Sylogist Ltd.

First Quarter 2022 Earnings

Conference Call Transcript

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Time: **9:00 AM MT**

Speakers:

Bill Wood
President and Chief Executive Officer

Xavier Shorter
Chief Financial Officer

Operator:

Welcome to the Sylogist First Quarter 2022 Earnings Conference Call.

As a reminder all participants are in a listen only-mode and the conference is being recorded.

I would now like to turn the conference over to Bill Wood, President and CEO. Please go ahead.

Bill Wood:

Hello and welcome to our earnings call for Q1 Fiscal 2022. I'm Bill Wood, Sylogist's President and CEO. On the call with me today is Xavier Shorter, our VP of Finance and Chief Financial Officer. In a moment, we will walk you through our performance for the quarter and also provide our outlook for the remainder of Fiscal 2022. To remind you, our fiscal year ends on September 30, and this quarter ended on December 31.

Before we get into it, I should note that this call may contain forward-looking statements relating to the future operations and profitability of the Company, any of which are subject to risks, uncertainties and assumption that actual events or outcomes may differ materially from those we contemplate here. Any such forward-looking statements are made as of today. And except as required by law, we have no obligation to revise them.

Sylogist is a software as a service, or SaaS, company that provides mission critical solutions primarily to three valuable public sector verticals: education, nonprofit and NGOs, and government. Our cloud based platform is well established and used by almost 2,000 customers worldwide.

We are hyper focused on being the leading, most trusted, profitable and growing SaaS provider to our public sector markets. We are delighted to report that we achieved record revenues in the first quarter at $12.6 million, up 32% year over year. In addition, the Company recorded key contract wins in Q1 of $5.9 million, which form a strong basis for ongoing organic growth.

Q1 also saw our acquisition strategy achieve significant results as we executed our two simultaneous, highly accredited deals: Mission CRM and Pavliks.com. Both acquisitions check the boxes on all three of our primary evaluation criteria: adding valuable IP, customer identity, and talent. Additionally, both were on growth paths that we are confident we can accelerate.

I'm pleased to report that the integration of these two companies is well ahead of schedule as we are tracking to complete our 200-plus integration task playbook by the end of this month, four months in versus the six months our plan affords.

I'm proud of how our team has stepped up to bring these two companies quickly and efficiently into the fold, while also continuing to ably lead their respective areas of Sylogist. This gives us even more confidence in our ability to execute on inorganic growth opportunities going forward.

Furthering our M&A readiness, we have increased our credit facility from $75 million to $125 million. To date, we have drawn down approximately $25 million, leaving substantial headroom for further inorganic value creation. We have continued to ramp up strategic growth investments. R&D spend is 450% from the same quarter last year, or $1 million more per quarter, and sales and marketing expenses are up 280%, or $500,000 more per quarter.

Notably, we significantly expanded our sales team in Q1 and again in early January by hiring several quota carrying account executives and sales engineers with significant experience in the markets we serve. I do want to mention that we encountered some headwinds in Q1, which affected our near-term performance. Notably, some unexpected delays in deployments of our contracted bookings and upgrades due to COVID-19 Omicron variant surge. However, these deployments have now resumed their anticipated cadence.

The quarter also did not fully reflect the anticipated Fiscal ‘22 revenue run rate contribution of Mission CRM and Pavliks. Both were acquired in the first few weeks of Q1, which understandably included myriad distractions that impacted the normal cadence of the businesses. With the conclusion of integration activities, we are seeing their usual pace and focus resume.

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Also, very notably, we are pleased to announce that we finalized our strategic retention program with our legacy school and municipal customer communities in North Carolina and Western Canada, respectively, in exchange for a commitment to three-year contracts. Extensive outreach to these customers over several months culminated in a modest 15% discount to face value on a year-over-year basis, which secured $6.4 million in ARR, or $19.1 million over the life of these new contracts, not including the service revenue that we will earn as we upgrade these customers to our modern platform. We consider the outcome to be significant and accretive to long-term shareholder value, as we have locked up material ARR that was at risk later in this fiscal year.

Other than the call outs I just highlighted, the business performed as or better than we planned in Q1. We are focused on our growth and driving value creation, guided by the rule of 40, and remain on track for our high single-digit organic growth target as we exit Fiscal ‘22 while maintaining strong EBITDA margins as we scale.

I'd like to now turn things over to Xavier Shorter to take us through our Q1 financials in more detail.

Xavier Shorter:

Thanks, Bill.

Revenue for the quarter was $12.6 million, up from $9.5 million in Q1 2021. This increase was due mainly to the acquisitions of Pavliks and Mission CRM, which contributed 17% of the total revenue. Our gross margin for the quarter was 65% compared to 73% in Q1 ’21. Margins declined as anticipated, mainly due to the Omicron related project delays, the recent acquisition and the strategic customer discounts that Bill mentioned.

R&D expenses were $1.2 million, up from $219,000 in Q1 last year. This was all according to plan. G&A costs rose to $2.2 million, up from $1.1 million in the same period last year. Sales and marketing costs increased from $175,000 to $667,000. These increases are due to our strategic investments in product advancement and innovation, growth capacity and scalability. As a result of these investments, and as planned, Adjusted EBITDA was $3.7 million in the quarter, down from $4.9 million last year.

Q1 saw a net loss of $99,000, down from a net income of $381,000 last year, as revenue growth typically lag the investments we're making, compounded by some latency in our project revenue we expected in Q1 due to the Omicron variant surge.

Earnings per share were down from $0.08 last year due largely to $2.5 million dollars in non-cash amortization expense related to the intangible assets we acquired in our recent acquisition. Sylogist distributed $3 million to shareholders in dividends in Q1, with quarterly dividends holding steady at $0.12 per share.

Our balance sheet is strong as we finished Q1 with $18.2 million in cash with approximately $100 million of headroom in our credit facility. We have the resources to pursue material M&A growth.

With that, I would like to hand the call back over to Bill with some final thoughts.

Bill Wood:

Thanks, Xavier.

Before we take a few questions, I just want to conclude with a few thoughts about our outlook for the remainder of the fiscal year. We made solid progress on both our organic and inorganic growth goals in Q1, securing material levels of ARR and service bookings in the quarter that we hadn't seen in several years, as well as closing two very strategic and accretive acquisitions.

Additionally, we secured strategic legacy customer communities with long-term ARR contracts that locked in a material component of our reoccurring revenue base for years to come and adds to our SaaS upgrade backlog. I consider these achievements to be clear indication that we are executing on our plan and gaining traction.

As we continue to execute and focus relentlessly on selling to our ideal customer profile, we remain confident that we can deliver on our growth objectives. With our increased line of credit, we have ample access to dry powder to continue to acquire and integrate meaningful strategic assets. With the acquisition of Mission CRM and Pavliks this quarter and Municipal Accounting Systems seven months prior, we are proving that we are proficient at identifying, closing and integrating high-quality strategic companies.

Notwithstanding our growth objectives, we remain committed to maintaining healthy but sustainable Adjusted EBITDA margins going forward. We are committed to maintaining a rule of 40 posture on our combined EBITDA earnings margin and revenue growth run rate.

I'll share another important data point. Since joining and prioritizing a customer first mindset at all we do in investing in our products and people, we have improved our customer net promoter score, or NPS, almost twofold to 41, widely considered a high score. The November NPS survey of our entire customer community had a greater than 25% response rate. That is a huge accomplishment in sea change, because, as I've shared previously, happy customers and their referrals are our best source of quality leads in creating positive buzz in our markets.

Our overall high customer wellness, a motivated talented team and expanding pipelines gives us confidence that our strategic investments and efforts are paying off. We are excited by what we've been able to get done in a short period of time. I look forward to sharing more evidence of successes throughout Fiscal 2022 as we continue to execute on our strategy and accelerate value creation.

I'd like to conclude that Sylogist is at a completely different place from where it was just 12 months ago. We have the strongest management team in the industry. While there's always room for continuing improvement, we are executing well against our strategic plan.

We'll now move into the Q&A session if there's questions in the queue. Let's move ahead.

Operator:

Thank you. The first question comes from Amr Ezzat with Echelon Partners. Please go ahead.

Michael Vaccarino:

Good morning. It's Michael Vaccarino here on behalf of Amr.

You spoke a bit about this in your prepared remarks. Can you provide a bit more colour and how your two recent acquisitions are performing relative to your expectations?

Bill Wood:

Yes. The Mission CRM ideal customer profile really overlaps meaningfully with our Serenic Navigator ERP. We already have a few customers adding one or the other depending on their respective starting point, which I think is great sign relative to not only the appetite within the base, as we anticipated, but the team's collaboration to make it happen. There are other crossing opportunities in the pipeline that we see.

Relative to the Pavliks' on the cross sell opportunity, we are already seeing Pavliks portal connector in introducing it within our government customer community, and are looking at opportunities to do the same for our K-12 and non-profit customers. We are also well along with fully integrating the Pavliks Dynamics 365 practice with our info strat business unit, and are beginning to see some cross selling opportunities materializing and adding bench strength to accelerate our implementations in North America.

Michael Vaccarino:

Great. On gross margins, should we expect mid-60% going forward in light of the recent acquisition? Or are there other moving parts that we should be thinking about?

Bill Wood:

Xavier, would you like to respond to that?

Xavier Shorter:

Yes, I'd say mid-60s to low 70s is probably where we track. We did have the delays. As Bill pointed out, we had some milestone billings that were deferred or delayed until this quarter. So, I see that picking up anywhere high 60s to low 70s.

Michael Vaccarino:

Great. Thank you. Can you remind us of what revenues are from the legacy platforms that you're sunsetting? I'm trying to get a sense of how this compares to the new a three-year contract you secured.

Bill Wood:

I don't think we've carved that out specifically in what we've shared previously, but I think you can unpack it generally from the comments that we shared today, which is $1.2 million per year, approximately 15% lightning of that portfolio in return for what we secured over a three-year timeframe, plus the services revenue on top of it.

Michael Vaccarino:

Okay. Last one for me, can you give us a sense of how we should expect operating expenses to evolve going forward? There are a couple of moving parts with investments in the business and widespread wage inflation. Maybe you can give us a sense of what stage you're at in terms of reinvesting in the business. Can you also speak to how pronounced the wage inflation you're experiencing is?

Bill Wood:

Xavier, please.

Xavier Shorter:

Our continued investment, so as Bill pointed out, we just brought on some quota carrying sales reps and sales engineers in Q1, and a couple more, or three more, in January. As far as other investments, we were really purposeful in some of the R&D spend over the last year to shore up and add innovation using offshore resources to get through some of our sprints. As far as pressures as far as wages, I think we're doing well in that regard, in that we're able to attract high talent, good talent, with our competitive salary offering as well as an opportunity for the employee bonus plan that was rolled out last year. I think we were able to secure really good talent. As for our continued spend, I see that we've made a lot of investment thus far. I think they'll start to bear fruit in securing, landing and bringing on more deals as the year progresses.

Bill Wood:

Just a reminder there on the employee bonus plan that was introduced. It was a think something that we wanted to get out ahead of relative to the overall pressures that are going on in the industry. The benefit there is hyper aligned with the success KPIs that we've articulated relative to the company’s performance. So, good alignment there in terms of overall value creation aligned with shareholder interests.

Michael Vaccarino:

Great. Thanks for providing more colour on that. Thanks for taking my questions. I’ll pass the line.

Operator:

The next question comes from Nick Agostino with Laurentian Bank Security. Please go ahead.

Nick Agostino:

Yes. Good morning. A few questions on my part.

First, Bill with regards to that three-year contract that you renegotiated, are there any other contracts or any other relationships that maybe are in a similar jeopardy? Because you said that these contracts were at risk late this year. Are there any other contracts that are in a similar situation, either for Fiscal 2022, or even Fiscal ’23, where you might need to offer similar pricing discounts?

Bill Wood:

Hi, Nick. Good morning. Great question.

No, this was a one-time event based on our portfolio as we see it now. We were aware of this. I was aware of it when I joined. We wanted to get out ahead of it, but the pricing discounts really locked in those customer communities, and their ARR, in a way that is very beneficial for myriad reasons. No, we're really not seeing anything else as we sit now relative to anything that we need to do it. We see that as a one-time event, and one that we wanted to get out ahead of with those two customer communities.

Nick Agostino:

Okay, appreciate that colour. Then looking at, because you spoke about rule of 40. Obviously, this quarter when you look at EBITDA margin and your overall revenue growth, I think you're north of 60%. At the same time, when I look at your EBITDA margin, it has been coming down from the 50% level; like this quarter, you're down to 30%. Just maybe give us an idea as to how when you guys are looking at the business and how you're modeling the business. Where do you guys see the floor when it comes to the EBITDA margin side of the whole equation?

Bill Wood:

Nick, I think the best way is really twofold. Obviously, the result lag the investment in terms of what we're doing. I think that the rule of 40 posture that we've articulated as we think about the overall year in Fiscal 2022 we see balancing and being at or above that overall posture. So, I think that you can back out, even though we're very conscious in the strategic spending that we're making. The effect of that we see accelerating in the latter part of this year and further through 2023.

To that end, I think it hopefully answers your questions with a little more specificity about how we're thinking about that. We are very conscientious about the spend, but knew, as I've shared since I started, this was a company that really needed to be jumpstarted in terms of its ability to move into a growth profile. To that end, the investments are made. We had certainly the realities of COVID affecting us through ‘21. Again, the surge of COVID Omicron variant impacted us through the first quarter of this year as well.

Nick Agostino:

Okay. Just to confirm, you did say that those impacts you saw through the first quarter, that those are, I guess, pretty much behind you right now?

Bill Wood:

That's correct.

Nick Agostino:

Okay. My follow-up question with regards to professional services. Certainly very strong number in the quarter, $2.9 million. Obviously, you've got those contracts you guys call out back in November of last year. Then you've got the professional services component tied to these new three-year contracts. Any colour you guys can provide as far as the run rate we should be thinking about when it comes to professional services as we move through Fiscal 2022? Should we be thinking of a $3-million plus run rate over the next few quarters?

Bill Wood:

Yes, I appreciate the insight you're hoping to gain there, but it really depends on the solutions, the project size, the customer footprint, as well if it's a new customer or customer cross sell in terms of our revenue recognition and the cadence for that. We're in all of those scenarios right now. I will say that it's unlikely that a typical deployment spans much more than three to 12 months. With the exception of a few very large projects that may take anywhere from 12 to 18, maybe even as long as 24 months. On the flip side of that, some of our solutions only take a few weeks to implement it.

I think the overall balance, anything that we've talked about in terms of materiality of the revenue that we brought in, in bookings, we're confident that we can see a majority of that in Fiscal 2022.

Nick Agostino:

Okay. Then my last question, obviously, just within the U.S. market. The infrastructure bill or bills have made their way through the House. Have you guys started to see any of those funds flow down to some of your customers and therefore started to see the benefits of that? Or is that something we should anticipate through the rest of this year? I'll leave it there.

Bill Wood:

We are starting to see that. The realities that I've shared before of the pressures that the reality that COVID placed on our customer community in appreciating that a digital transformation was not something that they could delay any longer. I think to that end, the infrastructure bill and the dollars we're seeing and available dollars that are put in without a lot of specificity into the markets we serve is showing up. I think it's moving people not only into a posture to accept that the transformation they need to make is real, but they have the budgets to be able to execute against that and get out and purchase what they need. We're very well positioned to be able to capture that increased momentum that we're seeing.

Nick Agostino:

Okay, great. Thank you.

Operator:

Our next question comes from Gavin Fairweather with Cormark Securities. Please go ahead.

Gavin Fairweather:

Good morning. I thought we'd start out on organic growth. You outlined some of the headwinds that the business saw in Q1 that led us to be negative in the quarter. Obviously, you remained confident in your high single-digit target for Fiscal '22 overall. So, I was hoping you could just provide a bit more colour on what you're seeing in the pipeline in terms of new revenue from the base and new logos as well, just to help us bridge that gap between Q1 and your Fiscal '22 expectations.

Bill Wood:

The sales pipeline overall continues to benefit from the pause that we saw in 2021, as well as the build of what I just described in organizations leaning in on what it is they need to do from a transformation standpoint. So, the bookings pipeline is strong, adding in the sales account executives quota carrying to be able to go out and get that. These aren't green. These are folks that are familiar and experienced in this space in being able to be effective hunters.

The idea of our customer wellness continuing to increase and at a very, I think, a very helpful level in terms of that main ingredient of driving quality leads to us that aren't just top of funnel general leads, but probably a colleague got to saying, "What it is, and how was your experience with Sylogist going?" and a customer saying, "We're very pleased, and they're a partner that helped us through very difficult times."

To that end, Gavin, I feel very good about our pipeline and now our bulked-up headcount to be able to go and deliver on the available revenue recognition associated with that. So, I think all things are very positive on both fronts in terms of the pipeline, as well as our ability to go get the revenue.

Gavin Fairweather:

That's great. Then just within the Bellamy and SunPac customer communities, can you give us a sense of what level of interest there is in those communities in upgrading or migrating to cloud? Maybe you can just provide us with some colour on kind of the revenue lift for you on the recurring and from a services perspective as you execute on those migrations?

Bill Wood:

I think it would be fair to say that it would have been a difficult conversation with any of them if they simply felt they were kicking the can down the road for the reasons I said. They too are pressured with the digital transformation that they have an appetite for knowing that they're on legacy systems.

The appetite across the communities is high. We have made a compelling case with really roadshow and purposeful webinars to acclimate them to our new technology, and a roadmap as to where we're going. So, I think there's quite a bit of excitement. So, this was a purposeful program and a conscious decision on behalf of these two customer communities about us as a partner long term.

I also feel that the pricing opportunity beyond the services revenue is real for it to be able to create some lift, not only because some of the more modern, more exciting, more innovation on the platforms that there'll be moving to, but also more IP that we can cross sell into it, as we talked about, the overall capabilities and added IP into the platform, including payments and so on.

I think these are all contributors to how the overall current position and wallet share of these customer communities can be increased over time with their upgrades.

Gavin Fairweather:

That's great. Maybe from a product R&D perspective, I know one of your priorities is getting to market with navigator for municipalities. Can you just provide us an update on that initiative, when you expect to be in market and how you're thinking about the ability to win new logos with that product?

Bill Wood:

Very excited about the opportunity. I think it is a market that we can lean in on and offer something that I believe that there's an appetite for within not just Canada or the U.S., but both, in the mid-market where a lot of legacy players are now running into the wall of meeting this digital transformation appetite. So, I think both from an organic and inorganic side, we have opportunities that we're excited about.

The overall go to market, it's a project that is already staffed. The base of the evolution is on technology and IP that we already have. It's simply adapting that to be able to meet the needs within the municipal community. To that end, we expect to be in a position to be able to have demonstrable interaction with these customers, in terms of queuing them up for some early adopters in 2023, then accelerate in the back half and '23 and '24 as we then cadence them into their upgrades and it suits where they are in their planning process.

Gavin Fairweather:

That’s great. Then just lastly for me. Obviously, the credit facility moving up to $125 million from $75 million previously. Obviously, the thought process I imagine is tied to M&A. So, perhaps you can just give us an update on the deal flow that you're seeing and the deal environment that you're encountering out there.

Bill Wood:

Our overall M&A pipe is strong, and actually stronger in terms of quality and visibility than any time that I've been with the Company over the last 15 months. I really give credit to the team to be able to have the discipline to not just be dialing out there and trying to find but really identifying, once we identify, getting into meaningful conversation about why Sylogist could be the partner that they should think about. Because, as I said before, if we can catch them before they're in a sales process, that usually leads to a positive result on a lot of fronts.

I think the idea for us is in the markets that I've talked about and that we're focused on. We continue to see quality targets. We are also now, because of the three acquisitions that we made in a pretty tight timeframe, and the results of those, what the kind of buzz are around those from those leaders and so on that were acquired, the positive experience that we had, it wasn't a buy and bury that the staff just dismissed and just trying to do it in a draconian way.

I think that has brought quality leads to us, both through brokers as well as direct outreach. So, I feel very good about kind of what we've demonstrated to ourselves and to the markets, and not just quantity but quality of targets that we're tracking.

Gavin Fairweather:

Great. That’s it for me. Thanks so much.

Operator:

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.