Sylogist Ltd.

Second Quarter 2022 Earnings

Conference Call Transcript

Date: **May 12th, 2022**

Time: **9:00 AM MT**

Speakers: **Bill Wood**
President and Chief Executive Officer

Xavier Shorter
Chief Financial Officer and VP, Finance

Operator:

Thank you for standing by, this is the conference operator. Welcome to the Sylogist Earnings Call for Q2 2022.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue you may press * then 1 on your telephone keypad. Should you need assistance during the conference call you may signal an operator by pressing * and 0.

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

Bill Wood:

Hello, and welcome to the earnings call for Q2 of Fiscal 2022. I'm Bill Wood, Sylogist President and CEO. On the call with me today is Xavier Shorter, our Chief Financial Officer. In a moment, we will walk you through our performance for the quarter that ended March 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 assumptions, and 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 to nearly 2000 customers worldwide, primarily in three valuable public sector verticals: education, nonprofit, and NGOs and government. We continue to execute our strategy to grow revenue both organically and inorganically to deliver increased shareholder value.

After experiencing headwinds in Q1 and the first half of Q2 due to the Omicron variant, our growth trajectory accelerated in the back half of the quarter. Q2 organic growth on an overall basis was slightly positive for the first time since I joined Sylogist, and for many quarters prior to that, and as I mentioned was up meaningfully over Q1. From another angle, adjusting for the strategic one-time customer discounts we discussed on our Q1 earnings call, organic growth this quarter was approximately 4%.

As a reminder, these were one-time discounts for two strategic legacy customer communities, which locked them into three-year contracts, securing $6.4 million in ARR plus the professional services and subscription fees associated with those customers moving to our modern cloud platform. We also saw material acceleration within the quarter, with organic growth increasing January to March.

While revenue in the early part of the quarter looked much like Q1 amid the continuing challenges of Omicron, revenue in March increased by 8% over the average of January and February. Overall, our growth strategy continues to show solid progress.

So far in Fiscal '22, we have closed nearly $9 million in new bookings with contribution from across the business, including our three most recent acquisitions. Our post demo close rate is trending up and now in the 35 to 40% range due to our strategic focus on an ideal customer profile, investments in best-in-class offerings and high customer satisfaction, which underpins strong references to peers considering our solutions.

Our workforce is stable and we continue to attract high quality talent, and hiring is on pace and budget. We're seeing strong inbound interest in new positions we post in sourcing great candidates ourselves, which minimizes escalating recruiter fees, and more importantly, gives us confidence in our go-forward outlook to drive growth and scale the business.

We are also leveraging strategic contractors to align with our in-house teams to accelerate our platform roadmap, innovation, and our competitive positioning, as well as deliver revenue generating project services. In support of our growth strategy, we are seeing a number of positive trends across the business. With that in mind, I want to highlight a few key developments.

First, we are seeing the Wen-GAGE platform, the financial HR student information and lunchroom solution we acquired with municipal accounting systems in late 2021, gain expanded traction. We are also increasing K through 12 customer wallet share, first with a newly developed employee document management module, which further rounds out our K-12 HR capabilities. The initial uptake of this module has been double what we expected, a very positive line that our new account management focus, agile product development methodology, and go-to market investments are working. I'm also pleased to report that we are already in discussions with several school districts in North Carolina, who are excited about the potential of the Wen-GAGE platform as their modern path forward.

Secondly, we have recently completed a successful pilot of SylogistPay, our new payments platform within our MAS K-12 customer community who see the simplicity and value of an integrated online payment solution for the various fees they collect. We are also ready to roll out SylogistPay within our newly acquired MissionCRM platform, and expect both to start contributing to our financial performance in Fiscal 2023. We are also earning new logo wins for SylogistPay with more exciting opportunities on the horizon.

Third, we are seeing the results of investments in our channel strategy, having signed up several well aligned new partners and re-established the relationship with several key partners that had drifted away prior to me joining the company. We have already landed several partner source bookings from our NaviPayroll, and Serenic Navigator solutions over the last few months through these partners.

Fourth, our strengthened partnership with Microsoft is paying dividends in terms at increased alignment of our respective product roadmaps and strategy, collaborative marketing and lead generation campaigns, and new sales opportunities.

Fifth, the on-prem to cloud customer upgrade queue is matriculating and customers are thrilled with the experience of using the software in a 100% SaaS environment. Not only is that paramount in continued strong retention and wallet share expansion, but the strong references they provide to peers that are looking to move to the cloud is invaluable.

Finally, we are on track for a pilot launch of our 100% cloud-based ERP platform for municipalities later this year. This not only provides a path forward for our current municipal customers, but catapults us into a desirable position to attack the large municipal market opportunity in North America.

I'm pleased to report that we completed the simultaneous integration of both the Mission CRM and Pavliks acquisitions into Sylogist in Q2. When I say integration, I mean: systems, people, processes, reporting lines, HR, strategy, customer billing, payroll, financial reporting, everything. To the credit of a proven integration playbook, the leadership team, and everyone involved that didn't stop doing their day jobs while they rolled up their sleeves, we were thrilled to do so in record time, bringing both companies completely under our umbrella in less than 120 days, versus our 180-day estimate. This further demonstrates our ability to transform and move the Company forward organically, as well as grow the business through acquisitions.

We look forward to continuing this positive trajectory through the back half of Fiscal 2022 and beyond, and remain confident in our high single digit organic growth target for Fiscal '22 that we shared previously, and we remain committed to operational excellence and a Rule of 40 posture with an EBITDA margin at or above 30%.

I'd now like to turn things over to Xavier to take us through the Q2 financials in more detail.

Xavier Shorter:
Thanks, Bill.

Revenue for the quarter was $13.1 million, up from $8.9 million in Q2 2021, an increase of 48%. This increase was due mainly to the acquisitions of MAS, Pavliks and Mission CRM, as well as the organic growth that Bill referred to in his opening remarks.

Our gross profit margin for the quarter was 64% compared to 71% in Q2 2021. Margins fell mainly due to the higher proportion of professional services revenue from recent acquisitions, and the purposeful customer discounts that secured $6.4 million in ARR. Operating expenses were up due to our continued investment in product development and go-to market capabilities. Adjusted EBITDA was $3.9 million in the quarter, down from $4.4 million last year, due to our strategic investments and growth.

We continue to anticipate that as we focus on growing our business, EBITDA margin should be at or above 30% going forward. Q2 saw net income of $685,000, down from $1.1 million last year. Earnings per share were $0.03 compared to $0.05 last year. Non cash amortization charges related to our recent acquisitions continue to have a material impact on our bottom line.

Sylogist also distributed $3 million in shareholders dividends in Q2, with the quarterly dividend holding steady at $12.5 per share. Our balance sheet is strong, as we finish the quarter with $16.9 million in cash. With substantial headroom in our credit facility, we have the resources to pursue further M&A growth. With that, I would like to hand off the call to Bill for some final thoughts.

Bill Wood:
Thanks, Xavier.

I'd like to share a few thoughts on our outlook. I see this quarter as further evidence that our growing investments are paying off. January and early February were difficult months as the Omicron variant continued to delay project work. However, we kept our heads down and pushed roadmap initiatives forward and aligned and expanded capacity.

By March, we were recognizing 8% growth over January and February results driven by both new deals and project delivery acceleration. Given the times when I also want to highlight that Sylogist is generally inflation proof, as we have repapered all customers and introduced an annual automatic price increase clause we can trigger. All new bookings and new projects are priced at the current rates. We are not subject to supply chain disruptions or any material third-party fee increases that could impact us.

In conclusion, Sylogist is hitting its stride, and we are tracking to our plan. We have made material progress in executing our overall growth strategy and initiatives, which our numbers are now starting to reflect. We are excited about the path ahead and determined to drive continued successes and shareholder value creation through the remainder of Fiscal 2022 and beyond.

Thank you for your continuing support and interest in Sylogist.

I now would like to open the call for questions.

Operator:
Thank you. We'll now begin the question-and-answer session.

Our first question is from Amr Ezzat with Echelon Partners. Please go ahead.

Amr Ezzat:
Bill, Xavier. Thanks for taking my questions and congrats on reverting back to positive organic growth territory.

Bill Wood:
Thanks, Amr.

Amr Ezzat:
My first question is on professional services. You guys seem to be running track record numbers, even if I exclude the contribution from acquisitions. Am I to assume you guys are at full utilization and is it hampering your growth at all?

Bill Wood:
Amr, this is Bill. Yes. Great question, and I think the key for us is, it had been hampering the idea of the projects actually kicking into gear. To that end, the Omicron variant really extended that into Q2 in the early part of it a little bit more than we anticipated.

In terms of the ability going forward though, our workforce is now in place. We've expanded our capability to deliver resources, both inhouse, as well as through retain contract external resources and we have the backlog in place. So, what we look at in terms of our anticipation going forward is our ability to deliver on projects that had been somewhat impeded as well as our workforce in place to be able to go get that revenue at an increased clip than we had before.

Amr Ezzat:
Great. Then maybe related to that Bill, can you speak to how labour inflation and I guess shortage in the tech space is impacting you guys? I know you're trying to go externally as well. Then would we expect any sort of margin erosion, or do the escalators that you spoke to at the back end of your prepared remarks fully cover any cost increases?

Bill Wood:
I wanted to call those two components out, both our ability to attract talent, our ability to have longstanding relationships really to the credit of our CTIO that came on board. She had relationships with offshore resources that were super well aligned with the delivery and product development efforts that we conduct within Sylogist, and we've been able to leverage those. So, we don't have a real angst about the idea of the ebb and flow. We have a good sight line to the dependability of those.

On the wage standpoint, while certainly wages are going up, the positions we're posting are getting great interest. As I've said in previous calls, Sylogist is a bit of a unique blend of a do-good company that also is in the technology space. To that end, for a person that has made a personal choice to say, listen, I want to change something about my trajectory, we are a unique opportunity for them to blend their skill set, as well as deliver on the idea of impacting the world in some way, be it locally or on a global basis because of the work that our customers do. So, I feel good about our ability to attract talent, the wages we're paying, and not getting into some of the need of placement agencies and so on.

We've had a relatively small dependency on them in terms of our hiring pace that we've escalated because of the inbound interest that we're getting. So, I feel quite comfortable in our overhead and our ability to manage our costs associated with a dependable workforce.

Amr Ezzat:
Great. That's great to hear. If I could switch gears to Mission CRM, I mean, it was always dubbed as a good acquisition that could become even a greater one, if they hit their earn out targets. I know we're still very early on, but can you give us an update on how things are tracking for them, and do you feel the Fiscal 2023 earn out targets are possible at all at this stage?

Bill Wood:
I think they too had some of the impact of Omicron in terms of their ability to have customer deals matriculate and deliver on services, but in the back half of Q2, much like the rest of the company overall, they have very strong backlog bookings matriculated in terms of what was anticipated maybe earlier in the year. Their workforce now is deployed at a pace that we anticipated a little bit earlier in the year as did they.

The appetite for their product is extraordinarily strong. There was no blind spots for us relative to that acquisition in terms of the opportunity in the market as we saw it, as well as the extension of us from a product Company to a platform play in terms of what we see the market having a strong appetite for. To that end, we think they're tracking quite well in terms of their overall trajectory of the growth that we anticipated for them.

Amr Ezzat:
Great. We'll stay tuned, I guess. With the integration of Pavliks now completed in record time, can you give us a sense of the current M&A environment for you guys and whether you guys are still seeing interesting opportunities, how pricings for potential targets has evolved over the past couple of quarters?

Bill Wood:
Yes, our pipeline is as strong and I think more refined than at any point. For us, we feel good about the number of targets and discussions that are ongoing. I think the overall price realities still continue to be high, but that's never really been a deterrent for us, both in terms of if we wanted to lean in and do a transaction, but also with what we proved out to be our ability to find companies that weren't, or didn't see themselves as being for sale and maybe not in a process and some of the dizzying prices that are associated with the feeding frenzy around that.

Now, do we see maybe some of the price at realities coming down as there's more pressure on tech companies in the market? Possibly, but I think to the extent as we look at it, we are still looking at how it adds value to us in terms of IP, customer density, as well as a workforce talent. Those are the criteria that will remain the same for us going forward.

Our pipeline is as strong or stronger than ever, and our conversations are going on in earnest on a ongoing basis. We just expanded that team also by another individual that'll be coming on board to be able to continue to prospect. So, it is grown, now since I joined, twofold, and I think it'll be a continued area where we continue to invest and look for opportunities on the inorganic side.

Amr Ezzat:
Fantastic. That's great colour. Congrats again. I'll pass the line.

Bill Wood:
Thank you, Amr.

Operator:
The next question is from Nick Agostino with Laurentian Bank. Please go ahead.

Salman Rana:
Yes. Thank you. This is Salman Rana on behalf of Nick Agostino.

First of all, congratulations on the result, guys. My first question is about the individual markets. It seems like the K-12 market, that's the vertical that pretty much drove growth in the last two periods.

First of all, does that hold true? Secondly, which vertical do you believe, Bill, is expected to drive growth in the coming quarter, fiscal quarter two?

Bill Wood:
Yes, I wouldn't put a particular anointment on K-12 as any disproportionate growth lever for us. We're seeing strong growth, especially in the back half of the quarter across the business. Specifically, we see the NPO NGO customer community strengthening relative to their appetite for project work, as well as new IP and expansion of subscriptions as they think about their usage within their footprint.

We're certainly seeing on the municipal side as dollars I think are getting closer to their budgets and being able to spend in the federal programs that are coming down to the local level, we are seeing more government activity, those deals have been slowed, but we see them still strong in the pipeline. We think in the back half of the year and into 2023. We see that as an area that will continue to strengthen for us.

Back to the education side, I do feel that there is opportunity and I believe that our competitive position on that landscape is very good. I think the MAS acquisition and the assets that they brought to us has allowed us to really refine our strategy about what that go-forward footprint looks like. I think to that end, we believe that there is opportunity, not only within that North Carolina community of customers that I think many had written off because of some of the realities that came to be a few years ago, that's very much back in play.

Lastly, as I mentioned in my prepared remarks, the municipal market which we see is going through a material transformation, that's why strategically we made that decision to invest in a true SaaS solution, in a brand new solution based on the Navigator platform for that community, we see that having strong growth potential and having that product development effort come to fruition in the latter part of this fiscal year will set us up to be able to start piloting with new logos, as well as existing logos in the back half of this calendar year, which we're very excited about from a North American perspective, not just a regional perspective in terms of our go-to market. So, we're going to be leaning in on that space.

Salman Rana:

Understood. That's great colour. Thank you, and could you provide us any colour into how fiscal quarter three to date is going? It seems like the momentum is carrying on from the last two weeks of March. Any additional colour there would be really appreciated.

Bill Wood:

Yes. I think you picked up on the right parts that we hoped others would in relative to the comments. We see our cadence at this point more similar to what we saw in the March timeframe than we did some of the pressures that we were seeing in the early part of Q2 that were, as I said, much, much more like Q1.

The outlook as we would think about it and our confidence in that is really coming from that strength and idea that projects are now at a cadence that we anticipated them to be. Our workforce is in place and our ability to churn through the revenue opportunity that we already have in hand is increasing. Now barring any resurgence, if you will, of Omicron that I think affects our market a little bit more than others, only because of the orientation they have to the public space that they serve to that end, that's out of our control.

But the things that we can control, we're feeling very good about in terms of our workforce alignment, our product readiness, as well as a competitive landscape and our ability to continue to win new bookings to continue to refill that backlog that we're churning through at an increased pace from any time I joined the company.

Salman Rana:

Understood. My last question is about the EBITDA margin. With this quarter's around 29.8% margin seems like Sylogist has pretty much set a floor especially with the outlook that you've provided and the growth opportunities going forward. What kind of margins are you targeting or expecting in the near term? Is that going to be in the high 30's, mid-30's? Any colour there would be appreciated. Thank you.

Bill Wood:

Yes. I think in a general sense, we continue to commit to that Rule of 40 posture and I think the blend that we see is high single digit complemented then by the EBITDA contribution to that Rule of 40 posture. We feel comfortable with that going forward, not in terms of the idea that we are going to get too locked into a number.

If there's opportunities that we want to invest behind to be, once we see real cadence and increase strength and have confidence in those, we will do so. We don't want to impede shareholder value creation by the idea of a posture that we've adopted, that we are not willing to put our money where our mouth is to be able to drive growth. That we're turning green shoots into really interesting opportunities or more interesting opportunities to create value. Overall in general, our Rule of 40 posture or greater is something that we're committed to with those two levers that they include.

Salman Rana:
Oh, okay that's great. Thank you very much, Bill. Will pass the line.

Operator:
The next question is from Maxim Barron with Cormark Securities. Please go ahead.

Maxim Barron:
Hi there. Thanks for taking my question.

I was hoping to follow up on one of those questions that was asked previously about the different patterns from the different customer groups that you have. I was just wondering if that improves a different churn rate that you are seeing in the market, and maybe how you see that progressing in the future?

Bill Wood:
Xavier, do you want to speak to that?

Xavier Shorter:
The question is around churn rate or matriculation of deals in the verticals?

Maxim Barron:
Changes in churn rates, primarily.

Xavier Shorter:

In churn rates. So, for us, over the last year, we've invested in a dedicated group for customer success, and that has paid huge dividend in communicating with all our customers. This culminated in those three-year deals for the legacy groups wherein we locked them in at ARR of $6.4 million over the next three years. These were customers in some instances ready to look elsewhere.

To that end, we see our retention rate quite high and our customer NPS that we measure kind of their attitude towards us and how well that group is doing has improved drastically. It's a sea change from where it was a year ago. I see the risk of churn kind of really low and kudos to the team for doing the great work that they're doing.

Maxim Barron:

That's good to hear that the risk of churn is kind of low at this point. The second question that I had was on your investment in intangibles. I know it ticked up a fair bit from the prior quarter. I was just wondering, is that related primarily to the SylogistPay solution that you guys are working on and should we expect this pace of investment to continue in the future?

Xavier Shorter:

Yes, so good question. The pace will continue. It's not squarely in any one of our offerings. We have transitioned entirely to an agile product deployment methodology, and within each one of our verticals, we have sprints. Within those sprints, we look to see what they're working on that is more of a maintenance and support standpoint and then also what is an enhancement or adding additional functionality for which there is a future market.

For us, at the end of Q2, that's really indicative of where we see it progressing for the remainder of the year, but again, it's an agile approach wherein we look at sprints enhancements to get them out the door to our customers more real-time, than say the waterfall where we would pick a few big projects and work on them over 18 months. Now, we're delivering at a much quicker cadence. So, yes, I see that investment as you see it through the end of Q2 to continue.

Maxim Barron:

Got you. That makes sense. Thanks for taking my questions. That's all I had.

Operator:

This concludes the question-and-answer session. I'd like to turn the conference back over to Bill Wood for any closing remarks.

Bill Wood:

I just want to thank you again for your continued support of Sylogist and reemphasize that we are tracking to our plan. I think the idea that good things are ahead for Sylogist, I continue to feel like the investments we're making are now turning into those things that we can clearly see relative to our customer opportunity in terms of cross selling IP that we have acquired as well as what we're building internally, as well as the market appetite for the solutions we have and the workforce to be able to deliver those in a dependable manner and scale the business going forward.

We feel very good about our posture as we exit to Q2, and then we're into Q3 in the back half of the year. To that end, I again, I appreciate your continuing support of the Company and wish you all a good day and be well.

Operator:

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