT, facility and equipment depreciation costs.

Starting mid-2020 through 2022, we will have to upgrade our sensors that use third-generation cellular communications to the fourth-generation Long-Term Evolution wireless technology, which will increase our cost of revenues.

In the near term, we expect our cost of revenues to increase in absolute dollars to the extent our installed base increases, but decrease as a percentage of revenues because certain of our costs of revenues are fixed and do not need to increase commensurate with increases in revenues. In addition, depreciation expense associated with deployed equipment is recognized only over the first five years of a customer contract.

Operating Expenses

Operating expenses consist of sales and marketing, research and development, and general and administrative expenses. Salaries, bonuses, stock-based compensation expense and other personnel costs are the most significant components of each of these expense categories. We include stock-based compensation expense incurred in connection with the grant of stock options and restricted stock units to the applicable operating expense category based on the equity award recipient's functional area.

We are focused on executing on our growth strategy. As a result, in the near term we expect our total operating expenses to increase in absolute dollars as we incur additional expenses due to growth and as a result of operating as a public company. Although our operating expenses will fluctuate, we expect that over time, they will generally decrease as a percentage of revenues.

Sales and Marketing

Sales and marketing expenses primarily consist of personnel-related costs attributable to our sales and marketing personnel, commissions earned by our sales personnel, marketing expenses for trade shows, conferences and conventions, consulting fees, travel and facility-related costs and allocated overhead.

In the near term, we expect our sales and marketing expenses to increase in absolute dollars primarily due to planned growth in our sales and marketing organization. This growth will include adding sales and marketing personnel and expanding our marketing activities to continue to generate additional leads. Sales and marketing expense may fluctuate from quarter to quarter based on the timing of commission expense, marketing campaigns and tradeshow.

Research and Development

Research and development expenses primarily consist of personnel-related costs attributable to our research and development personnel, consulting fees and allocated overhead. We have devoted our product development efforts primarily to develop new lower-cost sensor hardware, develop new features including a mobile application, improve functionality of our solutions and adapt to new technologies or changes to existing technologies.

We are investing in engineering resources to support further development of the ShotSpotter Missions crime forecasting software. The focus of this effort will be in the areas of data science modeling, user experience, core application functionality and backend infrastructure improvements, including integration of ShotSpotter gunshot data to enhance forecasting of gun violence.

In the near term, we expect our research and development expenses to increase in absolute dollars as we increase our research and development headcount to further strengthen our software and invest in the development of our service.

We will continue to invest in research and development to leverage our large and growing database of acoustic events, which includes those from both gunfire and non-gunfire. We also intend to leverage third-party AI and our own evolving cognitive and analytical applications to improve the efficiency of our solutions, which may include internal software applications, data analysis, event routing and customer outputs. Certain of these applications and outputs may expand the platform of services that we will be able to offer our customers.

General and Administrative

General and administrative expenses primarily consist of personnel-related costs attributable to our executive, finance, and administrative personnel, legal, accounting and other professional services fees, other corporate expenses and allocated overhead. We have recently incurred additional expenses in expanding our operations, including increased personnel, legal, insurance and accounting expenses, and the additional costs of achieving and maintaining compliance with Section 404 of the Sarbanes-Oxley Act and other regulations.

In the near term, we expect our general and administrative expenses to increase significantly in absolute dollars as we grow our business, support our operations as a public company and increase our headcount.

Other Expense, Net

Other expense, net, consists primarily of local and franchise tax expenses.

Income Taxes

Our income taxes are based on the amount of our taxable income and enacted federal, state and foreign tax rates, adjusted for allowable credits, deductions and the valuations allowance against deferred tax assets, as applicable.

Results of Operations

Comparison of Three Months Ended March 31, 2019 and 2018

The following table sets forth our selected condensed consolidated statements of operations data for the three months ended March 31, 2019 and 2018 (in thousands):

| | Three Months Ended March 31, | | | | Change | |
|-----------------------------|-------------------------------------|-------------------------------|-------------|-------------------------------|---------------|----------|
| | 2019 | As a % of Revenues | 2018 | As a % of Revenues | \$ | % |
| Revenues | \$ 9,593 | 100 % | \$ 6,907 | 100 % | \$ 2,686 | 39 % |
| Cost of revenues | 4,004 | 42 % | 3,308 | 48 % | 696 | 21 % |
| Gross profit | 5,589 | 58 % | 3,599 | 52 % | 1,990 | 55 % |
| Operating expenses: | | | | | | |
| Sales and marketing | 2,629 | 27 % | 1,554 | 22 % | 1,075 | 69 % |
| Research and development | 1,294 | 13 % | 1,236 | 18 % | 58 | 5 % |
| General and administrative | 1,986 | 21 % | 2,028 | 29 % | (42) | (2 %) |
| Total operating expenses | 5,909 | 62 % | 4,818 | 70 % | 1,091 | 23 % |
| Loss from operations | (320) | (3 %) | (1,219) | (18 %) | 899 | (74 %) |
| Other income (expense), net | (24) | — | 28 | — | (52) | (186 %) |
| Provision for income taxes | 18 | — | 26 | — | (8) | (31 %) |
| Net loss | \$ (362) | (4 %) | \$ (1,217) | (18 %) | \$ 855 | (70 %) |

Revenues

The increase of \$2.7 million was primarily attributable to new customers and expansions of existing customer coverage areas. We went live with 133 net new square miles since March 31, 2018.

Cost of Revenues

The increase of \$0.7 million was due primarily to a \$0.3 million increase in depreciation expenses associated with new customer deployment and expansions in existing customer coverage areas and a \$0.3 million increase in salaries expenses resulting from an increase in our headcount since March 31, 2018.

Gross margin increased by six percentage points because certain costs of revenues are fixed and did not increase commensurate with the increase in subscription revenues.

Operating Expenses

Sales and Marketing Expense

The increase of \$1.1 million was due primarily to a \$0.7 million increase in salaries, commissions and stock-based compensation expense resulting from an increase in headcount since March 31, 2018, and \$0.3 million in consulting expenses associated with the growth of our sales and marketing strategy.

Research and Development Expense

The increase of \$58,000 was due primarily to an increase in personnel expenses during the three months ended March 31, 2019.

General and Administrative Expense

The decrease of \$42,000 was due to a \$0.2 million decrease in legal expenses resulting from the settlement of litigation in 2018, partially offset by a \$0.1 million increase in salaries, benefits and bonuses resulting from an increase in headcount.

Other Income (Expense), Net

The decrease of \$52,000 in the three months ended March 31, 2019 was due to an increase in local and franchise taxes.

Income Taxes

Our income taxes are based on the amount of our taxable income and enacted federal, state and foreign tax rates, adjusted for allowable credits, deductions and the valuations allowance against deferred tax assets, as applicable. For the three months ended March 31, 2019 and 2018, our provision for income taxes consists of the foreign taxes only.

Liquidity and Capital Resources

Sources of Funds

Our operations have been financed primarily through net proceeds from the sale of equity, debt financing arrangements and cash from operating activities. Our principal source of liquidity is cash and cash equivalents totaling \$29.5 million as of March 31, 2019. We also have a \$10.0 million credit facility, of which no amounts outstanding as of March 31, 2019.

In March 2019, we issued and sold 250,000 shares of our common stock in an underwritten public offering, for which we received net proceeds of \$10.6 million after deducting estimated offering expenses.

We believe our existing cash and cash equivalent balances, our available credit facility and cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for at least the next 12 months. Our future capital requirements may vary materially from those currently planned and will depend on many factors, including our rate of revenue growth, the timing and extent of spending on sales and marketing, the expansion of sales and marketing activities, the timing of new product introductions, market acceptance of our products and overall economic conditions. We may also seek additional capital to fund our operations, including through the sale of equity or debt financings. To the extent that we raise additional capital through the future sale of equity, the ownership interest of our stockholders will be diluted, and the terms of these securities may include liquidation or other preferences that adversely affect the rights of our existing common stockholders. The incurrence of debt financing would result in debt service obligations and the instruments governing such debt could provide for operating and financing covenants that would restrict our operations.

Use of Funds

Our historical uses of cash have primarily consisted of cash used for operating activities, such as expansion of our sales and marketing operations, research and development activities and other working capital needs, and cash used in investing activities, such as property and equipment expenditures to install infrastructure in customer cities in order to deliver our solutions.

Cash Flows

Comparison of the Three Months Ended March 31, 2019 and 2018

The following table presents a summary of our cash flows for the three months ended March 31, 2019 and 2018:

| | March 31, | |
|---|------------------|-------------------|
| | 2019 | 2018 |
| | (in thousands) | |
| Net cash provided by (used in): | | |
| Operating activities | \$ 8,905 | \$ (2,224) |
| Investing activities | (930) | (2,995) |
| Financing activities | 11,339 | 342 |
| Net change in cash and cash equivalents | <u>\$ 19,314</u> | <u>\$ (4,877)</u> |

Operating Activities

For standard customer deployments, we typically achieve cashflow breakeven, on a direct variable cost-basis, in less than a year from the date of execution of the contract. Our net loss and cash flows provided by operating activities are significantly influenced by our increase in headcount to support our growth, increase in legal, outside services fees, and sales and marketing expenses, and our ability to bill and collect in a timely manner.

Net cash provided by (used in) operating activities increased \$11.1 million from the three months ended March 31, 2018 to the three months ended March 31, 2019 primarily due to a \$10.3 million increase in cash collected from customers, driven by new customer contracts and expansions of existing customer coverage areas since March 31, 2018.

Investing Activities

Our investing activities consist primarily of capital expenditures to install our solutions in customer coverage areas, purchases of property and equipment, and investment in intangible assets.

Investing activities used \$0.9 million and \$3.0 million in the three months ended March 31, 2019 and 2018, primarily for property and equipment expenditures to install our solutions in customer coverage areas.

Financing Activities

Cash generated by financing activities includes net proceeds from the exercise of stock options and warrants, proceeds from the employee stock purchase plan, proceeds from our secondary offering, offset by payment of indebtedness, and debt issuance and financing costs.

Financing activities provided \$11.3 million in cash during the three months ended March 31, 2019 from \$11.2 million in proceeds from the issuance of common stock upon our secondary offering and \$0.2 million in proceeds from the exercise of options, partially offset by \$0.1 million of payment of secondary offering costs.

Contractual Obligations and Commitments

There were no material changes during the three months ended March 31, 2019 to the contractual obligations and commitments disclosed in the Management's Discussion and Analysis of Financial Condition and Results of Operations section of our 2018 Annual Report on Form 10-K. See Note 10, *Leases*, and Note 11, *Commitments and Contingencies*, to the notes to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information regarding commitments.

Off-Balance Sheet Arrangements

As of March 31, 2019, we did not have any relationships with unconsolidated organizations or financial partnerships, such as structured finance or special purpose entities, that were established for the purpose of facilitating off-balance sheet

arrangements. We do not engage in off-balance sheet financing arrangements. In addition, we do not engage in trading activities involving non-exchange traded contracts.

Critical Accounting Policies and Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles (“GAAP”). The preparation of our consolidated financial statements requires us to make estimates, assumptions and judgments that affect the reported amounts of revenues, assets, liabilities, costs and expenses. We base our estimates and assumptions on historical experience and other factors that we believe to be reasonable under the circumstances. We evaluate our estimates and assumptions on an ongoing basis. Our actual results may differ from these estimates.

For the significant or material changes in our critical accounting policies during the three months ended March 31, 2019, see Note 3, *Summary of Significant Accounting Policies*, to the notes of our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q.

Recently Issued Accounting Pronouncements

See Note 3, *Summary of Significant Accounting Policies*, to the notes to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q for a summary of recently issued accounting pronouncements.

Item 3. Qualitative and Quantitative Disclosures about Market Risk

Market risk represents the risk of loss that may impact our financial position due to adverse changes in financial market prices and rates. Our market risk exposure is primarily the result of fluctuations in interest rates and foreign exchange rates as well as, to a lesser extent, inflation.

There were no material changes in our market risk during the three months ended March 31, 2019, compared to the market risk disclosed in the Qualitative and Quantitative Disclosures about Market Risk section of our 2018 Annual Report on Form 10-K.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our management has evaluated, under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13-a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act) as of the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that as of March 31, 2019, our disclosure controls and procedures were effective to provide reasonable assurance that the information we are required to file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Exchange Act Rule 13a-15(f)) during the quarter ended March 31, 2019 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including our principal executive officer and principal financial officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

On August 28, 2018, Silvon S. Simmons (the "Plaintiff") amended a complaint against the City of Rochester, New York and various city employees, filed in the United States District Court, Western District of New York, to add us and employees as a defendant. The amended complaint alleges conspiracy to violate plaintiff's civil rights, denial of the right to a fair trial, and malicious prosecution. The Plaintiff claims that ShotSpotter colluded with the City of Rochester to fabricate and create gunshot alert evidence to secure Plaintiff's conviction. On the basis of the allegations, the Plaintiff has petitioned for compensatory and punitive damages and other costs and expenses, including attorney's fees. We believe that the Plaintiff's claims are without merit and are disputing them vigorously.

We may become subject to legal proceedings, as well as demands and claims that arise in the normal course of our business, including claims of alleged infringement of third-party patents and other intellectual property rights, breach of contract, employment law violations, and other matters and matters involving requests for information from us or our customers under federal or state law. Such claims, even if not meritorious, could result in the expenditure of significant financial and management resources. We make a provision for a liability relating to legal matters when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These provisions are reviewed and adjusted to include the impacts of negotiations, estimated settlements, legal rulings, advice of legal counsel, and other information and events pertaining to a particular matter.

An unfavorable outcome on any litigation matters could require payment of substantial damages, or, in connection with any intellectual property infringement claims, could require us to pay ongoing royalty payments or could prevent us from selling certain of our products. As a result, a settlement of, or an unfavorable outcome on, any of the matters referenced above or other litigation matters or legal proceedings could have a material adverse effect on our business, operating results, financial condition and cash flows.

Item 1A. RISK FACTORS

Risks Related to Our Business and Industry

Our success depends on maintaining and increasing our sales, which depends on factors we cannot control, including the availability of funding to our customers.

To date, substantially all of our revenues have been derived from contracts with local governments and their agencies, in particular the police departments of major cities in the United States. To a lesser extent, we also generate revenues from federal agencies, foreign governments and higher education institutions. We believe that the success and growth of our business will continue to depend on our ability to add new police departments and other government agencies as customers of our public safety solution and new universities, corporate campuses and key infrastructure and transportation centers as customers of our security solutions. Many of our target customers have restricted budgets, such that we are forced to compete with programs or solutions that offer an alternative use of the same funds. A number of factors could cause potential customers to delay or refrain from purchasing our solutions or prevent expansion of their use of our solutions, including:

- decreases or changes in available funding, including budgetary allocations, government grants and other government funding programs;
- potential delays or changes in appropriations or other funding authorization processes;
- changes in fiscal or contracting policies;
- changes in elected or appointed officials; and
- changes in laws or public sentiment regarding privacy or surveillance.

The occurrence of any of the foregoing would impede our ability to maintain or increase the amount of revenues derived from these customers, which could have a material adverse effect on our business, operating results and financial condition.

Contracting with government entities can be complex, expensive and time-consuming.

The procurement process for government entities is in many ways more challenging than contracting in the private sector. We must comply with laws and regulations relating to the formation, administration, performance and pricing of contracts with government entities, including U.S. federal, state and local governmental bodies. These laws and regulations may impose added costs on our business or prolong or complicate our sales efforts, and failure to comply with these laws and regulations or other applicable requirements could lead to claims for damages from our customers, penalties, termination of contracts and other adverse consequences. Any such damages, penalties, disruptions or limitations in our ability to do business with government entities could have a material adverse effect on our business, operating results and financial condition.

Government entities often require highly specialized contract terms that may differ from our standard arrangements. For example, if the federal government provides grants to certain state and local governments for our solutions, and such governments do not continue to receive these grants, then these customers have the ability to terminate their contracts with us without penalty. Government entities often impose compliance requirements that are complicated, require preferential pricing or “most favored nation” terms and conditions, or are otherwise time-consuming and expensive to satisfy. Compliance with these special standards or satisfaction of such requirements could complicate our efforts to obtain business or increase the cost of doing so. Even if we do meet these special standards or requirements, the increased costs associated with providing our solutions to government customers could harm our margins. Additionally, even once we have secured a government contract, the renewal process can be lengthy and as time-consuming as the initial sale, and we may be providing our service for months past the contract expiration date without certainty if the renewal agreement will be signed or not.

Changes in the underlying regulatory conditions, political landscape or required procurement procedures that affect these types of customers could be introduced prior to the completion of our sales cycle, making it more difficult or costly to finalize a contract with a new customer or expand or renew an existing customer relationship. For example, customers may require a competitive bidding process with extended response deadlines, review or appeal periods, or customer attention may be diverted to other government matters, postponing the consideration of the purchase of our products. Such delays could harm our ability to provide our solutions efficiently and to grow or maintain our customer base.

If we are unable to maintain and expand coverage of our existing public safety customer accounts and further penetrate the public safety market, our revenues may not grow.

Our ability to increase revenues will depend in large part on our existing public safety solution customers renewing their annual subscriptions and expanding their mileage coverage, or purchasing and implementing our ShotSpotter Missions solutions. Most of our ShotSpotter Flex customers begin using our solution in a limited coverage area. Our experience has been, and we expect will continue to be, that after the initial implementation of our solutions, our new customers typically renew their annual subscriptions, and many also choose to expand their coverage area. If our existing customers do not renew their subscriptions, our revenues may decrease. However, some customers may choose to not renew or reduce their coverage. For example, as a result of widespread destruction caused by hurricanes in Puerto Rico and the U.S. Virgin Islands, in September 2017, we discontinued our service to our customers in coverage areas in those locations and we classified the contracts as expired because the customers were no longer live. At the time, the Housing Authority of Puerto Rico had been one of our largest customers. We cannot be certain when or if our customers in Puerto Rico and the U.S. Virgin Islands will recover their infrastructure and become live customers again. If other existing customers do not choose to renew or expand their coverage areas, our revenues will not grow as we anticipate.

Our ability to further penetrate the market for our public safety solutions depends on several factors, including: maintaining a high level of customer satisfaction and a strong reputation among law enforcement; increasing the awareness of our ShotSpotter Flex and ShotSpotter Missions solutions and their benefits; the effectiveness of our marketing programs; the availability of funding to our customers; and the costs of our solutions. Some potential public safety customers may be reluctant or unwilling to use our solution for a number of reasons, including concerns about additional costs, unwillingness to expose or lack of concern regarding the extent of gun violence in their community, uncertainty regarding the reliability and security of cloud-based offerings or lack of awareness of the benefits of our public safety solutions. If we are unsuccessful in expanding the coverage of ShotSpotter Flex by existing customers or adding new ShotSpotter Flex customers, our revenues and growth prospects would suffer.

If we are unable to sell our solutions into new markets, our revenues may not grow.

Part of our growth strategy depends on our ability to increase sales of our security solutions and add new customers for our public safety solution in markets outside of the United States. Due to our perception that there was greater opportunity in outdoor coverage, in 2018 we made the strategic decision to discontinue indoor coverage as part of our service offering. With this decision to cease our indoor coverage service offerings, we expanded our security solutions to include ShotSpotter Missions, ShotSpotter Labs, ShotSpotter SecureCampus and ShotSpotter SiteSecure. We are focused on both expanding these recent security solutions into new markets, as well as continuing the expansion of ShotSpotter Flex, but expansion into any new market into which we attempt to sell our solutions may not be receptive.

Our ability to successfully face these challenges depends on several factors, including increasing the awareness of our solutions and their benefits; the effectiveness of our marketing programs; the costs of our solutions; our ability to attract, retain and effectively train sales and marketing personnel; and our ability to develop relationships with communication carriers and other partners. If we are unsuccessful in developing and marketing our solutions into new markets, new markets for our solutions might not develop or might develop more slowly than we expect, either of which would harm our revenues and growth prospects.

Our sales cycle can be lengthy, time-consuming and costly, and our inability to successfully complete sales could harm our business.

Our sales process involves educating prospective customers and existing customers about the use, technical capabilities and benefits of our solutions. Prospective customers, especially government agencies, often undertake a prolonged evaluation process that may last up to nine months or more and that typically involves comparing the benefits of our solutions to alternative uses of funds. We may spend substantial time, effort and money on our sales and marketing efforts without any assurance that our efforts will produce any sales.

Additionally, events affecting our customers' budgets or missions may occur during the sales cycle that could negatively impact the size or timing of a purchase after we have invested substantial time, effort and resources into a potential sale, contributing to more unpredictability in the growth of our business. If we are unable to succeed in closing sales with new and existing customers, our business, operating results and financial condition will be harmed.

Changes in the availability of federal funding to support local law enforcement efforts could impact our business.

Many of our customers rely to some extent on funds from the U.S. federal government in order to purchase and pay for our solutions. Any reduction in federal funding for local law enforcement efforts could result in our customers having less access to funds required to continue, renew, expand or pay for our solutions. For example, changes in policies with respect to "sanctuary cities" may result in a reduction in federal funds available to our current or potential customers. If federal funding is reduced or eliminated and our customers cannot find alternative sources of funding to purchase our solutions, our business will be harmed.

If our business does not grow as we expect, or if we fail to manage our growth effectively, our operating results and business prospects would suffer.

Our ability to successfully grow our business depends on a number of factors including our ability to:

- accelerate our acquisition of new customers;
- further sell expansions of coverage areas to our existing customers;
- expand our international footprint;
- expand into new vertical markets, such as our ShotSpotter Missions and our security solutions;
- increase awareness of the benefits that our solutions offer; and
- maintain our competitive and technology leadership position.

As usage of our solutions grows, we will need to continue to make investments to develop and implement new or updated solutions technologies, security features and cloud-based infrastructure operations. In addition, we will need to appropriately scale our internal business systems and our services organization, including the suppliers of our detection equipment and customer support services, to serve our growing customer base. Any failure of, or delay in, these efforts could impair the performance of our solutions and reduce customer satisfaction.

Further, our growth could increase quickly and place a strain on our managerial, operational, financial and other resources, and our future operating results depend to a large extent on our ability to successfully manage our anticipated expansion and growth. To manage our growth successfully, we will need to continue to invest in sales and marketing, research and development, and general and administrative functions and other areas. We are likely to recognize the costs associated with these investments earlier than receiving some of the anticipated benefits, and the return on these investments may be lower, or may develop more slowly, than we expect, which could adversely affect our operating results.

If we are unable to manage our growth effectively, we may not be able to take advantage of market opportunities or develop new solutions or upgrades to our existing solutions, satisfy customer requirements, maintain the quality and security of our solutions or execute on our business plan, any of which could have a material adverse effect on our business, operating results and financial condition.

Our business is dependent upon our ability to deploy and deliver our solutions, and the failure to meet our customers' expectations could harm our reputation, which may have a material adverse effect on our business, operating results and financial condition.

Promoting and demonstrating the utility of our solutions as useful, reliable and important tools for law enforcement and security personnel is critical to the success of our business. Our ability to secure customer renewals and enter into new customer contracts is dependent on our reputation and our ability to deliver our solutions effectively. We believe that our reputation among police departments using ShotSpotter Flex is particularly important to our success. Our ability to meet customer expectations will depend on a wide range of factors, including:

- our ability to continue to offer high-quality, innovative and accurate gunshot detection and gunshot deterrence services, and precision policing software and solutions;
- our ability to maintain continuous monitoring during high outdoor-noise activity periods such as New Year's Day, the Fourth of July and Cinco de Mayo;
- our ability to maintain high customer satisfaction, including meeting our SLA standards;
- the perceived value and quality of our solutions;
- differences in opinion regarding the metrics that measure the success of our solutions;
- our ability to successfully communicate the unique value proposition of our solutions;
- our ability to provide high-quality customer support;
- any misuse or perceived misuse of our solutions;
- interruptions, delays or attacks on our platform;
- litigation- or regulation-related developments; and
- damage to or degradation of our sensors or sensor network by third parties.

Furthermore, negative publicity, whether or not justified, relating to events or activities attributable to us, our solutions, our employees, our partners or others associated with any of these parties, may tarnish our reputation. Damage to our reputation may reduce demand for our solutions and would likely have a material adverse effect on our business, operating results and financial condition. Moreover, any attempts to rebuild our reputation may be costly and time-consuming, and such efforts may not ultimately be successful.

Interruptions or performance problems associated with our technology and infrastructure may adversely affect our business and results of operations.

We have in the past experienced, and may in the future experience, performance issues due to a variety of factors, including infrastructure changes, human or software errors, intentional or accidental damage to our technology (including sensors), website or third-party hosting disruptions or capacity constraints due to a number of potential causes including technical failures, natural disasters or security attacks. If our security is compromised, our platform is unavailable or our users are unable to receive our alerts or otherwise communicate with our IRC, within a reasonable amount of time or at all, our business could be negatively affected. In some instances, we may not be able to identify the cause or causes of these performance problems within an acceptable period of time.

In addition, our IRC is located in a single facility. Although the functions of our IRC can be performed remotely, any interruption or delay in service from our IRC, such as from a communications or power outage, could limit our ability deliver our solutions. In addition, it may become increasingly difficult to maintain and improve the performance of our solutions, especially during peak usage times as the capacity of our IRC operations reaches its limits. If there is an interruption or delay in service from our IRC and a gunshot is detected but not reviewed in the allotted time, our software will queue the incident for off line review. This may result in delayed notifications to our customers and as a result, we could experience a decline in customer satisfaction with our solutions and our reputation and growth prospects could be harmed.

We expect to continue to make significant investments to maintain and improve the performance of our solutions. To the extent that we do not effectively address capacity constraints, upgrade our systems as needed and continually develop our technology to accommodate actual and anticipated changes in technology, our business, operating results and financial condition may be adversely affected.

We rely on wireless carriers to provide access to wireless networks through which our acoustic sensors communicate with our cloud network and with which we provide our notification services to customers, and any interruption of such access would impair our business.

We rely on wireless carriers, mainly AT&T and Verizon, to provide access to wireless networks for machine-to-machine data transmissions, which are an integral part of our services. Our wireless carriers may suspend wireless service to expand, maintain or improve their networks. These wireless carriers perform routine maintenance and periodic software and firmware updates that may damage our sensors or make them inoperable. Any suspension or other interruption of services would adversely affect our ability to provide our services to our customers and may adversely affect our reputation. In addition, the terms of our agreements with these wireless carriers provide that either party can cancel or terminate the agreement for convenience with 90 days' notice. If one of our wireless carriers were to terminate its agreement with us, we would need to source a different wireless carrier and/or modify our equipment during the notice period in order to minimize disruption in the performance of our solutions. Price increases or termination by our wireless carriers or changes to existing contract terms could have a material adverse effect on our business, operating results and financial condition.

We may be unable to continue delivery of our solutions due to natural disasters, power outages or other events impacting us or our customers, which could harm our operating results and financial condition.

We recognize revenue on a subscription basis as our solutions are provided to our customers over time. If our services are disrupted due to natural disasters, power outages or other events that we cannot control, as happened when hurricanes hit Puerto Rico and the U.S. Virgin Islands in 2017, we may not be able to continue providing our solutions as expected.

When we stop providing coverage, we also stop recognizing revenues as a result of the affected subscription agreement. If we are forced to discontinue our services due to natural disasters, power outages and other events outside of our control, our revenues may decline, which would negatively impact our results of operations and financial condition. In addition, we may face liability for damages caused by our sensors in the event of heavy weather or other natural disasters. We may also incur additional costs to repair or replace installed sensor networks damaged by heavy weather, hurricanes or other natural disasters.

Any of our facilities may be harmed or rendered inoperable by natural or man-made disasters, including earthquakes, tornadoes, hurricanes, wildfires, floods, nuclear disasters, acts of terrorism or other criminal activities, infectious disease outbreaks, and power outages, which may render it difficult or impossible for us to operate our business for some period of time. For example, our IRC and a data center that hosts some of our customer services are located in the San Francisco Bay Area, a region known for seismic activity. Our facilities would likely be costly to repair or replace, and any such efforts would likely require substantial time. Any disruptions in our operations could negatively impact our business and operating results, and harm our reputation. In addition, we may not carry business insurance or may not carry sufficient business insurance to compensate for losses that may occur. Any such losses or damages could have a material adverse effect on our business, operating results and financial condition. In addition, the facilities of significant vendors, including the manufacturer of our proprietary acoustic sensor, may be harmed or rendered inoperable by such natural or man-made disasters, which may cause disruptions, difficulties or material adverse effects on our business.

Real or perceived false positive gunshot alerts or failure or perceived failure to generate alerts for actual gunfire could adversely affect our customers and their operations, damage our brand and reputation and adversely affect our growth prospects and results of operations.

A false positive alert, in which a non-gunfire incident is reported as gunfire, could result in an unnecessary rapid deployment of police officers and first responders, which may raise unnecessary fear among the occupants of a community or facility, and may be deemed a waste of police and first responder resources. A failure to alert law enforcement or security personnel of actual gunfire (false negative) could result in a less rapid or no response by police officers and first responders, increasing the probability of injury or loss of life. Both false positive alerts and the failure to generate alerts of actual gunfire (false negative) may result in customer dissatisfaction, potential loss of confidence in our solutions, and potential liabilities to customers or other third parties, any of which could harm our reputation and adversely impact our business and operating results. Additionally, the perception of a false positive alert or of a failure to generate an alert, even where our customers understand that our solutions were utilized correctly, could lead to negative publicity or harm the public perception of our solutions, which could harm our reputation and adversely impact our business and operating results.

Economic uncertainties or downturns, or political changes, could limit the availability of funds available to our customers and potential customers, which could materially adversely affect our business.

Economic uncertainties or downturns could adversely affect our business and operating results. Negative conditions in the general economy both in the United States and abroad, including conditions resulting from changes in gross domestic product growth, financial and credit market fluctuations, political deadlock, natural catastrophes, such as the devastation caused by the hurricanes in Puerto Rico and U.S. Virgin Islands, warfare and terrorist attacks on the United States, Europe, the Asia Pacific region or elsewhere, could cause a decrease in funds available to our customers and potential customers and negatively affect the rate of growth of our business.

These economic conditions may make it extremely difficult for our customers and us to forecast and plan future budgetary decisions or business activities accurately, and they could cause our customers to reevaluate their decisions to purchase our solutions, which could delay and lengthen our sales cycles or result in cancellations of planned purchases. Furthermore, during challenging economic times or as a result of political changes, our customers may tighten their budgets and face constraints in gaining timely access to sufficient funding or other credit, which could result in an impairment of their ability to make timely payments to us. In turn, we may be required to increase our allowance for doubtful accounts, which would adversely affect our financial results.

We cannot predict the timing, strength or duration of any economic slowdown, instability or recovery, generally or within any particular industry, or the impact of political changes. If the economic conditions of the general economy or industries in which we operate worsen from present levels, or if recent political changes result in less funding being available to purchase our solutions, our business, operating results, financial condition and cash flows could be adversely affected.

We have not been profitable historically and may not achieve or maintain profitability in the future.

Although we had our first quarter of profitability in the fourth quarter of 2018, annually we have posted a net loss in each year since inception, and, had net losses of \$0.4 million and \$1.2 million during the three months ended March 31, 2019 and 2018, respectively. As of March 31, 2019, we had an accumulated deficit of \$97.7 million. We are not certain

whether we will be able to maintain high enough volume of sales of our solutions to sustain or increase our growth or maintain profitability in the future. We also expect our costs to increase in future periods, which could negatively affect our future operating results if our revenues do not increase. In particular, we expect to continue to expend substantial financial and other resources on:

- sales and marketing, including a significant expansion of our sales organization, both domestically and internationally;
- research and development related to our solutions, including investments in our engineering and technical teams;
- acquisition of complementary technologies or businesses, such as our acquisition of HunchLab technology in October 2018;
- continued international expansion of our business; and
- general and administrative expenses, including legal and accounting expenses related to operating as a public company.

These investments may not result in increased revenues or growth in our business. If we are unable to increase our revenues at a rate sufficient to offset the expected increase in our costs, our business, operating results and financial position may be harmed, and we may not be able to maintain profitability over the long term. Additionally, we may encounter unforeseen operating expenses, difficulties, complications, delays and other unknown factors that may result in losses in future periods. If our revenue growth does not meet our expectations in future periods, our financial performance may be harmed, and we may not maintain profitability in the future.

We may require additional capital to fund our business and support our growth, and our inability to generate and obtain such capital on acceptable terms, or at all, could harm our business, operating results, financial condition and prospects.

We intend to continue to make substantial investments to fund our business and support our growth. In addition, we may require additional funds to respond to business challenges, including the need to develop new features or enhance our solutions, improve our operating infrastructure or acquire or develop complementary businesses and technologies. As a result, in addition to the revenues we generate from our business and our existing cash balances, we may need to engage in additional equity or debt financings to provide the funds required for these and other business endeavors. If we raise additional funds through future issuances of equity or convertible debt securities, our existing stockholders could suffer significant dilution, and any new equity securities we issue could have rights, preferences and privileges superior to those of holders of our common stock. Any debt financing that we may secure in the future could involve restrictive covenants relating to our capital raising activities and other financial and operational matters, which may make it more difficult for us to obtain additional capital and to pursue business opportunities, including potential acquisitions. We may not be able to obtain such additional financing on terms favorable to us, if at all. If we are unable to obtain adequate financing or financing on terms satisfactory to us when we require it, our ability to continue to support our business growth and to respond to business challenges could be significantly impaired, and our business may be adversely affected. In addition, our inability to generate or obtain the financial resources needed may require us to delay, scale back, or eliminate some or all of our operations, which may have a material adverse effect on our business, operating results, financial condition and prospects.

The incurrence of debt may impact our financial position and subject us to additional financial and operating restrictions.

On September 27, 2018, we entered into a \$10.0 million senior secured revolving credit facility with Umpqua Bank (the “Umpqua Credit Agreement”), which we intend to use for general working capital purposes. As of March 31, 2019, we had no outstanding amounts due on nor any usage of the Umpqua Credit Agreement.

Under the Umpqua Credit Agreement, we are subject to various negative covenants that limit, subject to certain exclusions, our ability to incur indebtedness, make loans, invest in or secure the obligations of other parties, pay or declare dividends, make distributions with respect to our securities, redeem outstanding shares of our stock, create subsidiaries, materially change the nature of its business, enter into related party transactions, engage in mergers and business combinations, the acquisition or transfer of Company assets outside of the ordinary course of business, grant liens or enter

into collateral relationships involving company assets or reincorporate, reorganize or dissolve the Company. These covenants could adversely affect our financial health and business and future operations by, among other things:

- making it more difficult to satisfy our obligations, including under the terms of the Umpqua Credit Agreement;
- limiting our ability to refinance our debt on terms acceptable to us or at all;
- limiting our flexibility to plan for and adjust to changing business and market conditions and increasing our vulnerability;
- limiting our ability to use our available cash flow to fund future acquisitions, working capital, business activities, and other general corporate requirements; and
- limiting our ability to obtain additional financing for working capital to fund growth or for general corporate purposes, even when necessary to maintain adequate liquidity.

We are also required to maintain certain financial covenants tied to our leverage, interest charges and profitability. Our ability to meet such covenants (those negative covenants discussed in the preceding paragraph) or other restrictions can be affected by events beyond our control, and our failure to comply with the financial and other covenants would be an event of default under the Umpqua Credit Agreement. If an event of default under the Umpqua Credit Agreement, has occurred and is continuing, the outstanding borrowings thereunder could become immediately due and payable, and we would then be required to cash collateralize any letters of credit then outstanding, and the lender could refuse to permit additional borrowings under the facility. We cannot assure you that we would have sufficient assets to repay those borrowings and, if we are unable to repay those amounts, the lender could proceed against the collateral granted to them to secure such indebtedness. We have pledged substantially all of our assets as collateral, and an event of default would likely have a material adverse effect on our business.

New competitors may enter the market for our public safety solution.

If cities and other government entities increase their efforts to reduce gun violence or our solutions gain visibility in the market, companies could decide to enter into the public safety solution market and thereby increase the competition we face. In addition to other gunshot detection products, we also compete with other technologies and solutions targeting our public safety customers' resources for law enforcement and crime prevention. Our competitors could benefit from the disclosure of our data or information concerning our techniques and processes due to legal or other obligations (for example, as a result of public-records requests or subpoenas to provide information or to testify in court). Because there are several possible uses for these limited budgetary resources, if we are not able to compete successfully for these limited resources, our business may not grow as we expect, which could adversely impact our revenues and operating results.

The competitive landscape for our security solutions is evolving.

The market for security solutions for university campuses, corporate campuses and transportation and key infrastructure centers includes a number of available options, such as video surveillance and increased human security presence. Because there are several possible uses of funds for campus security needs, we may face increased challenges in demonstrating or distinguishing the benefits of ShotSpotter SecureCampus and ShotSpotter SiteSecure, our campus security solutions. In particular, while we have seen growing interest in our security solutions, interest in the indoor gunshot detection offering was limited, and as a result, in June 2018, we made the strategic decision to cease indoor coverage as part of our service offering. While our newly-acquired ShotSpotter Missions increases our outdoor detection services, we may face challenges in demonstrating or distinguishing the benefits of ShotSpotter Missions' development of crime forecasts and increased effectiveness of patrol resources.

Failure to effectively develop and expand our sales and marketing capabilities could harm our ability to increase our customer base and achieve broader market acceptance of our solutions.

To increase total customers and customer coverage areas and to achieve broader market acceptance of our solutions, we will need to expand our sales and marketing organization and increase our business development resources, including the vertical and geographic distribution of our sales force and our teams of account executives focused on new accounts and responsible for renewal and growth of existing accounts.

Our business requires that our sales personnel have particular expertise and experience in working with law enforcement agencies, other government organizations and higher education institutions. We may not achieve revenue growth from expanding our sales force if we are unable to hire, develop and retain talented sales personnel with appropriate experience, if our new sales personnel are unable to achieve desired productivity levels in a reasonable period of time or if our sales and marketing programs are not effective.

Our strategy includes pursuing acquisitions, and our inability to successfully integrate newly-acquired technologies, assets or businesses may harm our financial results. Future acquisitions of technologies, assets or businesses, which are paid for partially or entirely through the issuance of stock or stock rights, could dilute the ownership of our existing stockholders.

We may evaluate and consider potential strategic transactions, including acquisitions of, or investments in, businesses, technologies, services, products and other assets in the future. For example, in October 2018, we acquired the HunchLab technology and related assets from Azavea Inc. We also may enter into relationships with other businesses to expand our platform and applications, which could involve preferred or exclusive licenses, additional channels of distribution, discount pricing or investments in other companies.

We believe that part of our continued growth will be driven by acquisitions of other companies or their technologies, assets, businesses and teams. The HunchLab acquisition gives rise, and any acquisitions in the future that we complete will give rise, to risks, including:

- incurring higher than anticipated capital expenditures and operating expenses;
- failing to assimilate the operations and personnel or failing to retain the key personnel of the acquired company or business;
- failing to integrate the acquired technologies, or incurring significant expense to integrate acquired technologies, into our platform and applications;
- disrupting our ongoing business;
- diverting our management's attention and other company resources;
- failing to maintain uniform standards, controls and policies;
- incurring significant accounting charges;
- impairing relationships with our customers and employees;
- finding that the acquired technology, asset or business does not further our business strategy, that we overpaid for the technology, asset or business or that we may be required to write off acquired assets or investments partially or entirely;
- failing to realize the expected synergies of the transaction;
- being exposed to unforeseen liabilities and contingencies that were not identified prior to acquiring the company; and
- being unable to generate sufficient revenue and profits from acquisitions to offset the associated acquisition costs.

Fully integrating an acquired technology, asset or business into our operations may take a significant amount of time. We may not be successful in overcoming these risks or any other problems encountered with acquisitions. To the extent that we do not successfully avoid or overcome the risks or problems related to any such acquisitions, our results of operations and financial condition could be harmed. Acquisitions also could impact our financial position and capital requirements, or could cause fluctuations in our quarterly and annual results of operations. Acquisitions could include significant goodwill and intangible assets, which may result in future impairment charges that would reduce our stated earnings. We may incur significant costs in our efforts to engage in strategic transactions and these expenditures may not result in successful acquisitions.

We expect that the consideration we might pay for any future acquisitions of technologies, assets, businesses or teams could include stock, rights to purchase stock, cash or some combination of the foregoing. If we issue stock or rights

to purchase stock in connection with future acquisitions, net income per share and then-existing holders of our common stock may experience dilution

The nature of our business exposes us to inherent liability risks.

Our solutions, including ShotSpotter Flex, ShotSpotter SecureCampus and ShotSpotter SiteSecure, are designed to communicate real-time alerts of gunfire incidents to police officers and first responders. Due to the nature of such applications, we are potentially exposed to greater risks of liability for employee acts or omissions or system failures than may be inherent in other businesses. Although substantially all of our customer agreements contain provisions limiting our liability to our customers, we cannot be certain that these limitations will be enforced or that the costs of any litigation related to actual or alleged omissions or failures would not have a material adverse effect on us even if we prevail. Further, certain of our insurance policies and the laws of some states may limit or prohibit insurance coverage for punitive or certain other types of damages or liability arising from gross negligence, or other issues, such as damages caused due to installation of our sensors on buildings owned by third parties, and we cannot assure you that we are adequately insured against the risks that we face.

The nature of our business may result in undesirable press coverage or other negative publicity.

Our solutions are used to assist law enforcement and first responders in the event that gunfire is detected. Even when our solutions work as intended, the incidents detected by our solutions could lead to injury, loss of life and other negative outcomes, and such events are likely to receive negative publicity. If we fail to detect an incident, or if we detect an incident, such as a terrorist attack or active-shooter event, but the response time of law enforcement or first responders is not sufficiently quick to prevent injury, loss of life, property damage or other adverse outcomes, we may receive negative media attention. At times, our data or information concerning our techniques and processes may become a matter of public record due to legal or other obligations (for example, as a result of public-records requests or subpoenas to provide information or to testify in court), and we may receive negative media attention as a result.

In addition, our solutions require that our customers monitor alerts and respond timely to notifications of gunshots. If our customers do not fully utilize our systems, we may be subject to criticism and unflattering media coverage regarding the effectiveness of our solutions and the cost of our solutions to our customers. Such negative publicity could have an adverse impact on new sales or renewals or expansions of coverage areas by existing customers, which would adversely impact our financial results and future prospects.

Real or perceived errors, failures or bugs in our software could adversely affect our operating results and growth prospects.

Because our software is complex, undetected errors, failures or bugs may occur. Our software is often installed and used with different operating systems, system management software, and equipment and networking configurations, which may cause errors or failures of our software or other aspects of the computing environment into which it is deployed. In addition, deployment of our software into computing environments may expose undetected errors, compatibility issues, failures or bugs in our software. Despite our testing, errors, failures or bugs may not be found in our software until it is released to our customers. Moreover, our customers could incorrectly implement or inadvertently misuse our software, which could result in customer dissatisfaction and adversely impact the perceived utility of our products as well as our brand. Any of these real or perceived errors, compatibility issues, failures or bugs in our software could result in negative publicity, reputational harm, loss of or delay in market acceptance of our software, loss of competitive position or claims by customers for losses sustained by them. In any such event, we may be required, or may choose, for customer relations or other reasons, to expend additional resources in order to correct the problem. Alleviating any of these problems could require significant expenditures of our capital and other resources and could cause interruptions or delays in the use of our solutions, which could cause us to lose existing or potential customers and could adversely affect our operating results and growth prospects.

Interruptions or delays in service from our third-party providers could impair our ability to make our solutions available to our customers, resulting in customer dissatisfaction, damage to our reputation, loss of customers, limited growth and reduction in revenues.

We currently use third-party data center hosting facilities to host certain components of our solutions. Our operations depend, in part, on our third-party providers' abilities to protect these facilities against damage or interruption from natural disasters, power or communications failures, cyber incidents, criminal acts and similar events. In the event that any of our third-party facility arrangements is terminated, or if there is a lapse of service or damage to a facility, we could experience service interruptions in our solutions as well as delays and additional expenses in arranging new facilities and services. Any changes in third-party service levels at our data centers or any errors, defects, disruptions, cyber incidents or other performance problems with our solutions could harm our reputation.

Any damage to, or failure of, the systems of our third-party providers could result in interruptions to our solutions. Despite precautions taken at our data centers, the occurrence of spikes in usage volume, natural disasters, cyber incidents, acts of terrorism, vandalism or sabotage, closure of a facility without adequate notice or other unanticipated problems could result in lengthy interruptions in the availability of our services. Problems faced by our third-party data center locations, with the network providers with whom they contract, or with the systems by which our communications providers allocate capacity among their customers, including us, could adversely affect the experience of our customers. Interruptions in our services might cause us to issue refunds to customers and subject us to potential liability.

Further, our insurance policies may not adequately compensate us for any losses that we may incur in the event of damage or interruption, and therefore the occurrence of any of the foregoing could subject us to liability, cause us to issue credits to customers or cause customers not to renew their subscriptions for our applications, any of which could materially adversely affect our business.

If our security measures or those of our customers or third-party providers are compromised, or if unauthorized access to the data of our customers is otherwise obtained, our solutions may be perceived as not being secure, our customers may be harmed and may curtail or cease their use of our solutions, our reputation may be damaged and we may incur significant liabilities.

Our operations involve the storage and transmission of gunfire incident data, including date, time, address and GPS coordinates, occurring in our customer's coverage area. Security incidents, whether as a result of third-party action, employee or customer error, technology impairment or failure, malfeasance or criminal activity, could result in unauthorized access to, or loss or unauthorized disclosure of, this gunfire incident data, which could result in litigation expenses or damages, indemnity and other contractual obligations and other possible liabilities, including but not limited to government fines and penalties and mitigation expenses, as well as negative publicity, which could damage our reputation, impair our sales and harm our customers and our business. Cyber incidents and malicious internet-based activity continue to increase generally, and providers of cloud-based services have been targeted. If third parties with whom we work, such as vendors or developers, violate applicable laws or our security policies, such violations may also put our gunfire incident data at risk and could in turn have an adverse effect on our business. In addition, such a violation could expose the locations of our sensors, including those sensors for which we obtained third-party consents that include confidentiality obligations. We may be unable to anticipate or prevent techniques used to obtain unauthorized access or to sabotage systems because such techniques change frequently and often are not detected until after an incident has occurred. As we increase our customer base and our brand becomes more widely known and recognized, third parties may increasingly seek to compromise our security controls or gain unauthorized access to customer data or other sensitive information. Further, because of the nature of the services that we provide to our customers, we may be a unique target for attacks.

Many governments have enacted laws requiring companies to notify individuals of data security incidents or unauthorized transfers involving certain types of personal data. In addition, some of our customers contractually require notification of any data security incident. Accordingly, security incidents experienced by our competitors, by our customers or by us may lead to public disclosures, which may lead to widespread negative publicity. Any security compromise in our industry, whether actual or perceived, could harm our reputation, erode customer confidence in the effectiveness of our security measures, negatively impact our ability to attract new customers, cause existing customers to elect not to renew their subscriptions or subject us to third-party lawsuits, regulatory fines or other action or liability, which could materially and adversely affect our business and operating results. Further, the costs of compliance with

notification laws and contractual obligations may be significant and any requirement that we provide such notifications as a result of an actual or alleged compromise could have a material and adverse effect on our business.

While we maintain general liability insurance coverage and coverage for errors or omissions, we cannot assure you that such coverage would be adequate or would otherwise protect us from liabilities or damages with respect to claims alleging compromise or loss of data, or that such coverage will continue to be available on acceptable terms or at all.

We rely on the cooperation of customers and third parties to permit us to install our ShotSpotter sensors on their facilities, and failure to obtain these rights could increase our costs or limit the effectiveness of our ShotSpotter Flex solution.

Our ShotSpotter Flex solution requires us to deploy ShotSpotter sensors in our customer coverage areas, which typically entails the installation of approximately 20 to 25 sensors per square mile. The ShotSpotter sensors are mounted on city facilities and third-party buildings, and occasionally on city or utility-owned light poles, and installing the sensors requires the consent of the property owners, which can be time-consuming to obtain and can delay deployment. Generally, we do not pay a site license fee in order to install our sensors, and our contractual agreements with these facility owners provide them the right to revoke permission to use their facility with notice of generally 60 days.

To the extent that required consents delay our ability to deploy our solutions or facility owners do not grant permission to use their facilities, revoke previously granted permissions, or require us to pay a site license fee in order to install our sensors, our business may be harmed. If we were required to pay a site license fee in order to install sensors, our deployment expenses would increase, which would impact our gross margins. If we cannot obtain a sufficient number of sensor mounting locations that are appropriately dispersed in a coverage area, the effectiveness of our ShotSpotter Flex solution would be limited, we may need to reduce the coverage area of the solution, or we may not be able to meet our service level requirements, any of which could result in customer dissatisfaction or have a material adverse impact on our reputation, our business and our financial results.

If we fail to offer high-quality customer support, our business and reputation may suffer.

We offer customer support 24 hours a day, seven days a week, as well as training on best practices, forensic expertise and expert witness services. Providing these services requires that our personnel have specific experience, knowledge and expertise, making it more difficult for us to hire qualified personnel and to scale up our support operations. The importance of high-quality customer support will increase as we expand our business and pursue new customers. We may be unable to respond quickly enough to accommodate short-term increases in customer demand for support services or scale our services if our business grows. Increased customer demand for these services, without corresponding revenues, could increase our costs and harm our operating results. If we do not help our customers use applications within our solutions and provide effective ongoing support, our ability to sell additional applications to, or to retain, existing customers may suffer and our reputation with existing or potential customers may be harmed.

Our reliance on wireless carriers will require updates to our technology, and making such updates could result in disruptions in our service or increase our costs of operations.

Approximately half of our installed ShotSpotter sensors use fourth-generation (“4G”) Long-Term Evolution (“LTE”) wireless technology and half use third-generation (“3G”), cellular communications. Our US wireless carriers have advised us that they will discontinue their 3G services in the future and our ShotSpotter sensors will not be able to transmit on these networks. As a result, we will have to upgrade the sensors that use 3G cellular communications at no additional cost to our customers prior to the discontinuation of 3G services, before the end of 2022. These sensor replacements will require significant capital expenditures and may also divert management’s attention and other important resources away from our customer service and sales efforts for new customers. In the future, we may not be able to successfully implement new technologies or adapt existing technologies to changing market demands. If we are unable to adapt timely to changing technologies, market conditions or customer preferences, our business, operating results and financial condition could be materially and adversely affected.

Concerns regarding privacy and government-sponsored surveillance may deter customers from purchasing our solutions.

Governmental agencies and private citizens have become increasingly sensitive to real or perceived government or third-party surveillance and may wrongly believe that our outdoor sensors, which act, as acoustic devices installed in urban areas or public facilities, allow customers to listen to private conversations and monitor private citizen activity. Our sensors are not designed for “live listening” and are triggered only at loud impulsive sounds that may likely be gunfire. However, perceived privacy concerns may result in negative media coverage and efforts by private citizens to persuade municipalities, educational institutions or other potential customers not to purchase our solutions for their communities, campuses or facilities. In addition, laws may exist or be enacted to address such concerns that could impact our ability to deploy our solutions. For example, the City of Toronto, Canada decided against using ShotSpotter solutions because the Ministry of the Attorney General of Ontario indicated that it may compromise Section 8 of Canada’s Charter of Rights and Freedoms, which relates to unreasonable search and seizure. If customers choose not to purchase our solutions due to privacy or surveillance concerns, then the market for our solutions may develop more slowly than we expect, or it may not achieve the growth potential we expect, any of which would adversely affect our business and financial results.

We rely on a limited number of suppliers and contract manufacturers, and our proprietary ShotSpotter sensors are manufactured by a single contract manufacturer.

We rely on a limited number of suppliers and contract manufacturers. In particular, we use a single manufacturer, with which we have no long-term contract and from which we purchase on a purchase-order basis, to produce our proprietary ShotSpotter sensors. Our reliance on a sole contract manufacturer increases our risks since we do not currently have any alternative or replacement manufacturers, and we do not maintain a high volume of inventory. In the event of an interruption from a contract manufacturer, we may not be able to develop alternate or secondary sources without incurring material additional costs and substantial delays. Furthermore, these risks could materially and adversely affect our business if our contract manufacturer is impacted by a natural disaster or other interruption at a particular location because each of our contract manufacturers produces our products from a single location. Although our contract manufacturer has alternative manufacturing locations, transferring manufacturing to another location may result in significant delays in the availability of our sensors.

Many of the key components used to manufacture our proprietary ShotSpotter sensors also come from limited or sole sources of supply. Our contract manufacturer generally purchases these components on our behalf, and we do not have any long-term arrangements with our suppliers. We are therefore subject to the risk of shortages and long lead times in the supply of these components and the risk that suppliers discontinue or modify components used in our products. In addition, the lead times associated with certain components are lengthy and preclude rapid changes in quantities and delivery schedules. Developing alternate sources of supply for these components may be time-consuming, difficult, and costly, and we or our suppliers may not be able to source these components on terms that are acceptable to us, or at all, which may undermine our ability to fill our orders in a timely manner.

If we experience significantly increased demand, or if we need to replace an existing supplier or contract manufacturer, we may be unable to supplement or replace such supply or contract manufacturing on terms that are acceptable to us, which may undermine our ability to deliver our products to customers in a timely manner. For example, for our ShotSpotter sensors, it may take a significant amount of time to identify a contract manufacturer that has the capability and resources to build the sensors to our specifications. Identifying suitable suppliers and contract manufacturers is an extensive process that requires us to become satisfied with their quality control, technical capabilities, responsiveness and service, financial stability, regulatory compliance, and labor and other ethical practices. Accordingly, the loss of any key supplier or contract manufacturer could adversely impact our business, operating results and financial condition.

Our solutions use third-party software and services that may be difficult to replace or cause errors or failures of our solutions that could lead to a loss of customers or harm to our reputation and our operating results.

We license third-party software and depend on services from various third parties for use in our solutions. In the future, such software or services may not be available to us on commercially reasonable terms, or at all. Any loss of the right to use any of the software or services could result in decreased functionality of our solutions until equivalent technology is either developed by us or, if available from another provider, is identified, obtained and integrated, which

could harm our business. In addition, any errors or defects in or failures of the third-party software or services could result in errors or defects in our solutions or cause our solutions to fail, which could harm our business and be costly to correct. Many of these providers attempt to impose limitations on their liability for such errors, defects or failures, and if enforceable, we may have additional liability to our customers or third-party providers that could harm our reputation and increase our operating costs.

We will need to maintain our relationships with third-party software and service providers, and obtain from such providers software and services that do not contain any errors or defects. Any failure to do so could adversely impact our ability to deliver effective products to our customers and could harm our operating results.

If we do not or cannot maintain the compatibility of our platform with applications that our customers use, our business could suffer.

Some of our customers choose to integrate our solutions with certain other systems used by our customers, such as real-time crime center platforms or computer-aided dispatch systems. The functionality and popularity of our solutions depend, in part, on our ability to integrate our solutions these systems. Providers of these systems may change the features of their technologies, restrict our access to their applications or alter the terms governing use of their applications in an adverse manner. Such changes could functionally limit or terminate our ability to use these technologies in conjunction with our solutions, which could negatively impact our customer service and harm our business. If we fail to integrate our solutions with applications that our customers use, we may not be able to offer the functionality that our customers need, and our customers may not renew their agreements, which would negatively impact our ability to generate revenues and adversely impact our business.

We are subject to governmental regulation and other legal obligations, particularly related to privacy, data protection and information security, and our actual or perceived failure to comply with such obligations could harm our business. Compliance with such laws could impair our efforts to maintain and expand our customer base, and thereby decrease our revenue.

Our outdoor sensors are acoustic devices that are designed to recognize impulsive sounds that are likely to be gunfire. ShotSpotter sensors do not use high gain, directional or other specialized microphones.

The sensors do not have the ability to live stream audio. Typically, sounds, noises or voices captured on the secure sensors are cached temporarily but are written over and permanently deleted within 48-72 hours. When a sensor is triggered by an impulsive sound, it creates a potential gunshot "incident" that contains a recording, which includes no more than two seconds before the incident and four seconds after the incident. This audio snippet is preserved indefinitely for potential evidentiary use.

There is the potential to include human voices that occur at the same time as the gunshot in these incident audio snippets. We retain incident audio snippets are retained indefinitely as evidence. We also use information collected to support, expand and improve our software algorithms as well as our gunfire detection and notification methods. Sensors are often installed in densely populated urban areas. They are not designed or tuned to capture human voices, but it is possible they could pick up a human voice. Human voices are not impulsive and do not typically trigger the sensors, and unless accompanied by an impulsive sound no audio snippet would be transmitted out of the sensor. The human voice would be temporarily cached on the sensor for 48-72 hours and would then be written over and permanently deleted. Information collected from loud impulsive sounds ("incidents") is used to provide information to our customers regarding those incidents, but shared information is limited, by both our technology and our privacy policies, to the audit snippet containing the incident.

Our handling and storage of data is subject to a variety of laws and regulations, including regulation by various government agencies and various state, local and foreign agencies. The U.S. federal and various state and foreign governments have adopted or proposed legislation that regulates the monitoring and collection of personal information of individuals and that mandates security requirements with respect to certain personally identifiable information. In the United States, the Federal Trade Commission and numerous state attorneys general are imposing standards for the online collection, distribution, use and storage of data by applying federal and state consumer protection laws. The lack of a clear and universal standard for protecting such information means, however, that these obligations may be interpreted and applied in a manner that is inconsistent from one jurisdiction to another and may conflict with other requirements or our

practices. Any failure or perceived failure by us to comply with privacy or security laws, policies, legal obligations or industry standards or any security incident that results in the unauthorized release or transfer of sensitive corporate information, personally identifiable information or other customer data may result in governmental enforcement actions, litigation, fines and penalties and/or adverse publicity, and could cause our customers to lose trust in us, which could have an adverse effect on our reputation and business.

Some proposed laws or regulations concerning privacy, data protection and information security are in their early stages, and we cannot yet determine how these laws and regulations may be interpreted nor can we determine the impact these proposed laws and regulations may have on our business. Such proposed laws and regulations may require companies to implement privacy and security policies, permit users to access, correct and delete personal information stored or maintained by such companies, inform individuals of security breaches that affect their personal information, and, in some cases, obtain individuals' consent to use personal information for certain purposes. In addition, a foreign government could require that any personal information collected in a country not be disseminated outside of that country, and we may not be currently equipped to comply with such a requirement. Our failure to comply with federal, state and international data privacy laws and regulators could harm our ability to successfully operate our business and pursue our business goals.

Our quarterly results of operations may fluctuate significantly due to a wide range of factors, which makes our future results difficult to predict.

Our revenues and results of operations could vary significantly from quarter to quarter as a result of various factors, many of which are outside of our control, including:

- the expansion or contraction of our customer base;
- the renewal or nonrenewal of subscription agreements with, and expansion of coverage areas by, existing customers;
- the size, timing, terms and deployment schedules of our sales to both existing and new customers;
- the introduction of products or services that may compete with us for the limited funds available to our customers, and changes in the cost of such products or services;
- changes in our customers' and potential customers' budgets;
- our ability to control costs, including our operating expenses;
- our ability to hire, train and maintain our direct sales force;
- the timing of satisfying revenue recognition criteria in connection with initial deployment and renewals;
- fluctuations in our effective tax rate; and
- general economic and political conditions, both domestically and internationally.

Any one of these or other factors discussed elsewhere in this report may result in fluctuations in our revenues and operating results, meaning that quarter-to-quarter comparisons of our revenues, results of operations and cash flows may not necessarily be indicative of our future performance.

Because of the fluctuations described above, our ability to forecast revenues is limited and we may not be able to accurately predict our future revenues or results of operations. In addition, we base our current and future expense levels on our operating plans and sales forecasts, and our operating expenses are expected to increase in the short term. Accordingly, we may not be able to reduce our costs sufficiently to compensate for an unexpected shortfall in revenues, and even a small shortfall in revenues could disproportionately and adversely affect our financial results for that quarter. The variability and unpredictability of these and other factors could result in our failing to meet or exceed financial expectations for a given period.

Because we generally recognize our subscription revenues ratably over the term of our contract with a customer, fluctuations in sales will not be fully reflected in our operating results until future periods.

Our revenues are primarily generated from subscriptions to our solutions. With the exception of a small number of legacy customers, our customers do not have the right to take possession of our equipment or software platform. Revenues from subscriptions to our software platform is recognized ratably over the subscription period beginning on the date that

the subscription is made available to the customer, which we refer to as the “go-live” date. Our agreements with our customers typically range from one to five years. As a result, much of the revenues that we report in each quarter are attributable to agreements entered into during previous quarters. Consequently, a decline in sales, customer renewals or market acceptance of our solutions in any one quarter would not necessarily be fully reflected in the revenues in that quarter, and would negatively affect our revenues and profitability in future quarters. This ratable revenue recognition also makes it difficult for us to rapidly increase our revenues through additional sales in any period, as revenues from new customers generally are recognized over the applicable agreement term. Our subscription-based approach may result in uneven recognition of revenues.

We recognize subscription revenues over the term of a subscription agreement. Once we enter into a contract with a customer, there is a delay until we begin recognizing revenues while we survey the coverage areas, obtain any required consents for installation, and install our sensors, which together can take up to several months or more. We begin recognizing revenues from a sale only when all of these steps are complete and the solution is live.

While most of our customers elect to renew their subscription agreements following the expiration of a term, in some cases, they may not be able to obtain the proper approvals or funding to complete the renewal prior to such expiration. For these customers, we stop recognizing subscription revenues at the end of the current term, even though we may continue to provide services for a period of time while the renewal process is completed. Once the renewal is complete, we then recognize subscription revenues for the period between the expiration of the term of the agreement and the completion of the renewal process. As a result of the widespread destruction caused by the hurricanes in Puerto Rico and the U.S. Virgin Islands in 2017, we discontinued our service to our customers in those service areas and classified the contracts as expired and stopped recognizing revenues. We cannot be certain when or if the affected customers will resume operations and renew their contracts.

The variation in the timeline for deploying our solutions and completing renewals may result in fluctuations in our revenues, which could cause our results to differ from projections. Additionally, while we generally invoice for 50% of the contract cost upon a customer’s go-live date, our cash flows may be volatile and will not match our revenue recognition.

We are in the process of expanding our international operations, which exposes us to significant risks.

We currently operate in limited number of locations outside the United States. A key component to our business strategy is to expand our international operations to increase our revenues from customers outside of the United States as part of our growth strategy. Operating in international markets requires significant resources and management attention and will subject us to regulatory, economic and political risks in addition to those we already face in the United States. In addition, we will need to invest time and resources in understanding the regulatory framework and political environments of our potential customers overseas in order to focus our sales efforts. Because such regulatory and political considerations are likely to vary across jurisdictions, this effort will require additional time and attention from our sales team and could lead to a sales cycle that is longer than our typical process for sales in the United States. We also may need to hire additional employees and otherwise invest in our international operations in order to reach new customers. Because of our limited experience with international operations as well as developing and managing sales in international markets, our international expansion efforts may not be successful.

In addition, we face and will continue to face risks in doing business internationally that could adversely affect our business, including:

- the potential impact of currency exchange fluctuations;
- the need to comply with local data residency requirements;
- the availability and reliability of local data centers and internet bandwidth providers;
- the difficulty of staffing and managing international operations and the increased operations, travel, shipping and compliance costs associated with having customers in numerous international locations;
- potentially greater difficulty collecting accounts receivable and longer payment cycles;
- the availability of coverage by wireless carriers in international markets;
- higher or more variable costs associated with wireless carriers and other service providers;

- the need to offer customer support in various languages;
- challenges in understanding and complying with local laws, regulations and customs in foreign jurisdictions, including laws regarding privacy and government surveillance;
- export controls and economic sanctions administered by the Department of Commerce Bureau of Industry and Security and the Treasury Department's Office of Foreign Assets Control;
- compliance with various anti-bribery and anti-corruption laws such as the Foreign Corrupt Practices Act and United Kingdom Bribery Act of 2010;
- tariffs and other non-tariff barriers, such as quotas and local content rules;
- more limited protection for our intellectual property in some countries;
- adverse or uncertain tax consequences as a result of international operations;
- currency control regulations, which might restrict or prohibit our conversion of other currencies into U.S. dollars;
- restrictions on the transfer of funds;
- deterioration of political relations between the United States and other countries; and
- political or social unrest or economic instability in a specific country or region in which we operate, which could have an adverse impact on our operations in that location.

Also, we expect that due to costs related to our international expansion efforts and the increased cost of doing business internationally, we will incur higher costs to secure sales to international customers than the comparable costs for domestic customers. As a result, our financial results may fluctuate as we expand our operations and customer base worldwide.

Our failure to manage any of these risks successfully could harm our international operations, and adversely affect our business, operating results and financial condition.

We are dependent on the continued services and performance of our senior management and other key personnel, the loss of any of whom could adversely affect our business.

Our future success depends in large part on the continued contributions of our senior management and other key personnel. In particular, the leadership of key management personnel is critical to the successful management of our company, the development of our products, and our strategic direction. We also depend on the contributions of key technical personnel.

We do not maintain "key person" insurance for any member of our senior management team or any of our other key employees. Our senior management and key personnel are all employed on an at-will basis, which means that they could terminate their employment with us at any time, for any reason and without notice. The loss of any of our key management personnel could significantly delay or prevent the achievement of our development and strategic objectives and adversely affect our business.

If we are unable to attract, integrate and retain additional qualified personnel, including top technical talent, our business could be adversely affected.

Our future success depends in part on our ability to identify, attract, integrate and retain highly skilled technical, managerial, sales and other personnel. We face intense competition for qualified individuals from numerous other companies, including other software and technology companies, many of whom have greater financial and other resources than we do. Some of these characteristics may be more appealing to high-quality candidates than those we have to offer. In addition, new hires often require significant training and, in many cases, take significant time before they achieve full productivity. We may incur significant costs to attract and retain qualified personnel, including significant expenditures related to salaries and benefits and compensation expenses related to equity awards, and we may lose new employees to our competitors or other companies before we realize the benefit of our investment in recruiting and training them. Moreover, new employees may not be or become as productive as we expect, as we may face challenges in adequately or appropriately integrating them into our workforce and culture. If we are unable to attract, integrate and retain suitably

qualified individuals who are capable of meeting our growing technical, operational and managerial requirements, on a timely basis or at all, our business will be adversely affected.

Volatility or lack of positive performance in our stock price may also affect our ability to attract and retain our key employees. Many of our senior management personnel and other key employees have become, or will soon become, vested in a substantial amount of stock or stock options. Employees may be more likely to leave us if the shares they own or the shares underlying their vested options have significantly appreciated in value relative to the original purchase prices of the shares or the exercise prices of the options, or, conversely, if the exercise prices of the options that they hold are significantly above the market price of our common stock. If we are unable to appropriately incentivize and retain our employees through equity compensation, or if we need to increase our compensation expenses in order to appropriately incentivize and retain our employees, our business, operating results and financial condition would be adversely affected.

We may be subject to additional obligations to collect and remit certain taxes, and we may be subject to tax liability for past activities, which could harm our business.

State, local and foreign jurisdictions have differing rules and regulations governing sales, use, value added and other taxes, and these rules and regulations are subject to varying interpretations that may change over time, particularly with respect to software-as-a-service products like our solutions. Further, these jurisdictions' rules regarding tax nexus are complex and vary significantly. If one or more jurisdictions were to assert that we have failed to collect taxes for sales of our solutions, we could face the possibility of tax assessments and audits. A successful assertion that we should be collecting additional sales, use, value added or other taxes in those jurisdictions where we have not historically done so and do not accrue for such taxes could result in substantial tax liabilities and related penalties for past sales or otherwise harm our business and operating results.

Our ability to use our net operating losses to offset future taxable income may be subject to certain limitations.

As of December 31, 2018, we had federal net operating loss carryforwards ("NOLs") of approximately \$85.4 million, of which \$80.6 million will expire between 2026 through 2037, if not utilized, and \$4.8 million which do not expire. As of December 31, 2018, we also had state NOLs of approximately \$54.3 million, which will expire, if not utilized, in 2019 through 2038. These federal and state NOLs are available to reduce future income subject to income taxes. In general, under Section 382 of the Internal Revenue Code of 1986, as amended ("the Code"), a corporation that undergoes an "ownership change" is subject to limitations on its ability to utilize its NOLs to offset future taxable income. Past or future changes in our stock ownership, some of which are outside of our control, may have resulted or could result in an ownership change. State NOLs generated in one state cannot be used to offset income generated in another state.

We may be subject to litigation for a variety of claims or to other legal requests, which could adversely affect our results of operations, harm our reputation or otherwise negatively impact our business.

We may be subject to litigation for a variety of claims arising from our normal business activities. These may include claims, suits, and proceedings involving labor and employment, wage and hour, commercial and other matters. The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention and resources, and lead to attempts on the part of other parties to pursue similar claims. Any adverse determination related to litigation could adversely affect our results of operations, harm our reputation or otherwise negatively impact our business. In addition, depending on the nature and timing of any such dispute, a resolution of a legal matter could materially affect our future operating results, our cash flows or both.

An unfavorable outcome on any litigation matters could require us to pay substantial damages, or, in connection with any intellectual property infringement claims, could require us to pay ongoing royalty payments or could prevent us from selling certain of our products. As a result, a settlement of, or an unfavorable outcome on, any of the matters referenced above or other litigation matters could have a material adverse effect on our business, operating results, financial condition and cash flows.

We, or our customers, may be subject to requests for our data or information concerning our techniques and processes, pursuant to state or federal law (for example, public-records requests or subpoenas to provide information or to testify in court). This data and information, some of which we may deem to be confidential or trade secrets, could therefore become a matter of public record and also become accessible by competitors, which could negatively impact our business.

Changes in financial accounting standards may cause adverse and unexpected revenue fluctuations and impact our reported results of operations.

The accounting rules and regulations that we must comply with are complex and subject to interpretation by the Financial Accounting Standards Board (“FASB”), the Securities and Exchange Commission and various bodies formed to promulgate and interpret appropriate accounting principles. In addition, many companies’ accounting disclosures are being subjected to heightened scrutiny by regulators and the public. Further, the accounting rules and regulations are continually changing in ways that could impact our financial statements.

Changes to accounting principles or our accounting policies on our financial statements going forward are difficult to predict, could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of the change. In addition, were we to change our critical accounting estimates, including the timing of recognition of subscription and professional services revenues and other revenue sources, our results of operations could be significantly impacted.

Risks Related to Our Intellectual Property

Failure to protect our intellectual property rights could adversely affect our business.

Our success depends, in part, on our ability to protect proprietary methods and technologies that we develop or license under patent and other intellectual property laws of the United States, so that we can prevent others from using our inventions and proprietary information. If we fail to protect our intellectual property rights adequately, our competitors might gain access to our technology and our business might be adversely affected. However, defending our intellectual property rights might entail significant expenses. Any of our patent rights, copyrights, trademarks or other intellectual property rights may be challenged by others, weakened or invalidated through administrative process or litigation.

As of March 31, 2019, we had 31 U.S. patents directed to our technologies, as well as one granted patent in Israel. We have patent applications pending for examination in the United States, Europe, Mexico and Brazil, but we cannot guarantee that these patent applications will be granted. We also license one other U.S. patent from one third party. The patents that we own or those that we license from others (including those that may be issued in the future) may not provide us with any competitive advantages or may be challenged by third parties.

Additionally, the process of obtaining patent protection is expensive and time-consuming, and we may not be able to prosecute all necessary or desirable patent applications at a reasonable cost or in a timely manner. Even if issued, there can be no assurance that these patents will adequately protect our intellectual property, as the legal standards relating to the validity, enforceability and scope of protection of patent and other intellectual property rights are uncertain.

Any patents that are issued may subsequently be invalidated or otherwise limited, allowing other companies to develop offerings that compete with ours, which could adversely affect our competitive business position, business prospects and financial condition. In addition, issuance of a patent does not guarantee that we have a right to practice the patented invention. Patent applications in the United States are typically not published until 18 months after their earliest priority date or, in some cases, not at all, and publications of discoveries in industry-related literature lag behind actual discoveries. We cannot be certain that third parties do not have blocking patents that could be used to prevent us from marketing or practicing our software or technology.

Effective patent, trademark, copyright and trade secret protection may not be available to us in every country in which our software is available. The laws of some foreign countries may not be as protective of intellectual property rights as those in the United States (in particular, some foreign jurisdictions do not permit patent protection for software), and mechanisms for enforcement of intellectual property rights may be inadequate. Additional uncertainty may result from changes to intellectual property legislation enacted in the United States, including the recent America Invents Act, or to the laws of other countries and from interpretations of the intellectual property laws of the United States and other countries by applicable courts and agencies. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property.

We rely in part on trade secrets, proprietary know-how and other confidential information to maintain our competitive position. Although we endeavor to enter into non-disclosure agreements with our employees, licensees and others who may have access to this information, we cannot assure you that these agreements or other steps we have taken will prevent unauthorized use, disclosure or reverse engineering of our technology. Moreover, third parties may independently develop technologies or products that compete with ours, and we may be unable to prevent this competition. Third parties also may seek access to our trade secrets, proprietary know-how and other confidential information through

legal measures (for example, public-records requests or subpoenas to provide information or to testify in court) and it could be expensive to defend against those requests. Disclosure of our trade secrets, proprietary know-how and other confidential information could negatively impact our business.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We may initiate claims or litigation against third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. Litigation also puts our patents at risk of being invalidated or interpreted narrowly and our patent applications at risk of not issuing. Additionally, we may provoke third parties to assert counterclaims against us. We may not prevail in any lawsuits that we initiate, and the damages or other remedies awarded, if any, may not be commercially viable. Any litigation, whether or not resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel, which may adversely affect our business, operating results, financial condition and cash flows.

We may be subject to intellectual property rights claims by third parties, which are extremely costly to defend, could require us to pay significant damages and could limit our ability to use certain technologies.

Companies in the software and technology industries, including some of our current and potential competitors, own large numbers of patents, copyrights, trademarks and trade secrets and frequently enter into litigation based on allegations of infringement or other violations of intellectual property rights. In addition, many of these companies have the capability to dedicate substantially greater resources to enforce their intellectual property rights and to defend claims that may be brought against them. The litigation may involve patent holding companies or other adverse patent owners that have no relevant product revenues and against which our patents may therefore provide little or no deterrence. We may have previously received, and may in the future receive, notices that claim we have misappropriated, misused, or infringed other parties' intellectual property rights, and, to the extent we gain greater market visibility, we face a higher risk of being the subject of intellectual property infringement claims.

There may be third-party intellectual property rights, including issued or pending patents that cover significant aspects of our technologies or business methods. Any intellectual property claims, with or without merit, could be very time-consuming, could be expensive to settle or litigate and could divert our management's attention and other resources. These claims could also subject us to significant liability for damages, potentially including treble damages if we are found to have willfully infringed patents or copyrights. These claims could also result in our having to stop using technology found to be in violation of a third party's rights. We might be required to seek a license for the intellectual property, which may not be available on reasonable terms or at all. Even if a license were available, we could be required to pay significant royalties, which would increase our operating expenses. As a result, we may be required to develop alternative non-infringing technology, which could require significant effort and expense. If we cannot license or develop technology for any infringing aspect of our business, we would be forced to limit or stop sales of our software and may be unable to compete effectively. Any of these results would adversely affect our business, operating results, financial condition and cash flows.

If we are unable to protect our intellectual property, or if we infringe on the intellectual property rights of others, our business may be harmed.

Our success depends in part on intellectual property rights to the services that we develop. We rely on a combination of contractual and intellectual property rights, including non-disclosure agreements, patents, trade secrets, copyrights and trademarks, to establish and protect our intellectual property rights in our names, services, innovations, methodologies and related technologies. If we lose intellectual property protection or the ability to secure intellectual property protection on any of our names, confidential information or technology, this could harm our business. Our intellectual property rights may not prevent competitors from independently developing services and methodologies similar to ours, and the steps we take might be inadequate to deter infringement or misappropriation of our intellectual property by competitors, former employees or other third parties, any of which could harm our business. We have registered patents and pending patent applications directed to our technology. We have registered trademarks in the United States that have various expiration dates unless renewed through customary processes. Our registered patents and/or trademark registrations may be unenforceable or ineffective in protecting our intellectual property. Most of our patents and pending patent applications have been filed only in the United States and are therefore not enforceable in countries outside of the United States. Our trademarks may be unenforceable in countries outside of the United States, which may adversely affect our ability to build our brand outside of the United States.

Although we are not presently aware that our conduct of our business infringes on the intellectual property rights of others, third parties may nevertheless assert infringement claims against us in the future. We may be required to modify our products, services, internal systems or technologies, or obtain a license to permit our continued use of those rights. We may be unable to do so in a timely manner, or upon reasonable terms and conditions, which could harm our business. In addition, future litigation over these matters could result in substantial costs and resource diversion. Adverse determinations in any litigation or proceedings of this type could subject us to significant liabilities to third parties and could prevent us from using some of our services, internal systems or technologies.

Our use of open source software could subject us to possible litigation.

A portion of our technologies incorporates open source software, and we expect to continue to incorporate open source software into our platform in the future. Few of the licenses applicable to open source software have been interpreted by courts, and their application to the open source software integrated into our proprietary technology platform may be uncertain. If we fail to comply with these licenses, then pursuant to the terms of these licenses, we may be subject to certain requirements, including requirements that we make available the source code for our software that incorporates the open source software. We cannot assure you that we have not incorporated open source software in our software in a manner that is inconsistent with the terms of the applicable licenses or our current policies and procedures. If an author or other third party that distributes such open source software were to allege that we had not complied with the conditions of one or more of these licenses, we could incur significant legal expenses defending against such allegations. Litigation could be costly for us to defend, have a negative effect on our operating results and financial condition or require us to devote additional research and development resources to change our technology platform.

Risks Related to the Ownership of Our Common Stock

Our stock price may be volatile or may decline regardless of our operating performance, resulting in substantial losses for investors.

The market price of our common stock may be highly volatile and may fluctuate substantially as a result of a variety of factors, some of which are related in complex ways. Since shares of our common stock were sold in our initial public offering (“IPO”), in June 2017 at a price of \$11.00 per share, our stock price has ranged from an intraday low of \$9.33 to an intraday high of \$66.14 through May 7, 2019.

The market price of our common stock may fluctuate significantly in response to numerous factors, many of which are beyond our control, including the factors listed below and other factors described in this “Risk Factors” section:

- actual or anticipated fluctuations in our operating results;
- the financial projections we may provide to the public, any changes in these projections or our failure to meet these projections;
- failure of securities analysts to initiate or maintain coverage of our company, changes in financial estimates by any securities analysts who follow our company, or our failure to meet these estimates or the expectations of investors;
- ratings changes by any securities analysts who follow our company;
- changes in the availability of federal funding to support local law enforcement efforts, or local budgets;
- announcements by us of significant technical innovations, acquisitions, strategic partnerships, joint ventures or capital commitments;
- changes in operating performance and stock market valuations of other software companies generally;
- price and volume fluctuations in the overall stock market, including as a result of trends in the economy as a whole;
- changes in our board of directors or management;
- sales of large blocks of our common stock, including sales by our executive officers, directors and significant stockholders;
- lawsuits threatened or filed against us;

- short sales, hedging and other derivative transactions involving our capital stock;
- general economic conditions in the United States and abroad;
- other events or factors, including those resulting from war, incidents of terrorism or responses to these events; and
- media misperception of our sales and customer relationships, including press announcements or media mentions of future sales that may be misleading or inaccurate.

In addition, stock markets have experienced extreme price and volume fluctuations that have affected and continue to affect the market prices of equity securities of many software companies. Stock prices of many software companies have fluctuated in a manner unrelated or disproportionate to the operating performance of those companies. In the past, stockholders have instituted securities action litigation following periods of market volatility. If we were to become involved in securities litigation, it could subject us to substantial costs, divert resources and the attention of management from our business and adversely affect our business, operating results, financial condition and cash flows.

Substantial future sales of shares of our common stock could cause the market price of our common stock to decline.

Certain holders of our shares of common stock have the right, subject to various conditions and limitations, to include their shares of our common stock in registration statements relating to our securities, including approximately 3.3 million shares that were registered in connection with the Registration Statement on Form S-3 that became effective on July 27, 2018, of which approximately only 136,000 were sold in an underwritten registered secondary offering in March 2019. If the offer and sale of these shares are registered, they will be freely tradable without restriction under the Securities Act. In addition, non-affiliates have the ability to sell shares of our common stock in the open market or through block trades without subject to volume restrictions under Rule 144 of the Securities Act. In addition, in the future we may issue common stock or other securities if we need to raise additional capital. The number of new shares of our common stock issued in connection with raising additional capital could constitute a material portion of the then outstanding shares of our common stock. In the event a large number of shares of common stock are sold in the public market, such share sales could reduce the trading price of our common stock.

If securities or industry analysts do not publish research or reports about our business, or publish negative reports about our business, our share price and trading volume could decline.

The trading market for our common stock depends in part on the research and reports that securities or industry analysts publish about us or our business, our market and our competitors. We do not have any control over these analysts. If one or more of the analysts who cover us downgrade our shares of common stock or change their opinion of our shares of common stock, our share price would likely decline. If one or more of these analysts cease coverage of our company or fail to regularly publish reports on us, we could lose visibility in the financial markets, which could cause our share price or trading volume to decline.

We are an “emerging growth company” and we cannot be certain if the reduced disclosure requirements applicable to emerging growth companies will make our common stock less attractive to investors.

We are an “emerging growth company,” as defined in the Jumpstart Our Business Startups Act (the “JOBS Act”), and we take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not “emerging growth companies” including, but not limited to, not being required to comply with the auditor attestation requirements of Section 404 of the Sarbanes-Oxley Act, reduced disclosure obligations regarding executive compensation in our periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved. We will remain an “emerging growth company” for up to five years, although we will cease to be an “emerging growth company” upon the earliest of (i) the last day of fiscal year 2022, (ii) the last day of the first fiscal year in which our annual gross revenues are \$1.07 billion or more, (iii) the date on which we have, during the previous rolling three-year period, issued more than \$1 billion in non-convertible debt securities or (iv) the date on which we are deemed to be a “large accelerated filer” as defined in the Securities Exchange Act of 1934, or the Exchange Act. We cannot predict if investors will find our common stock less attractive or our company less comparable to certain other public companies because we will rely on these exemptions. If some investors find our common stock less attractive as a result, there may be a less active trading market for our common stock and our stock price may be more volatile.

We incur substantial costs as a result of being a public company.

As a public company, we are incurring significant levels of legal, accounting, insurance and other expenses that we did not incur as a private company. We are subject to the reporting requirements of the Exchange Act, the Sarbanes-Oxley Act, the Dodd-Frank Act, the listing requirements of the Nasdaq Capital Market, and other applicable securities rules and regulations. Compliance with these rules and regulations increases our legal and financial compliance costs, makes some activities more difficult, time-consuming or costly and increases demand on our systems and resources as compared to when we operated as a private company. The Exchange Act requires, among other things, that we file annual, quarterly and current reports with respect to our business and operating results. The Sarbanes-Oxley Act requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and, if required, improve our disclosure controls and procedures and internal control over financial reporting to meet this standard, significant resources and management oversight may be required. As a result, management's attention may be diverted from other business concerns, which could adversely affect our business and operating results. Although we have already hired additional corporate employees to comply with these requirements, we may need to hire more corporate employees in the future or engage outside consultants, which would increase our costs and expenses.

In addition, changing laws, regulations and standards relating to corporate governance and public disclosure are creating uncertainty for public companies, increasing legal and financial compliance costs and making some activities more time-consuming. These laws, regulations and standards are subject to varying interpretations, in many cases due to their lack of specificity, and, as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies. This could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. We intend to invest resources to comply with evolving laws, regulations and standards, and this investment may result in increased general and administrative expenses and a diversion of management's time and attention from revenue-generating activities to compliance activities. If our efforts to comply with new laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to their application and practice, regulatory authorities may initiate legal proceedings against us and our business may be adversely affected.

As a result of disclosure of information in this report and in the filings that we are required to make as a public company, our business, operating results and financial condition have become more visible, which has resulted in, and may in the future result in threatened or actual litigation, including by competitors and other third parties. If any such claims are successful, our business, operating results and financial condition could be adversely affected, and even if the claims do not result in litigation or are resolved in our favor, these claims, and the time and resources necessary to resolve them, could divert the resources of our management and adversely affect our business, operating results and financial condition.

We do not intend to pay dividends for the foreseeable future.

We have never declared or paid any cash dividends on our common stock and do not intend to pay any cash dividends in the foreseeable future. We anticipate that we will retain all of our future earnings for use in the development of our business and for general corporate purposes. Any determination to pay dividends in the future will be at the discretion of our board of directors. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any future gains on their investments.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of our company more difficult, limit attempts by our stockholders to replace or remove our current management and limit the market price of our common stock.

Provisions in our certificate of incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. Our certificate of incorporation and bylaws include provisions that:

- establish a classified board of directors so that not all members of our board of directors are elected at one time;
- permit the board of directors to establish the number of directors and fill any vacancies and newly-created directorships;
- provide that directors may only be removed for cause;

- require super-majority voting to amend some provisions in our certificate of incorporation and bylaws;
- authorize the issuance of “blank check” preferred stock that our board of directors could use to implement a stockholder rights plan;
- eliminate the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws; and
- establish advance notice requirements for nominations for election to our board of directors or for proposing matters that can be acted upon by stockholders at annual stockholder meetings.

In addition, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which generally prohibits stockholders owning 15% or more of our outstanding voting stock from merging or otherwise combining with us for a period of three years following the date on which the stockholder became a 15% stockholder without the consent of our board of directors. These provisions may frustrate or prevent any attempts by our stockholders to replace or remove our current management by making it more difficult for stockholders to replace members of our board of directors, which is responsible for appointing the members of our management, and otherwise discourage management takeover attempts.

Our certificate of incorporation designates the Court of Chancery of the State of Delaware as the exclusive forum for certain litigation that may be initiated by our stockholders, which could limit our stockholders’ ability to obtain a favorable judicial forum for disputes with us.

Pursuant to our certificate of incorporation, unless we consent in writing to the selection of an alternative forum, the Court of Chancery of the State of Delaware is the sole and exclusive forum for (1) any derivative action or proceeding brought on our behalf, (2) any action asserting a claim of breach of a fiduciary duty owed by any of our directors, officers or other employees to us or our stockholders, (3) any action asserting a claim arising pursuant to any provision of the Delaware General Corporation Law, our certificate of incorporation or our bylaws or (4) any action asserting a claim governed by the internal affairs doctrine. Our certificate of incorporation further provides that any person or entity purchasing or otherwise acquiring any interest in shares of our common stock is deemed to have notice of and consented to the foregoing provision. The forum selection clause in our certificate of incorporation may limit our stockholders’ ability to obtain a favorable judicial forum for disputes with us.

Our certificate of incorporation further provides that the federal district courts of the United States of America will be the exclusive forum for resolving any complaint asserting a cause of action arising under the Securities Act. However, on December 19, 2018, the Delaware Chancery Court issued an opinion invalidating this provision in the certificates of incorporation of Delaware corporations. The Chancery Court held that a Delaware corporation can only use its constitutive documents to bind a plaintiff to a particular forum where the claim involves rights or relationships established by or under Delaware’s corporate law. This case may be appealed to the Delaware Supreme Court. In light of this recent court decision, on December 21, 2018 we announced that we do not currently intend to enforce the foregoing federal forum selection provision unless the relevant court decision is appealed and the Delaware Supreme Court reverses the decision. If there is no appeal or if the Delaware Supreme Court affirms the Chancery Court’s decision, then we intend to seek approval by our stockholders to amend our certificate of incorporation at our next regularly-scheduled annual meeting of stockholders to remove the invalid provision.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

(a) Unregistered Sales of Equity Securities

None.

(b) Use of Proceeds from Public Offering of Common Stock

Our initial public offering of common stock was effected through a Registration Statement on Form S-1 (File No. 333-217603), which was declared effective on June 6, 2017. There has been no material change in the planned use of proceeds from our IPO as described in our final prospectus filed with the SEC pursuant to Rule 424(b) and other periodic reports previously filed with the SEC.

We used \$13.7 million of the net proceeds from our IPO to repay our outstanding indebtedness of \$13.5 million, including early termination fees of \$0.2 million, during the quarter ending September 30, 2017. On October 3, 2018, we used \$1.7 million of our IPO proceeds to fund the acquisition of HunchLab.

Item 6. Exhibits

A list of exhibits is set forth below.

Exhibit Index

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | | Filed Herewith |
|----------------|---|---------------------------|-----------|---------|---------------|----------------|
| | | Form | File No. | Exhibit | Filing Date | |
| 3.1 | Amended and Restated Certificate of Incorporation | 8-K | 001-38107 | 3.1 | June 13, 2017 | |
| 3.2 | Amended and Restated Bylaws | 8-K | 001-38107 | 3.2 | June 13, 2017 | |
| 31.1 | Certification of Principal Executive Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 31.2 | Certification of Principal Financial Officer Pursuant to Rules 13a-14(a) and 15d-14(a) under the Securities Exchange Act of 1934, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 32.1* | Certification of Principal Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. | | | | | X |
| 101.INS | XBRL Instance Document | | | | | X |
| 101.SCH | XBRL Taxonomy Extension Schema Document | | | | | X |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document | | | | | X |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document | | | | | X |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document | | | | | X |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document | | | | | X |

* Furnished herewith and not deemed to be “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and shall not be deemed to be incorporated by reference into any filing under the Securities Act of 1933, as amended, or the Exchange Act (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SHOTSPOTTER, INC.

Date: May 9, 2019

By: /s/ Ralph A. Clark
Ralph A. Clark
President and Chief Executive Officer

Date: May 9, 2019

By: /s/ Alan R. Stewart
Alan R. Stewart
Chief Financial Officer

CERTIFICATION

I, Ralph A. Clark, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ShotSpotter, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 9, 2019

/s/ Ralph A. Clark

Ralph A. Clark

President and Chief Executive Officer

CERTIFICATION

I, Alan R. Stewart, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ShotSpotter, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

May 9, 2019

/s/ Alan R. Stewart

Alan R. Stewart

Chief Financial Officer

CERTIFICATION

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Ralph A. Clark, the President, Chief Executive Officer and Director of ShotSpotter, Inc. (the "Company") and Alan R. Stewart, Chief Financial Officer of the Company, each hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the period ended March 31, 2019, to which this Certification is attached as Exhibit 32.1 ("the Quarterly Report") fully complies with the requirements of Section 13(a) or Section 15(d) of the Exchange Act; and
2. The information contained in the Quarterly Report on Form 10-Q fairly presents, in all material respects, the financial condition and results of operations of the Company.

In Witness Whereof, the undersigned have set their hands hereto as of the 9th day of May, 2019.

/s/ Ralph A. Clark

Ralph A. Clark
President and Chief Executive Officer

/s/ Alan R. Stewart

Alan R. Stewart
Chief Financial Officer

This certification accompanies the Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of ShotSpotter, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing."