Sylogist Ltd.

Third Quarter 2022 Earnings

Conference Call Transcript

Date: **August 11th, 2022**

Time: **11:00 AM MT**

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

Xavier Shorter
Chief Financial Officer

Operator:
Welcome to the Sylogist Earnings Call for Q3 2022.

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 our earnings call for Q3 of Fiscal ‘22. I'm Bill Wood, Sylogist’s 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 on June 30, 2022.

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 2,000 customers worldwide in three public sector verticals: education, non-profit and NGOs, and government.

Q3 was a turning point for Sylogist. As I’ve shared on previous calls over the past year, we have strategically invested in advancing our offerings and shifting from siloed products to an integrated SaaS platform and scaling our delivery capacity and our go-to-market efforts, all of which were essential to driving organic growth towards a high single-digit run rate exiting Fiscal Year 2022. The investments we made bolsters our ability to win new business, expand our revenue recognition capacity, and strengthen customer relationships, further underpinning our ARR and creating an opportunity to earn greater customer wallet share going forward.

I am very pleased to see the ROI begin to materialize in the quarter as we drove 7% organic growth. Adjusting for the strategic discounts we’ve previously extended to legacy customer communities, our organic growth rate was 10%. This is a foundational achievement for Sylogist, as it’s further proof that our strategy is working. We saw growth across all aspects of the business. Professional services was the largest contributor as sales accelerated, several new projects came online, and increased talent capacity was in place to recognize revenue.

Our three most recent acquisitions continue to deliver and track to plan, with Municipal Accounting Systems increasing customer wallet share and landing new business, Pavliks seeing strong traction in both recurring and professional services revenue, and Mission CRM on track to grow its top line over 100% this fiscal year. With both a strong sales pipeline and revenue backlog, we anticipate their positive momentum will continue.

As I've mentioned on previous calls, we have several strategic initiatives in flight that we expect will further drive revenue growth and value creation going forward. In the coming months, we will be rolling out a new, comprehensive, 100% cloud-based municipal government solutions that's unlike anything on the market today.

This launch will allow us to compete for and win new business in the large North American municipal government market, and also provides a modern path forward for our legacy municipal customers. Given the rollout plan which includes early adopters in Fiscal Year '23, with a full scale rollout thereafter, we anticipate material revenue growth from this initiative will occur in Fiscal Year '24.

We continue to build on the successful pilot of our Sylogist Pay solution, with the payment platform driving both new logo and customer wallet share transaction fee revenue that we expect will begin to materially contribute in the back half of Fiscal Year '23 as transaction volume builds.

We are continuing to see WenGAGE, the financial HR student information and lunchroom solution we acquired in '21, grow its already impressive market share in Oklahoma, while gaining traction in new markets, more specifically, the investments we've made to ready it for launch in North Carolina and elsewhere. Given the education markets' buying cycle, we anticipate expansion will begin to contribute to revenue growth in the back half of Fiscal Year '23.

The ongoing upgrade of our customers from their on-premise posture to our new SaaS solution is driving professional services revenue while improving net revenue retention and strong word of mouth referrals, which, as I said previously, is so important to driving new bookings. We anticipate customer upgrades to our SaaS solution will accelerate in Fiscal Year ’23 as federal stimulus dollars are put to use in the public sectors we serve.

We have also materially expanded our go-to-market collaboration with Microsoft’s Technology for Social Impact division and expect new bookings in the NPO/NGO space to accelerate for both our Serenic Navigator ERP and the MissionCRM fundraising solution starting in Q2 ’23.

Lastly, we are seeing our recommitment to our partner and channel community leading to increased bookings. Given the material value creation opportunity they present, we plan to accelerate our investments behind these initiatives going forward to push further. A key aspect that sets Sylogist in the FinTech space is that we have executed the transformation of the Company and our growth strategy, mindful of profitability.

I’m pleased to report that EBITDA for Q3 was 31%, bringing our year-to-date to 30%, which is right on plan. We also continue to see M&A as a growth and value creation accelerant. The deal pipeline is stronger than it’s been since I joined the company. Although private tech company valuations have yet to fall to the same extent as the downward pressure on public markets, the number and economics of quality deals are looking more favourable to us as it relates to ours, and with our integration playbook proven out in a strong balance sheet and significant headroom within our $125 million credit facility, suffice it to say we are actively pursuing strategic acquisitions.

I think it important to share some thoughts on our business’ resilience relative to the current inflationary pressures. Although a significant recessionary downturn may cause prospects and customers to delay decisions and implementations, and in turn affect near-term growth prospects, we anticipate our core business would remain strong. Our platform’s mission-critical nature and our high level of recurring revenue generally insulate our core business from such shocks, as we demonstrated during COVID, and give us confidence in our continued profitability and the needed resources to execute our plan.

To further improve our business’ resilience, over the course of this year, we repapered all customers to establish contractual conformity across the business. The new contracts have a built-in annual auto price escalator up to 5%, should we choose to exercise it. This, together with the opportunity to evaluate our billing rates relative to the project services on a deal-by-deal basis, serve to largely insulate our ARR and margins from inflationary pressures. Further, given the do-good nature of the markets we serve, we've been able to attract top talent seeking that connection, even in tight markets. We're primarily finding great talent from direct outreach and inbound interest, without third-party recruiters and related placement fees.

I'll now turn things over to Xavier to take you through the financials in more detail.

Xavier Shorter:
Thanks, Bill.

Revenue for the quarter was $13.7 million, up from $9.5 million in Q3 2021, an increase of 44%. This increase was due mainly to the acquisitions of MAS, Pavliks, and Mission CRM, as well as the 7% organic growth Bill just discussed. A more favourable exchange rate also provided a modest tailwind to the strong expansion in our underlying business as major projects kicked off and ramped up.

Our gross profit margin for the quarter was 62% compared to 70% in Q3 2021. Margins fell mainly due to the ramp-up of large implementations and upgrades, tight labour markets, and rapid growth led to a need for short-term, third-party contractors. Training new employees took up time that would have otherwise been billable. The uptake in new business also contributed, with some professional services staff using otherwise billable time to help with demos.

Margins were also pressured relative to last year by the higher proportion of professional services revenue from recent acquisitions and new sales, and the strategic customer discounts that secured $6.4 million in ARR. Operating expenses were up due to the acquisitions and our investments in the product development and go-to-market capabilities.

Adjusted EBITDA was $4.3 million in the quarter, up from $3 million for Q3 last year. This increase was due mainly to the recent acquisitions. Our Q3 Adjusted EBITDA margin was 31% and our year-to-date June Adjusted EBITDA margin was 30%, in line with our target.

Q3 saw net income of $895,000 compared to essentially breakeven last year. Earnings per share were $0.04 per share compared to nil last year. This increase was mainly due to the impacts of the acquisitions.

Our balance sheet is strong, as we finished Q3 with $12.5 million of cash. This represents our seasonally low cash balance for the year, as many customers, mainly in our K-12 vertical, will be paying their annual renewals in the next 90 days, anticipated to exceed $12 million.

With that, I would like to hand off the call to Bill for some final thoughts.

Bill Wood:
Thanks, Xavier.

In conclusion, I'd like to reflect briefly on the path to get here. We have spent the last 18 months making fundamental changes within Sylogist. We have reorganized divisions, invested in our products to achieve a full SaaS posture, ramped our go-to-market strategy and the Sales team, hired top talent, and given the team clarity, resources, and a value creation of aligned financial incentive to do great work.

That team, along with what I consider to be the strongest management team in the business, has brought us to where we are today, posting high single-digit organic growth and a healthier Rule of 40 posture. Going forward, we are committed to expanding investments behind the strategic initiatives I've outlined above to drive value creation. We are very excited about what the future holds for Sylogist and I appreciate your support.

I'd like to now open the call up for questions, as time allows.

Operator:
Thank you. The first question is from Amr Ezzat with Echelon Partners. Please go ahead.

Amr Ezzat:
Thanks for taking my questions, and congrats on a strong organic growth quarter.

Bill, my first one is on the organic growth, in fact. Do we sort of think about that 7% to 10% growth as a sustainable level that you could consistently achieve going forward, or should we be looking for some volatility quarter to quarter?

Bill Wood:
Hi, Amr, thanks for your question.

Generally, because there is some lumpiness in our bookings and the project spin-up, there could be some peaks and valleys within that. But for the most part, that's our target and our plan calls for, and as I've said for quite some time, that sustainable high single-digit growth is our goal, with some peaks and valleys as I mentioned.

Amr Ezzat:
Okay, that's fantastic. Xavier, maybe I appreciate your comments on margins, but if I'm looking specifically on gross margins, is the erosion we're seeing quarter to quarter mostly related to the very strong growth in professional services? Or is there anything else driving that?

Then, I know you don't really give guidance, but if I'm thinking about next year, do you feel that we've troughed, in terms of gross margins, or can we see further erosion?

Xavier Shorter:
Hi, Amr.

As far as the gross margin is concerned, you're spot-on, in that professional services does command a lower margin than, say, a subscription. As we were working through our backlog, a lot of getting those projects stood up had to do with the front end of professional services. Also, as we look at the businesses we bought, the Pavliks business does have an arm for customized D365 work, which is primarily professional services.

With those, as well as the purposeful discounts we give, the margins are where we think we will be. I think as subscription picks up, then we would still be in that band, but it may improve a bit in the next fiscal. Right now we're in the midst of planning for Fiscal '23, and more to come.

Amr Ezzat:
Great, thanks. On Mission CRM, I'm not sure if your views have evolved from last quarter or since you guys have acquired the company, we were speaking about a very big exit, a number for Fiscal 2023 in terms of revenues. Do you guys still feel that number could be achieved?

Bill Wood:

Yes, I think they, too, got penalized by the Omicron flare-up in the early part of the year in Q1 and Q2, but we see the strength in their bookings and their pipeline building with each passing month as organizations lean in and are very excited about the solution and services around it that they offer. It's industry-leading at this point. It's really the premier Microsoft-based solution for the space, and we're very optimistic; while maybe not reaching their peak in what, their first year, possibility-wise, it was an ambitious goal. Again, they're already up 100% year over year, and we expect them to continue to work at the pace that we've seen in Q3, and expect to continue in Q4 and beyond.

Amr Ezzat:

Great. For the quarter, I'm assuming they're at $0.5 million in revenues. Is that close to where they are?

Bill Wood:

Xavier, do you have a comment on that?

Xavier Shorter:

Sorry, Amr, what was the question?

Amr Ezzat:

Sorry, on Mission CRM, are they close to $0.5 million in revenues for the quarter? Is that a good number?

Xavier Shorter:

We don't really break out the performance by any one particular entity on revenue for a particular quarter. But they're tracking well, and they're tracking to be more than 100% up from where they were when we bought them, for the year.

Amr Ezzat:

Okay. Okay, that's great. Maybe one last one. Bill, you spoke to the M&A pipeline. Would we expect you guys to be more acquisitive in the next 12 months relative to the last 12 months?

Bill Wood:

Our appetite continues to be high. We're also, I would say, prudent and strategic in how we look and really evolve ourselves in diligence to evaluate companies. Our cadence this year wasn't impacted by interest in any way, shape, and form. It was really, deals that we looked at maybe turned out not to be quite what we anticipated or wanted, strategically, and others rolled to a point, maybe at a price point that we thought was foolish and not really appropriate for our investor community and value creation long term.

To that end, Amr, we continue to be acquisitive in posture, and as I said, we are talking, and our deal cadence now is greater than it's been since I joined. We had about 200 targets in our tracker; now we're up over almost 400 targets in North America and beyond that we have some level of scrutiny and exploration on with. It's a healthy pipeline and we see that continuing, and we see maybe some of the prices related to some of the deals. But we'll be as aggressive as we need to be on the deals that are strategic for us to drive our plan forward.

Amr Ezzat:

Understood, and I appreciate that it's hard to forecast these things. Congrats again. I'll pass the line.

Bill Wood:

Thank you, sir.

Operator:

The next question is from Jim Byrne with Acumen Capital. Please go ahead.

Jim Byrne:

Hi, good morning, guys. Thanks for taking my questions.

Just a couple for me. Back to the organic growth, when do you expect to see that? I know you touched on it in some of your opening remarks there, Bill. But the organic growth on the subscription maintenance side, is it the next quarter? Some of the initiatives you were referring to sounded like later in '23 and into '24, so just want to get a sense of how you think of growth in that segment.

Bill Wood:
Hi, Jim, thanks for your question.

Yes, for us, remember, as a SaaS company, we're out of the old posture of licences, which used to be a very large impact in a single quarter, or in a single month, for that matter, which are now spread out over 12 months as we recognize that revenue. The fulsomeness of the deals that we are getting really aren't seen until a full year of absorption into our financials. Deals that we book maybe over the last quarter really don't show up in fulsomeness until that same period next year.

But it continues to be—I mean, we are a software company, and to that end, we want to sell as much passive revenue as possible. But in doing so, we need to make sure that we then have the bodies to deliver on that. We are not a download it and you're on your own kind of a solution, other than as we're seeing some of our SylogistPay opportunity being taken up that way as we execute our strategy. But for the most part, we have active services associated with it.

Yes, we continue to see a market that's now more conducive to us pushing out and having deals out there that we can matriculate to success, that kind of had built up and installed some out in the early part of the year. We see now kind of moving back to more of a normal posture in the latter part of Q3, and as we push into Q4, into the new year.

Jim Byrne:
Okay. Then, I guess the follow-on would be, presumably that business is higher margin than the professional services side. Just back to the bottom line, gross margin outlook, are there gives and takes there as subscription grows? Do you have to invest that will continue to keep margins in this ballpark?

Bill Wood:
Yes, I feel that our—my posture since I started was earning the right to be able to take our use of capital and look at it in a way that we could be in a position, and once we've earned the trust, and I think through this quarter and us executing against our plan as we continue to do, that puts us in a position, as I shared in my remarks, to look at where we've teed up opportunities; and for goodness' sakes, we would be remiss not to invest in the back of those to push those forward.

While we will be very conscientious of profitability, and certainly these markets demand that and reward companies like us for being so, we're going to continue to make sure that we recognize the opportunity. Because, I don't want to say it's fleeting, but there are opportunity and windows that we feel are very conducive here as we look out over the next 12 to 15 months, that we want to make sure we're investing in the back of those things that we've teed up well to be able to drive value.

Jim Byrne:
Okay. Then last one for me, just updated thoughts on the dividends. You mentioned M&A as a further avenue for growth, and a significant avenue for growth. Honestly, the dividend is a pretty significant use of cash. What are your thoughts here, either in the short term, or in the next couple years?

Bill Wood:
Same thoughts there, Jim. I said that that would be earned when we could have a conversation about that when we have developed a posture that ultimately, the use of capital, not just returning in and of itself to shareholders, but how we could put that to use inside the business.

As I've shared previously, we and the Board certainly evaluate that in terms of our fiduciary responsibility to make sure that we are creating the best opportunities for Sylogist going forward. I think to that end, the dividend, while we respect it and we look at it in terms of how it fits into our overall posture, it's one at a stage we feel that that capital may be better used inside the company to drive growth and value creation.

Jim Byrne:
All right, that's great. That's it for me, thank you.

Operator:
This concludes the question-and-answer session. I would like to turn the conference back over to Bill Wood for closing remarks.

Bill Wood:
Thank you.

As I shared in my remarks, I feel Q3 was a turning point and a milestone for us, because, for a few quarters now, I was confident and shared with you that the work being done was good work, purposeful work, and leading us on a path to be in a position to be able to start to open up the real value that Sylogist presents going forward. I can say that more confidently now as it's showing up in the financials, confidently only because I think it's more visible to our investor community and onlookers to be able to start to see the traction occurring within the financials.

But I will share that, overall, I've never been more positive about what the opportunities are for Sylogist going forward. I'm very excited about that, and sincerely appreciate the support of our investor community to help us to get here and underpin, I think, where we are and want to be going forward. Thank you.

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