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CORPORATE PARTICIPANTS

Scott Smith SoundHound AI Inc - Investor Relations

Keyvan Mohajer SoundHound AI Inc - Chief Executive Officer, Director

Nitesh Sharan SoundHound AI Inc - Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Gil Luria D.A. Davidson & Co. - Analyst

Mike Latimore Northland Securities, Inc. - Analyst

Glenn Mattson Ladenburg Thalmann & Co. Inc. - Analyst

Brett Knoblauch Cantor Fitzgerald & Co. - Analyst

PRESENTATION

Operator

Good day, and thank you for standing by, and welcome to SoundHound Q1 2024 earnings conference call. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your speaker today, Scott Smith, Head of Investor Relations. Please go ahead.

Scott Smith - SoundHound AI Inc - Investor Relations

Good afternoon and thank you for joining our first-quarter 2024 conference call. With me today is our CEO, Keyvan Mohajer, and our CFO, Nitesh Sharan. We will begin with some short remarks before moving to Q&A.

We'd like to remind everyone that we will be making forward-looking statements on this call. Actual results could differ materially from those suggested by our forward-looking statements. Please refer to our filings with the SEC for a detailed discussion of the risks and uncertainties that could affect our business and for discussion statements that qualify as forward-looking statements.

In addition, we may discuss certain non-GAAP measures. Please refer to today's press release for more detailed financial results and further details on the definitions, limitations, and uses of those measures and reconciliations from GAAP to non-GAAP.

Also note that the forward-looking statements on this call are based on information available to us as of today's date. We undertake no obligation to update any forward-looking statements except as required by law.

Finally, this call is being audio webcast in its entirety on our Investor Relations website. An audio replay will be available following today's call.

With that, I'd like to turn the call over to our CEO, Keyvan Mohajer. Please go ahead, Keyvan.

Keyvan Mohajer - SoundHound AI Inc - Chief Executive Officer, Director

Thank you, Scott, and thank you to everyone for joining the call today. Once again, we are reporting very strong growth. First-quarter revenue was up 73%. Just a few days ago, we reached the milestone of being a public company for two years.

While the tough external conditions of the last two to three years have weakened or eliminated many organizations, we have become stronger. We have nearly tripled our first-quarter revenue in just two years, while better leveraging our expenses, and we have more than doubled our cash position to its record high of approximately $225 million on the balance sheet. Our three-pillar strategy is working.

This quarter was a special quarter for our pillar two, where we offer AI customer service solutions for businesses. About 30% of our revenue was from pillar two with over 10,000 locations laid in production and over 100,000 in our pipeline. Just a year ago, these numbers were negligible.

And for the first time, our next-generation drive-thru AI service dynamic interaction is now live with one of the top global QSR brands, and the results are incredible beyond expectation. The main challenge our customers face on the first day of being live with dynamic interaction was that our AI was so fast at taking orders that their kitchen could not keep up with the pace.

Of course, they're addressing that on their side and are pleased with the results and immediately decided to expand to more locations. As we've said before, our AI solutions save cost for our customers, improves the experience of their users, and also increases revenue by adding throughputs and proactively offering upsells.

Dynamic interaction is a SoundHound technological breakthrough like no other. We believe its impact on voice and conversational interfaces will be as meaningful as the Apple multi-touch technology on touch interfaces. If you have not seen it in action, check out the videos on our website. We have built a competitive moat with our proprietary technology that is creating a massive opportunity in customer service.

We have agreements executed with several other large QSR brands that will be deploying dynamic interaction in the next few months, for example, Church's Chicken. The earlier version of our drive-thru AI experience has been live for several years and continues to thrive.

White Castle continues to expand its footprint with more locations opening, including one of their busiest locations next to Disney World. Another major QSR with over 2000 locations uses our AI for drive-thru and continues to expand our offering to more locations as they add more drive-through capabilities to their existing in-store and takeout services.

Next, our Smart Ordering offering continues its strong adoption. Smart Ordering uses our voice AI for answering all inbound phone calls to take customer food orders and to answer numerous questions, allowing restaurants to free up their staff to focus on making food and engaging with customers in-store. We handle millions of calls per month, and we power national brands such as Chipotle, Casey's, Firehouse, Noodles, and Five Guys.

Last quarter, we announced the pilot with Jersey Mike's. The pilot was successful, and they're adding more locations. We also expanded with Applebee's and now have our voice AI offering across multiple franchisees, resulting in an additional 500 locations this quarter alone.

We introduced a product called SoundHound Employee Assist, which uses our conversational voice AI technology to support employees like a copilot across a variety of task via their headset. We already have several customers benefiting from this new service, and we will have more to share soon.

Last year, we expanded our AI customer service offering beyond restaurants with Smart Answering, a product that handles multiple calls at once 24/7, conveniently filtering out spam calls, providing verbal and SMS responses, taking configurable actions, capturing leads with intelligent messaging and answering questions about policies, hours, products, services, pricing and more. Smart Answering is showing rapid growth within pillar two and already has hundreds of locations signed up from single-location small businesses to brands such as Planet Fitness.

We estimate our pillar two total addressable market to be over $100 billion with over 1 million restaurants and approximately 30 million businesses in North America alone that we can offer our solutions to. And with dozens of languages we already provide to our pillar one customers, we plan to also go international in pillar two. We believe with large language models and generative AI and most importantly, the data science and machine learning behind our proprietary software, the time is now.

Very few companies can offer businesses of all sizes and affordable fast and easy to implement solution that addresses their growing needs. While other point solution providers and legacy call center vendors are trying to evolve their offerings to include AI, we already have a fully automated and therefore, easily scalable solution. We own our tech. We have big data from real interactions and nearly 20 years of experience. This is why we are winning.

Moving on to pillar one, where we power products such as cars, TVs, and IoT devices. Within this category, our customers choose us because they believe our technology is the best, and we help them protect their brand users' data and because we partner with them to differentiate and innovate. We power millions of devices in dozens of languages. And this quarter, we reached an annual run rate of over 4 billion queries and in Q1, it represents a growth of more than 60% year over year.

Last year, we announced SoundHound Chat AI, which combines the power of large language models with our AI assistant, making it more capable and powerful. This is an upsell feature that will increase royalties from existing customers, and its unmatched quality is helping us win new customers.

Last quarter, we talked about DS Automobiles being the first to quickly run a trial run to live production, which was unprecedented with car manufacturers. We have signed up new brands for SoundHound Chat AI, including Opel, Peugeot, and Vauxhall due to the success of their launch. And now this quarter, we are pleased to add Alfa Romeo and Lancia.

We also went live into production with Stellantis vehicles in Japan. With our customer, Stellantis, we have been the first company anywhere in the world to launch a voice assistant integrated with ChatGPT into vehicles. We are also pleased to have been awarded a design win for our first automobile customers in Latin America with Stellantis. This is a brand-new competitive win.

We also continue to gain interest and make progress with EV manufacturers. For example, a deal we won last quarter with a prominent US-based EV maker, we will voice-enable their full fleet of market-leading vehicles later this summer. This means we have gone from signing to in production in a matter of months, thanks to SoundHound's industry-leading capabilities and market-ready products.

Additionally, we won a deal with a leading Asian electric car manufacturer to embed our software that aims to bring affordable and luxury electric cars with powerful engines. This is a brand-new automaker we have not announced before.

This quarter, we announced the collaboration with NVIDIA during the GTC conference. The solution we are partnering on combines SoundHound Chat AI with large language models running in vehicle on NVIDIA DRIVE for seamless voice interaction. Together with NVIDIA, we can now deliver in-vehicle generative AI responses with no connectivity required.

We are also now partnering with Arm and have been officially added to their partner program. More to come on that later this year.

Just today, we announced a partnership with Perplexity, which will bring cutting-edge online LLMs to SoundHound Chat AI. This allows us to offer a truly multifaceted, next-generation voice assistant to phones, cars and IoT devices. SoundHound Chat AI will leverage per Perplexity to provide accurate up-to-date responses to web-based queries that static offline LLMs cannot currently answer, expanding the type and complexity of the questions the assistant is able to answer.

The move makes SoundHound AI the most advanced voice assistant available on the market today. We believe we are the only voice AI platform to be able to quickly provide this unified integration, combining our own technology seamlessly with third-party providers.

We have also reached an important milestone with Polaris. Our multimodal, multilingual, generative AI foundation model. Polaris now beats our latest state-of-the-art speech recognition model in terms of accuracy, speed, model size, and run costs, which already beat the other vendors we benchmarked against by a large margin, including models provided by the big tech. Polaris is now live in production with a growing percentage of our customers, and we will continue to provide updates on its progress.

We believe voice AI is a bigger opportunity than just conversational AI. Our data and know-how, along with our continued investment in this level of R&D will strengthen our position as a leader in our space.

As I mentioned earlier, we have three pillars: royalties from voice-enabled products, subscription from voice-enabled services, and the third pillar is monetization from connecting those services to products. As we increase the notable names that we sign every quarter -- and this quarter is no different -- we get one step closer to mobilizing this third pillar, significantly increasing our addressable market while creating new, more convenient and accessible consumer experiences.

We believe pillar three will create the voice commerce ecosystem of the future, and many customers are signing up in pillar one and pillar two in eager anticipation of us rolling out this monetization strategy. We are excited to see our portfolio of customers using voice-enabled services continue to grow, which should allow us to begin to offer this new commercial ecosystem.

In closing, we continue to build a strong business and fortify our financial position, all while gaining market share. We couldn't be more pleased with the demand you're seeing and the high praise we are receiving from the customers we are serving. With another quarter of strong growth and notable customer wins, our momentum continues to grow.

We remain passionate about what we do, and that has not changed in the 20 years since we founded the company. We look forward to continued strong growth and creating value for our stakeholders. We are grateful to our amazing team that makes this all possible as well as our customers, partners, investors and shareholders.

With that, I'll now turn the call over to Nitesh to talk about our financial performance, key growth drivers, and outlook for the remainder of the year.

Nitesh Sharan - SoundHound AI Inc - Chief Financial Officer

Thank you, Keyvan, and good afternoon, everyone. Q1 revenue increased by 73% year over year. The results indicate another positive mile marker on our growth journey in which we exceeded $11 million in revenue in our seasonally smallest quarter of the year. We like where we are today, and we are excited about what we are quickly becoming.

Our AI solutions attractively reside at a critical intersection. Macro factors like persistent inflation and wage pressures drive many of our customers towards automation for productivity. Concurrently, consumer demand for increased speed and convenience drive our customers towards automation to accelerate throughput and increase revenue.

AI connects this intersection seamlessly, and generative AI massively extend the value proposition further. The penultimate result is high consumer interest in SoundHound.

With our recent acquisitions, SYNQ3, now fully in the mix, the benefits of integrating this pioneering restaurant tech organization with our years of voice AI innovations are clear. And the breadth of coverage we now have in the restaurant sector is so exciting and showing up in overflowing customer activity. One of the measures we use to gauge that traction is backlog.

Last quarter, I introduced a combined pillar one and pillar two customer demand metric called cumulative subscriptions and bookings backlog. In Q1, we saw approximately 80% year-over-year growth to $682 million with an average duration of about seven years. As a reminder, this measure includes new subscription revenue streams and our traditional royalty contract.

The methodology for our pillar one contracts has not changed. We include only committed customer contracts for exactly the duration of the contract period and capture various facets of the deal and total contract value like construct. These facets include minimum commitment, target volumes, professional services, and other arrangements. We do not include renewals until the renewal takes place even if contracts include auto renewal provisions.

For subscriptions, cumulative subscriptions and bookings backlog takes into account customers where we are the leading or exclusive provider and assumes a four-year ramp to fully scale with the total 5-year duration. We have incorporated reasonable assumptions about adoption percentages with lower percentages applying to pilot and proof-of-concept customers.

Furthermore, this metric does not include pipeline opportunities for which we have well over a 100,000-location opportunity for pillar two alone. This metric is intended to directionally convey our medium-term revenue growth prospects.

Before I walk through the financial results for the first quarter, given the impact of the acquisition to various aspects of the GAAP financials, we are introducing two new non-GAAP financial measures for gross margins and EPS to help investors better track how we manage the business operationally. I'll share more context in the relevant sections below.

Q1 revenue was $11.6 million, up 73% year over year. We saw growth in Q1 across all major industry categories. Pillar two represented approximately 30% of revenue in the quarter, combining organic growth with positive contributions of roughly $3 million from the acquisition of SYNQ3.

We also had a strong quarter in pillar one as automotive royalties went up with volume increases year over year. Auto units and cloud users both expanded strong double digits in the quarter. Additionally, we continue to see growing demand in our generative AI solutions, and we are seeing meaningful opportunities starting to be realized for accelerated unit price expansion. We also signed a multiyear commitment in the TVs and devices category, and that led to strong double-digit growth from devices in the quarter.

In Q1, our gross margins were 60%, down year over year, largely resulting from the acquisition, including the mix of lower margin call center agent business. On a stand-alone basis, gross margins were up year over year. Adjusted for acquisition impacts, notably the non-cash amortization of purchased intangibles, gross margins would have been 65.5%. This is the non-GAAP gross margin metric I introduced above.

While the call center business does pressure margins in the near term, we are excited about what this new capacity can do for broader business opportunities and equally so, for the valuable training data it provides our AI models. That said, our goal over time is to automate and modernize. So we expect gross margin improvements through the year and ultimately back to pre-merger levels.

R&D expenses were $14.9 million in Q1, an increase of 5% year over year. We have streamlined our R&D cost, increased efficiencies, and are prioritizing investments in disruptive innovation to expand our suite of products to address a wider array of customer needs.

We are accelerating the training and deployment of large language models to provide even more value to customers, enabling us to open many doors and a wide variety of new conversational AI use cases. That said, we will continue to be thoughtful and opportunistic with greater emphasis on bringing unique value through best-of-breed large language models, including multilingual ASR foundation model, generative AI solutions, and voice AI capabilities that intermediate and arbitrate between our own models and partner LLMs.

Sales and marketing expenses were $5.5 million in Q1, an increase of 14% year over year. We continue to invest in go-to-market and customer engagement to capture the strong momentum and heightened demand, and we are expanding reach through brand and industry marketing, demand generation and high ROI lead-gen strategy.

Our sales reach continues to expand with both direct sales and through an amazing ecosystem of strategic channel partners. We know the best go-to-market ROI comes from customers loving us. And this quarter, with one of the largest QSRs, we were introduced to their executive management team as the best partners their team has ever worked with.

G&A expenses were $10.3 million in Q1, an increase of 41% year over year. The increases in G&A reflect two main elements that we talked about last quarter. Our year-over-year comparison continues to be impacted by investments in financial and non-financial processes and internal controls to support requirements under stocks 404(b) as we became a large, accelerated filer last year, and this quarter also factors in acquisition related costs.

All operating expense line items were impacted by the SYNQ3 acquisition, as well as higher employer-related tax costs and increased compensation. Non-cash employee stock compensation was $7 million in Q1. As a result, our operating loss for Q1 was $28.5 million. This included non-cash acquisition impacts related to the fair value accounting that will likely introduce volatility into this line for the foreseeable future.

OI&E was $4.2 million of net expense for the quarter, and net loss was $33 million in Q1 compared to $27.4 million in the prior-year period. This led to a net loss per share in Q1 of $0.12 compared to $0.14 in the previous year.

Adjusting for non-cash acquisition related amortization of purchased intangibles, fair value adjustments, M&A transaction costs, stock-based comp, and other non-cash items, our non-GAAP EPS loss was $0.07 in the quarter. This is a measure we will continue to report upon in future quarters given it better normalizes the ongoing operating results of the business.

Adjusted EBITDA was a loss of $15.4 million in Q1. The year-over-year decrease was a result of the previously mentioned higher operating costs as well as the SYNQ3 acquisition impact. Net cash used in operating activities for the three months ended March 31, 2024, was about $21 million.

Our cash position at quarter end was $226 million, of which $212 million was in [cash and equivalents]. With this strong cash position, we have given ourselves some great optionality to drive the business forward and further improve our financial profile. We entered a new ATM program in the quarter to provide us with capital-raising flexibility, although our balance sheet and forward projections indicate we don't have any time-sensitive capital-raising needs.

It would only be necessitated strategically either for capital structure optimization purposes or if another attractive acquisition opportunity presented itself, where the economic value merited it. All that said, we don't take this strength for granted and are committed to being prudent stewards of capital, focusing on creating long-term sustainable growth and profitability.

With that, let me discuss our outlook for the remainder of 2024. We are excited about the opportunities ahead and pleased with our top-line performance, coupled with the demand we are seeing in pillars one and two, and we are driving new opportunities in pillar three. We are ahead of pace in having pillar two exceed 20% of total revenue mix this year, and we see that mix increasing as we go into 2025.

Given the Q1 performance, we are raising the lower end of our guidance and narrowing our initial range, which steps up our mid-point to $71 million. Therefore, our revenue guidance for the full year is now $65 million to $77 million. We continue to believe the right expectation for subsequent quarters is roughly 50% year-on-year growth. We hope to outperform, but at this stage, we believe this is the appropriate expectation.

Furthermore, we still expect to cross $100 million in revenue and deliver adjusted EBITDA profitability in 2025. As I noted last quarter, the increased cost impact on gross margins and adjusted EBITDA is temporary, and we expect both to improve as we move forward.

With the SYNQ3 acquisition, we are working on migrating their cloud and AI infrastructure to SoundHound so in the immediate term, we have some duplicative costs. In addition, while a portion of SYNQ3's revenue is AI-driven, they also have a legacy call center operation, which their team has been gradually upgrading with AI. We expect to further accelerate this migration, which will ultimately calibrate their gross margins to ours over time. Overall, though, based on initial conversations with customers and partners, we are making great progress, and there is strong interest to even further increase the value we create for customers.

I'll close with another note of conviction in the business we are building. As I've said before, the path forward isn't always linear. In particular, creating disruptive transformational innovation is not for everyone, but it's a strong part of SoundHound's DNA.

When the pieces start falling together, though there's a gravitational force at play. With our proven track record of progress, as each quarter passes, we get closer to our escape velocity. Despite our achievements so far, we don't take our success for granted, and we fight for it every day to aim higher and push the boundaries further measurably and persistently.

Thank you. We will now move to Q&A.

QUESTIONS AND ANSWERS

Operator

Thank you. (Operator Instructions)

Gil Luria, D.A. Davidson.

Gil Luria - D.A. Davidson & Co. - Analyst

Yes, good afternoon. A lot of product announcement and advances. Let me focus on a couple of the ones that seem most intriguing. The first one around the NVIDIA in vehicle. It would be a big step forward for the whole technology around AI to do the inferencing without connectivity. What's the timeline do you think that you can deliver this to one of your automotive customers? So that's one.

I'll bundle the second one on product, which is on the Perplexity, it sounds like you're going to be leveraging Perplexity AI in the SoundHound Chat AI app. Is there a potential down the road for SoundHound technology to be the front-end for the Perplexity app.

Keyvan Mohajer - SoundHound AI Inc - Chief Executive Officer, Director

Thanks for the great questions. So the NVIDIA announcement, as you noted, very big milestone because these generative AI large language models are very large. Typically, they don't fit on the edge, but with this partnership, we are able to run them on the edge, and a lot of the functionality will not need cloud. You still need cloud, like if you want real-time weather information or sports scores, you need cloud connectivity. But for a lot of the functionalities, whether it's from general knowledge to getting things done inside a car or a device, you actually don't need the cloud connectivity.

We think that the use cases are beyond automotive. In automotive, things take longer, especially when you're talking about hardware change. For software, as I mentioned in my comments earlier, we are actually -- we had one case when we went from signing the deal to going to production in a matter of just a few months. But when you talk about the hardware change, that takes longer.

But we think it's not just about automotive, even for QSR, dynamic interaction, drive-thru automation, you could actually bring some of that to the edge. So we are excited about things that can happen faster with that partnership.

For Perplexity, it is not just about our Chat AI app. Our Chat AI is also a platform we offer to our customers, like automotive customers and beyond. We will offer it to them as well, and it will be for additional -- it's an upgrade feature, right?

So they have already upgraded -- a lot of them have already upgraded from our pre-LLM versions to add the Chat AI feature. And as I mentioned again earlier on the call, that's an upsell. So our royalty, we expect, will go up. Now to access to the online LLM, it will be another upgrade moment for us. So it is very much beyond the Chat AI application that's on the phone.

Now you also asked if we would power Perplexity properties. We haven't announced anything yet, but it's a beginning of a partnership we're excited about. We are both NVIDIA portfolio companies -- like NVIDIA invested in us, and then we are very complementary. So we think there's a lot more we can do with them.

Gil Luria - D.A. Davidson & Co. - Analyst

Thank you, Nitesh, one for you. A little big picture. Last year, you were very effective at changing your overall cost structure to fit, frankly, what the capital markets needed you to do, which is to show a clear path to profitability. You did that very effectively. You reached that point.

But as you sit here today, with significant cash on your balance sheet, much lower burn rate, and the long series of opportunities, a couple of which we just discussed, is there a potential or an opportunity for you to move the lever a little bit the other way and say, hey, we have so many opportunities on the technology front that maybe we need to fund more of those and relax a little bit of that shift to profitability?

Nitesh Sharan - SoundHound AI Inc - Chief Financial Officer

Yeah. Thanks, Gil. I'll start by saying principally, we're trying to drive and create long-term value for customers, and we're seeding and hearing the demand. And we're seeing how the technology opportunity is intersecting with that consumer demand real-time and expanding, frankly, every conversation we have with customers. So I think the opportunity in front of us is tremendous.

And so I don't think that gives us a carte blanche to just go spend, spend, spend. We do need to be thoughtful about the pathway and have conveyed our directionality towards getting to a breakeven profile next year. But to your point, I think there is more opportunity that we're seeing every day in terms of active conversations with customers to really go faster, to invest in the solutions.

I think, certainly, your first question on the opportunities in the auto is certainly there, and we're seeing that, especially with the speed that we're able to move with some of the EV players. But more broadly, on the restaurant side in particular, in customer service, there is just so much demand. We highlighted in our prepared remarks a bit around the traction that we're getting with larger and larger QSRs. The larger and larger QSRs for us could be -- at scale with them hundreds of millions of annual revenue -- recurring revenue.

So we see the size of the prize in the short term. And we also know given the ecosystem is so very dynamic, a lot of new players, lot of new technologies that are advancing very quickly, tremendous pace of innovation going on, we need to stay agile. And so that's why the balance sheet is super important for us to have this real arsenal in our back pocket to be thoughtful.

We will do it very judiciously and prudently with capital mindfulness around driving strong returns. But there's a balance in all of that. So I can't give a sort of unidirectional statement. I know ultimately the principle that we govern our choices on investments around is it really creating value for customers, and are we hearing that? And as the echoes get louder and louder for that, we're going to go and serve those consumer interests. So I hope that's not too opaque of an answer for you, but that's how we think about it.

Operator

Mike Latimore, Northland Capital Markets.

Mike Latimore - Northland Securities, Inc. - Analyst

Thanks, yeah. Congrats on all the developments here. Maybe can you just talk a little bit about the synergies you're seeing with SYNQ3 so far. What kind of cross-sells, opportunities are you seeing and have had? Are you able to leverage some of their data to train your models? And then are you able to use some of their resources to help with deployments?

Keyvan Mohajer - SoundHound AI Inc - Chief Executive Officer, Director

Yeah, I'll start and maybe Nitesh can add more about. But absolutely, we see the synergy. We are -- it was a fantastic acquisition. We couldn't be more proud of it. Every day, we feel it. They have a ton of data, and we are already using that to make our models better.

They have a lot of integration, and it's not just about offering a magical AI model that does everything. You have to go and integrate with POS systems. And a lot of these enterprise customers have their own in-house systems that you have to integrate with. They have to -- analytics and menu management and so on. They have a lot of that we are using to accelerate our scale with are organic customers as well -- so on the technology and data side.

But the synergy between the two companies are in terms of experience -- we started as an AI company; we identified restaurant as a very right a business to go into. They started as -- they were restaurant operators, and they identified automation as a good business to get into. And we started nearly 20 years ago each, and then they became more AI. We came into restaurants, but they understand that industry really well. And that's experience is what we needed to improve our scale as we go forward.

Nitesh Sharan - SoundHound AI Inc - Chief Financial Officer

Yeah, and I'll just add a couple of points on that. I think, I kind of break it up into three categories. Revenue, there's a lot of opportunities in terms of the cross-sell, upsell, Keyvan alluded to. I'd say, on top of that, just the relationships they bring and some of the extended conversations were happening much faster than what we would have been able to do alone. That's happening at accelerated pace.

And then just the ability to bring our core engines along with what they've already built, I think is an accelerant with their own customers but also with new customer relationships. So from a revenue standpoint, this is the multi -- sort of medium longer-term opportunities. We just get even more excited several months into the acquisition from the thesis we had going into it.

On the cost side, we've talked about a couple of these, Mike, and I'd say these are -- we're in the midst of this journey, but there are some back-end costs in terms of cloud migration that we're in the middle of driving. There are architectural things in the software stack that we can bring our own again, capabilities in. Go faster than what we were doing, learn from learnings on both sides.

So there's cost elements that you'd certainly didn't see in the Q1 numbers because the Q1 numbers sort of reflect a lot of both acquisition transactional stuff but also just the, call it, unsynergized cost structure -- that's not even a word -- but that's what we're doing on the cost side. And so I think over the next quarters, you'll see more of that efficiency drive through.

One specific thing is the gross margin, and I commented about this in the prepared remarks. But gross margins were depressed in the quarter, but this is okay. This is on plan. We know that they have a call center business and we, over time, will be migrating that to automation. Being able to leverage the real-time production data is gold, to be able to improve our models. And so we're in process of driving that on our own.

And just to put some data points out there -- you didn't ask it -- but SoundHound's gross margin year over year on a standalone basis was up over 300 basis points. So we're still driving the great margin profile, but we're going to have this transition with SYNQ3.

And then lastly, I'll just say the innovation opportunity in terms of synergies and notably, again, data. Data is so important here, real-time, improving our models. And just again, being able to come together and go, boy, this really matters to customers, to be able to talk to their operators in 10,000 locations to say this is what matters to the restaurant ecosystem and to make our products more attuned to what they need, those types of things we're very excited about. So we could go much longer on this, but I know it's a short call, so I'll stop there, but there's a lot more excited about it.

Mike Latimore - Northland Securities, Inc. - Analyst

Sounds like great progress out of the gate. And then just real quick on the restaurant vertical, is there a clear leader here between phone ordering versus drive-thrus in terms of just like what's in the pipeline? Is it skewed to one or to the other very much here? Or is it kind of balanced between phone ordering and driver thrus?

Nitesh Sharan - SoundHound AI Inc - Chief Financial Officer

It's pretty -- it's balanced. Well, it is a bit of short-term, long-term answer to that question. It's balanced, and I would extend it to other opportunities, not simply the phone versus drive-thru, but we're excited about some conversations we're having on with the program we called Employee Assist, which is helping in-store employees. And there's in-app conversations going on that a lot of restaurants are excited about.

Our Smart Answering capability is sort of front-end vehicle on a lot of this is something else. So there's a suite of opportunities. And part of my last answer on innovation, I mean, those are things that are sort of getting incubated here.

And then as we've said before, there's sort of a timeline of deployment. So we know with drive thru, there is hardware requirement. There are hardware requirements. There are cycles we need to go through. We're building great partnerships with many hardware providers to standardize and move faster there.

But that is -- we know that as the breakthrough. Nobody else is doing -- I mean, certainly, we don't disparage competition -- we know that there are other players that could come. But right now it's greenfield. We have a unique value proposition that we're driving. And so we want to go really fast.

And then even on phone ordering it, they have a lot of great partners, and we're growing in that space. And some -- what we find is in certain cuisine types, you see a heavier weighting of phone volume. And so we're going to service those particular cuisine types, more so in that front. So little balanced, but excited on multiple fronts.

Operator

Thank you. Glenn Mattson, Ladenburg.

Glenn Mattson - Ladenburg Thalmann & Co. Inc. - Analyst

Hi. And I apologize if this is repetitive because I missed part of Keyvan's prepared remarks. But Nitesh, you just kind of talked about some of the gating factors in rolling out the offering in retail like some of the equipment that has to be placed in it. And I think last call you guys also kind of talked about the demand just been a little bit higher than you could handle at the given time and that some customers are kind of put on hold while you decide who best to serve and how quickly and everything.

So I guess I'm just trying to figure out or understand if there's been some change there, if you caught up to some of that demand somewhat or if there's more investment needed to make to get to that spot and just kind of an update on where you are from that point of view.

Nitesh Sharan - SoundHound AI Inc - Chief Financial Officer

Yeah. Thanks, Glenn. We're working hard. We are making progress for sure. We don't like that -- last time -- I just want to clarify also, it's not that we're talking about months and months out. We are really trying to address some of these things where we've got a bit of a pipeline that we need to work through with those customers. So there's been a lot of progress.

You'll see unpacking our costs this time -- I know it will be a little complicated with the acquisition, but if I break it apart into kind of three pieces: one is just acquisition transitional things, one is the inclusion of sort of acquisition plus other one-time dynamics and seasonal things, and then there's sort of investments that we will continue to make. Again, it would go back to Gil's question like this target of getting to still profitability next year.

We are accelerating investment in the right pockets to serve that consumer demand and customer demand. So to Glenn to your question, we are making sure that we are hiring the right people, investing in the right capabilities so that we can quickly get and serve customers the right way. And so I'd say we are making really good progress on that.

The challenge in it -- maybe a silver lining challenge is that we're hitting a lot more demand too. Every time we have meaningful innovation and progress, the word gets around pretty quickly, particularly in the restaurant side. We're excited actually. I think it's coming up very soon, the largest restaurant conference show in Chicago, and we've got a big showcase ready to go there, to just get our word out.

So while we are making progress with those existing relationships, the dynamic we're faced with as we're getting more and more demand. And that's a good problem to have but we don't -- we can't sit back, rest on our laurels, we got to invest to make sure that we're serving customer demand.

And so I mentioned in the prepared remarks, with one of the largest QSRs, hearing feedback about the technology moving really well -- in fact, the challenge in that situation was the dynamic interaction technology was taking the orders too quickly for the back ordering preparation to handle. That's -- obviously, we want to work with them together to get that situation ameliorated. But that's a good sign of the progress we can make.

And then hearing comments from our customers about the positivity of working with us, that's what we want to keep fueling. We know that's a virtuous cycle that can keep building.

So I think we're trying really hard to keep pace with it. We're investing to make sure we're serving consumer demand -- customer demand. But I will acknowledge we're still faced with a lot of demand that we're trying to work through.

Glenn Mattson - Ladenburg Thalmann & Co. Inc. - Analyst

Great. That's very helpful and a good problem to have, of course. Second question just for me. The -- I feel like you've hinted at this in the past, maybe in this call as well. But just the outlook for what you're thinking about for future or further acquisitions beyond SYNQ3. Now I realize you have some digestion to do here for that SYNQ3 acquisitions still. But curious what your thought process is in terms of what kind of attributes you're looking for in future acquisitions? And what -- how big your appetite is, I guess? Thanks.

Nitesh Sharan - SoundHound AI Inc - Chief Financial Officer

Sure. So I'll start with, our opportunity organically is tremendous. Just -- we're excited about what SYNQ3 is bringing. We're excited about what we're able to address. But just with the capabilities we have right now, we know we can do a lot of great things. So 100%, the organization is focused on driving that, and it could fuel great long-term growth and build an amazing business.

The ecosystem around us and the macro landscape and what we're seeing from other players, there's multiple things happening. First, I think the recent shift, GenAI is disrupting a lot of people. Number two, it's bringing a lot of new players into the ecosystem.

So we are certainly not going to sit with our head in the sand and kind of just drive our own agenda. We're going to be very mindful because number one, it's not just an acquisition story; it's about partnerships. It's about learning from others. And so we're going to take a very holistic view of being very thoughtful of who are the new players. And we have a team dedicated to being on top of this all the time.

And so the architecture, we think about any organic investment or inorganic opportunity is through our three-pillar framework. We are aggressively going out and driving voice-enabled products: autos, IoT, other devices. We're aggressively starting the journey through customer service leading with restaurants, but our Smart Answering is scaling across others Keyvan mentioned in prepared remarks around fitness centers, beauty salons, real estate industry and so forth -- many, many different types of businesses that we are now servicing.

And we are now, because of the scale, seeing great opportunities in generating momentum with monetization, which is when we're integrating the voice-enabled services with voice-enabled products. And frankly, we see opportunity to drive that organically. And then when we find companies who are doing a great -- they're doing some great things in a particular pocket, we're going to talk to them. And if there is -- 12 things need to line up for M&A to ever make sense, but certainly partnerships makes sense a lot, and we're expanding those. We mentioned a few of those on the call today.

So we're going to be open-minded. Having a strong balance sheet gives us and affords us the opportunity to be thoughtful. And yet again, we're going to be prudent stewards. So everything needs to be on strategy, needs to be on where the world is moving, what the tech is allowing, what customers want.

And in terms of -- I guess you also asked, like appetite, it's all about -- to me, return on capital above your cost of capital, risk adjusted. And as long as that math works out, then we'll be open to it. But we are a small disruptive company, so it's not always a dollar sign; it's also a speed sign.

We want to go fast and continue to disrupt aggressively. So if there's sort of an opportunity that seems like that would slow us down, that's not the right thing. If things that will make us go faster, that's the right thing. So that's the frame we use.

Operator

Thank you. (Operator Instructions)

Brett Knoblauch, Cantor Fitzgerald.

Brett Knoblauch - Cantor Fitzgerald & Co. - Analyst

Hi, guys. Thanks for taking my questions. On the restaurant side of the business, it's nice to see kind of demand continue to increase there. Can you talk maybe about where that demand is coming from, from a lead gen perspective? Is it your outbound sales motion? Are they coming to you, for example, like with Applebee's -- it seems like that got deployed very quickly or is it the POS partnerships that you have with Square and Olo? Just to be curious more on that front about the go-to-market strategy on the restaurant side.

Keyvan Mohajer - SoundHound AI Inc - Chief Executive Officer, Director

Yeah. Thanks for the question. So it's a combination. We have events that we participate in that increases awareness, like the one that's coming up, National Restaurant Association. We have now a good-sized sales team. The SYNQ3 acquisition augmented that.

But we have seen a big shift that maybe 18 months ago, we had to knock on these doors and educate them about the value of voice AI automation. But now we see them knock on our door. Like, a lot of these brands that we used to dream about talking to, now they are coming to us knocking on our door, and they want to move fast. So there has been a very big change in the dynamic of the market.

Brett Knoblauch - Cantor Fitzgerald & Co. - Analyst

Perfect. Thank you. And then on the partnership side, I guess what partnership are you most excited about from a monetization opportunity over the near term? Would it be in NVIDIA? Would it be Arm? Perplexity? Any insights into how we should be thinking about those translating into financials?

Keyvan Mohajer - SoundHound AI Inc - Chief Executive Officer, Director

Yeah, I think channel partnerships are very impactful when there is a complementary business that has the same customers offering them something else than our service on top of it, can be very complementary. And they can bring us those opportunities or take our stuff and take it to their customers. Like Olo, for example, is a partnership we are really excited about.

Those channel partnerships are a very key. But if we can improve our product, we know that it's going to translate to more adoption and more revenue. So the Perplexity partnership that we announced today was along those lines.

Operator

Thank you. (Operator Instructions)

At this time, I'm showing no further questions. This concludes today's conference call. Thank you for participating. You may now disconnect.