TECSYS INC.
First Quarter FY2019 Results
Financial Analyst Call
Thursday, September 6, 2018 @ 4:30pm

Operator

Good afternoon, everyone. Thank you for standing by. Welcome to the TECSYS First Quarter Fiscal 2019 Results Conference Call. At this time, all participants are in a listen-only mode. Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions.

If anyone has difficulties during the conference, please press star 0 for operator assistance at any time. Please note that the complete first quarter report including MD&A and financial statements are filed on (CR) this morning - this afternoon, September the 6th 2018.

Some of the statements in this conference call, including the question and answer period may include forward-looking statements that are based on management's beliefs and assumptions. Actual results may differ materially from such statements. I would like to remind everyone that this call is being recorded on Thursday, September the 6th, 2018 at 4:30 pm Eastern Time.

I would not turn the conference over to Mr. Peter Brereton, Chief Executive Officer of TECSYS. Please go ahead, sir.

Peter Brereton

Thank you and good afternoon, everyone. We appreciate you joining us for today's call. Joining me today is Berty Ho, our interim CFO. I'll start by summarizing the key events to the quarter. Berty will then review our Q1 financial results and we'll then take your questions.

Earlier today we issued our unaudited 2019 first quarter financial results and a copy of those results is available on our website at tecsys.com. For the second year in a row, we made strong gains in terms of business development activity. This past quarter set records in terms of first quarter with contract bookings of 10.6 million, an 8% increase over the 9.9 million achieved in Q1 of 2018.

This number includes strong bookings for our cloud business which bodes well for the future. In fact, 19% of the bookings for the first quarter were recurring revenues versus 5% of bookings in Q1 of last year. Included in the new contracts are two IDNs, demonstrating a return to growth in our healthcare business. One is based in the southern U.S. and is one of the largest public hospital systems in the country. It consists of seven facilities, four affiliate hospitals in 2017 revenue of over 4.5 billion.

The second IDN is based in New York State and comprises four general hospitals, 25 primary care centers, and three walk-in clinics and pediatric care centers. Its 2017 revenue is over $1.3 billion. Like many of our IDN customers, both hospital systems have initially contracted for single solutions, one for delivery management, another for warehouse management. Both have significant room for expansion and as we've seen with our other customers our initial engagement provides the basis for us to offer more solutions.

As we said last quarter, our healthcare business is picking up and hospitals have returned to actively engaging with us on our solutions and we have also added personnel to address the increased demand we are seeing. It is important to note, however, that the sales cycle in the healthcare sector remains long and it takes about 18 to 24 months before hospital typically signs on to a solution.

We also signed a new customer that provides packing and distribution into the global pharmaceutical industry. This is a highly regulated industry that requires strict compliance and accountability from government bodies such as the FDA. Our years of experience developing software that addresses the needs of regulated businesses with high compliance requirements, such as provincial liquor boards led them to choose TECSYS.

Speaking of liquor boards, last quarter we also signed a new contract with an existing provincial liquor board customer to upgrade their systems with our latest technology. This is a testament to the value our solutions deliver. Liquor boards require a high degree of tracking and traceability in their distribution systems and our software allows them to do that efficiently with minimum scanning and product handling.

Well, to some extent, Q1 was a typical summer quarter. We continued to have a success in our renewed healthcare business and in building the pipeline for longer term growth. Q1 also included our user conference held in Orlando. We hold this conference every 18 months and alternate between spring and fall as well as East and West.

So, this was the Eastern spring conference, attendance was strong and healthcare customer attendance was up to five - 50%. This type of conference is a great investment in our customers and our future. The conference expenses added approximately 300,000 to our cost of services and operating expenses and impacted the bottom line by both the same amount. There is no equivalent expense in the comparable quarter last year due to the timing of our conferences.

Berty will now provide some detail on our financials for the quarter.

Berty Ho

Thanks, Peter. Overall, our financial results were flat compared to Q1 of fiscal 2018. Once we take into account the negative impact of the stronger Canadian dollar against the U.S. Approximately, 64% of revenue in the quarter was generated in the U.S. with the Canadian dollar valued at an average exchange rate of 1.28 in q1 fiscal 2019 compared to 132 in fiscal year 2018.

Revenue in the first quarter was $16.3 million, a 1.4% decline from $16.5 million in Q1 fiscal 2018. The stronger Canadian dollar and the unfavorable variance of the company's partial hedging of U.S. revenue give rise to an unfavorable variance of 300,000 in the first quarter of fiscal year 2019 against the same period of fiscal 2018. In the quarter, services revenue was flat at $6.1 million compared to $6.1 million in the first quarter of fiscal 2018.

Most of our services revenue is for implementation assistance which includes consulting, training, and some product adaptation. With our backlog currently at 47.8 million, we expect that services revenue will remain healthy with a near-term and increase as we bring our new business. Proprietary product revenue increase by 6.2% in the quarter to 1.3 million from 1.2 to 1.3 million, I'm sorry, from 1.2 in Q1 fiscal 2018, and third-party product revenue declined by 4.3% to 1.5 million.
Cloud maintenance subscription revenue declined slightly by 1% to $7 million from $7.1 million in Q1 fiscal year 2018 due to the stronger Canadian dollar. Gross margin for the first quarter of fiscal 2019 was $7.6 million or 47% of revenue compared to $7.8 million or 47% in the first quarter of fiscal 2018. Operating expenses for Q1 fiscal 2019 was $7.7 million flat compared to the same quarter of last year.

As a percentage of revenue, operating expenses were flat at 47% of revenue this past quarter compared to the same quarter last year. G&A expenses remained flat year-over-year at $1.6 million. Sales and marketing expenses declined slightly to $3.4 million from $3.6 million. And R&D expenses increased by 7.7% to $2.7 million from $2.5 million in Q1 fiscal year 2018 primarily due to an increase in consulting and employee costs.

Loss from operations in the quarter amounted to $98,000 compared to a profit of $65,000 in Q1 2018. The decline is explained primarily by the negative impact of the exchange rate as mentioned previously. EBITDA was 536,000 for the first quarter of fiscal 2019, compared to 687,000 in Q1 of 2018. A decline of 22%, again, a reflection of the foreign currency impact. We ended the quarter with cash and cash equivalent and long-term investment of $24.4 million compared to $23.5 million at the end of fiscal 2018, giving us a lot of flexibility for future capital deployment.

I'll now hand it over to Peter.

Peter Brereton

Thanks, Berty. While we are coming out of a traditionally quiet quarter, our record contract bookings along with the increased activity in our healthcare business indicate that we have everything in place for a strong fiscal 2019. As well our cloud first strategy is starting to pay off. The total bookings during the quarter for our cloud offering surpass the amount we booked during the whole fiscal year 2018.

We believe increasing the value of our recurring revenue will drive value creation for our shareholders. So, allow me to point out some of the interesting numbers again in Q2. You will note that deferred revenue on the balance sheet rose from two - or sorry, rose by $2.6 million from $10.8 million at the end of Q4 fiscal 2018 to $13.4 million at the end of Q1 fiscal 2019.

Total bookings are up 8% to 10.4 million. Included in that $10.6 million booking number is $2 million of recurring revenue up from $519,000 in the first quarter of last year. Our backlog rose by $6.1 million from the end of Q1 last year to the end of Q1 this year, rising from $41.7 million to $47.8 million. We believe that all of this signifies a rising acceptance of subscription-based options in the markets that we serve and provides long term gains for both customers and shareholders.

With that, I will turn the call over for questions and back to the operator.

Operator

Thank you. Ladies and gentlemen, if you'd like to register a question, please press the 1 followed by the 4 on your telephone. You will hear a three-tone prompt to acknowledge your request. If your question isn't answered and you'd like to withdraw your registration, please press the one, followed by the three. If you're using a speakerphone, please lift your handset before entering your request. One moment please for the first question.

And our first question today comes from the line of Gavin Fairweather from Cormark. Your line is open, please proceed.

Gavin Fairweather

Hey, there. Good morning or good afternoon.

Peter Brereton

Good afternoon.

Berty Ho

Hey, good afternoon.

Gavin Fairweather

I just wanted to circle back on the cloud and you mentioned in your prepared remarks, 90% of bookings are being in the cloud and the increased acceptance of that type of deployment in the market, you know, how quickly do you expect this shift to take place? It seems like after being fairly slow since we're picking up speed here, I'm just curious of your thoughts on how long this will take to play out and ultimately how far can it go.

Peter Brereton

I mean, the question, we've seen - I mean, over the past several years we feel like we've seen a lot of resistance to sort of a cloud-based approach in the - particularly in the healthcare segment, but we feel like that's sort of melting away fairly quickly at this point. More of the players in the market, you know, whether it be Workday or Infor, et cetera are all moving to a cloud-based subscription model. And, you know, as such as we look over the next couple of years, we fully expect that portion of the business continue to rise.

How high it will go? Hard to say at this point. I mean, personally I think we could see subscription-based, you know, bookings getting up into the sort of 30% to 40% range, you know, over the next couple of years but that's a - that's not a hard-and-fast prediction, it's just my gut feel.

Gavin Fairweather

Okay. That's helpful and then just secondly before I requeue, I recall correctly the first pharmacy customer is ought to go live in September. I'm just curious if you have any color on how that's progressing and any kind of takeaway through the process here.

Peter Brereton

At this point that go live is on track. They - well, on track as these multi-year types of implementations go from the standpoint that I think the go live date slipped by a week or 10 days or something like this. So, at this point they're still planning the go live in the - I think, it's the end of the third week in September.

And at this point, it's right on track. I mean, the challenge - a lot of the delays through the last calendar year have been sort of polishing their data and getting their data ready for final go-live, but at this point, it looks like it's tracking well and we're, you know, looking forward to being able to report back at the end of the quarter on how that - how it's going.

Gavin Fairweather

Okay, great. I'll requeue. Thank you.

Peter Brereton

Thanks.

Operator

Our next question comes from the line of a (Amir Asat) from Ashland Partners. Your line is open. Please proceed.

Amir Asat

Good afternoon, again, gents.

Peter Brereton

Good afternoon.

Berty Ho

Good afternoon.

Amir Asat

First on your contract bookings, congrats on another solid quarter there. I was wondering if you can give us some color on when we can expect you to start realizing some revenues on some of these contracts and I appreciate that it's sometimes in the client's hands, namely last quarter, you mentioned signing your largest contract yet. So, there have you started doing any work or when do you expect to start realizing some of that revenue?

Peter Brereton

That - yes, that particular contract we expect that will go into sort of full implementation mode in about another 30 days. That project definitely sort of started a little more slowly than we were anticipating. You know, you sort of pushed our contract signing and then sort of we lost - definitely lost a little momentum after that, but they had some work to do on their side. They had to assemble a team and I get some infrastructure ready and so on. So, they've been working on that.

So that should - we believe that's going to sort of pick up speed very shortly here. The scheduled start is, I believe, is the end of this month.

So, I mean, our - from our standpoint, I mean, we're - you know, we've run sort of three years in a row kind of with bookings sort of running in the $42 million to $43 million range. You know we're now sort of looking at our 12-month bookings running around sort of $48 million.

So, they've, you know, they really have sort of picked up a notch and, I mean, certainly our expectation is that, you know, that's turning into revenue now as we speak. I mean there was a - there was definitely a lag time, but we're in it now.

Amir Asat

Understood. That's very helpful. Then, I guess, like if I'm thinking about the average life of a contractor or the bookings you announced like this quarter, how does it look like overall and then how does it look like for the cloud contracts relative to your traditional business?

Peter Brereton

Sorry. I'm not sure I understand the - understood the question, could you give that to me one more time?

Amir Asat

Yes, so in terms of like the average life of these contracts...

Peter Brereton

Okay.

Amir Asat

So, let's say, you know, like that last contract, the largest one, you know, like you're starting in 30 days, how long do you expect the...

Peter Brereton

Oh, I see.

Amir Asat

...contract to run.

Peter Brereton

Yes, that - I mean, that implementation process is expected to runs, you know, over short of 24 to 30 months. You know, the - you know, during that time, you know, they may well come back and sort of add to that contract, but in terms of that particular contract, that's kind of a 24 to 30-month contract would then, follow on maintenance revenues that continue on from there.

Amir Asat

Understood. Then is that like typical when I'm thinking about your total contract bookings like over the last 12 months, would that be like a fair sort of average life?

Peter Brereton

No, that's long. Because it - because of the size of it and because they bought the whole suite at once, that's long. I mean, more typical for us is, you know, we sign a contract, typically the bulk of the revenue is recognized within 12 months.

Amir Asat

Understood. I just want to circle back quickly on the cloud bookings. Again, like she said 19% I think versus 5% last year, is that like a one-off from like one customer or is it broad-based?

Peter Brereton

No, that was pretty broad-based. I think we had about, what, eight or nine accounts in there, I think.

Berty Ho

Right. Yes.

Peter Brereton

Yes. There is no elephant in there.

Amir Asat

Understood. Then, maybe just one last one you mentioned in your prepared remarks that you added new employees to deal with the increased activity yet your OpEx is still very flattish. So, I'm wondering, you know, like what's happening there in terms of like head counts and are you going to layer more investments or how do we think about your capacity with the current headcount that you have.

Peter Brereton

Yes. I mean, we've had some natural attrition in there. So, we allowed sort of a natural attrition to run, but focus the hiring around particularly point of views healthcare expertise. So, you know, hence the - you know, very flat OpEx, you know, from - as we move forward from here, we do have to bring R&D numbers up a little bit. We're being very careful with that, but they will have to rise a little bit.

But I think the investment, you know, focus from here is in sales and marketing. You know, we feel like we're at a point where we have now - we've proven out the solutions. We've got successful ORs operating. We've got, you know, successful cath labs running, you know, et cetera. The pharmacy that was - we want to the first one about to go live now, so the - we feel like we've sort of made that - made the investment in the product and the proof points around the product, and it's time now to sort of accelerate the sales and marketing and really focus on driving up bookings.

Amir Asat

Great. Thank you very much.

Peter Brereton

Okay.

Operator

Our next question comes from the line of Nick Agostino from Laurentian Bank. Your line is open. Please proceed.

Nick Agostino

Yes. Good afternoon.

Peter Brereton

Good afternoon.

Nick Agostino

I guess, Peter - good afternoon, Peter. If we just look at - just maybe give us a little bit of your outlook as far as growth is concerned for fiscal 2019, how do you guys look at the overall top-line growth and has that change given that fiscal Q1 came in flat year-over-year?

Peter Brereton

Overall it hasn't changed. I mean we're seeing the - you know, we're always frustrated in this - I mean, frustrated with this for decades. I'm not sure it's changed. We're always frustrated by the lag time between, you know, when you see bookings rise and you begin to see revenue to rise. So, you know, you see that in there. You know, as I've mentioned earlier, the shift to a higher amount of recurring revenue of course is a good thing for the business and a good thing for investors, but it means the revenue doesn't hit Q1, so we're not really seeing a change.

There is - there are some disturbances still going on in the market. I mean, they, you know, the fear around the Affordable Care Act is subsided and we've seen healthcare come back quite nicely. In fact, you know, hospital bookings in Q1 were roughly double hospital bookings in q1 of last year. So, you know, that's a really good indicator.

But on the other side, on the complex distribution side, the, you know, the current sort of tariff wars for lack of a better term is definitely a distraction in the general complex distribution market. You know, we saw accounts in Q1 that we were actively engaged with that have had to slow down a little bit, while they figure out sort of where to source product from and do they need to move their factories around and so on to deal with the various, you know, tariff tips that are going on.

So, there is some distraction there. We don't see it impacting our growth plans at this point for the year. But, you know, it certainly could if that worsens rather than improves.

Nick Agostino

Okay. Good. I appreciate that color. And if we look at the deal sizes you announced this quarter of the three new wins I think for a total of $1.9 million last quarter and I think in prior quarters, the commentary was less potential IDN wins in terms of total number, but certainly deal size is getting bigger. And I think last quarter you had one case where a customer took on the full suite of products from the get-go.

Peter Brereton

Yes.

Nick Agostino

This quarter we're kind of seeing a little bit of reversion back to more deals, smaller sizes and maybe taking one product. How do you guys, you know, three months later, how do you guys look at that market?

Peter Brereton

Yes, I think I even made the comment in, you know, on the agreement we signed in the fourth quarter that sort of it was exceptional that they sort of took the whole suite. But certainly, we have seen generally the trend to larger deal sizes. You know, in this case both of these organizations decided to start small, so trying to turn it into a trend is probably difficult.

What we are seeing from a pipeline standpoint is that our customer base in the IDN space is willing to take on larger projects and so we're seeing sort of significant opportunities to sign agreements. It's - in most cases, it is now with the existing established base where we already have sort of a trust and an understanding of each other, and we're able to put larger agreements together more quickly.

So, I think you'll see this year the larger agreements actually coming out of the base, although of course we do consume you continue to pursue new accounts as well.

Nick Agostino

Okay, and then just one last one for me. In the case of the IDN wins, you broke out one being a warehouse management, the other one being delivery management, can you indicate if in either case it was a competitive situation, just given the fact that it was the deals, the way they were allocated wasn't segment that as opposed to a suite of products and I'll leave it there.

Peter Brereton

I mean, in both cases there was some competition, but in both cases, they do have their eye on a more - on an eventual suite deployment which then sort of leads them to want to go with a company that has the complete platform end-to-end. So, I mean in both cases the end-to-end platform was a key factor to the win, but there were, you know, point solution competitors in each case.

Nick Agostino

Okay. Actually, I will add one more, because you just mentioned point solution, is - I think at your user conference, the point of use devices was certainly resonating as far as quicker sale cycle and it was a product that you are able to deliver across many areas of a hospital and I got the sense that there was lots of - that the demand was growing in that - for that particular segment, is that still the case three months or a couple of months later?

Peter Brereton

Absolutely. I mean, you know, summer is always quiet for that stuff, but if you were, you know, I mean we don't share our pipelines on the, you know, publicly of course but if you were to look inside our pipeline, you would see a substantial amount of the pipeline activity is related to, you know, accelerated adoption of point-of-use capability within our customer base.

Nick Agostino

Okay. Perfect. Thank you.

Peter Brereton

Great.

Operator

Ladies and gentleman, as a reminder to register for a question on the phone hit the 1-4. Our next question comes to the line of (Justin Kenwood) from GMP Securities. Your line is open. Please proceed.

Justin Kenwood

Hi. Thanks for taking my call. On the comments of the preference by customers for cloud services over the licensed sales, is this on both the healthcare and complex distribution or are you seeing strength in one over the other?

Peter Brereton

I wouldn't say one over the other. We have seen in the past, I think it's more, (Justin), that just - we're seeing a softening on the healthcare side in terms of sort of resistance to subscription starting to soften. You know, the complex distribution side has always been sort of somewhat open to it, looked at it, you know, in terms of sort of their own sort of capital situation, would they rather sort of buy or rent basically and so on.

The hospital market has always been very against it, combination of accounting reasons, a lot of these projects funded with endowment funds. They didn't want to, you know, so they'd rather come in as a capital expense than as a capital item rather than an operating expense. But, again, that seems to be shifting. I think part of the - part of it is the attraction to have a sort of a bundled fixed expense that they can just count on year after year with us sort of handling more of the details of that for them.

But - so, I think healthcare is really more just starting to catch up to complex distribution a little bit. And, you know, we think overall, you know, the market is definitely continuing to move in that direction.

Justin Kenwood

Okay. And, then I know of at least one peer that, you know, saw the license sales evaporate pretty quickly in preference for the SaaS or cloud revenue. Do you anticipate that type of transition to maybe play out with you guys or do you think it will be kind of more gradual?

Peter Brereton

We think it'll be more gradual. Like we're just not seeing a sort of a rapid shift to it, but we are seeing it often. You know, we could push it a lot harder and move a lot faster in that direction if we wanted to. I don't see any reason to. You know, the upfront license fee model with maintenance is a perfectly acceptable model for both customers and us, but so is the subscription model.

So, we intended to sort of stay in lockstep with the market on that. The, you know, if you look at our overall business model, we - you know, so much of our business model is based on services delivered to our customer base whether it'd be, you know, cloud or, you know, customer care, maintenance, support, consulting, implementation, et cetera, that, you know, the - our license fees are not a large portion of our overall revenues anyway. So, you know, even if that did accelerate a little more quickly, I don't think you'd be looking at sort of a huge shock to the P&L.

Justin Kenwood

Got it. Make sense. And then just for acquisitions, you know, the cash balance rose again this quarter. Are you seeing any change in the multiples out there or willingness of companies to sell?

Peter Brereton

We - I don't - we haven't really seen a change in multiples. We continue to look both sort of North American for add-on products that could add to our, you know, product portfolio as well as European opportunities that could add to our, you know, geographic footprint. And, you know, we think there's some good opportunities on both sides. You know, so, I mean, you're right the cash balance continues to grow.

We continue to look for a good opportunity to deploy it and, you know, we're - you know, Berty had moved to focus exclusively on M&A for a while where he had to back in as interim CFO.

He's now been, you know, that's now been taking up some of his time, but he's definitely kept the M&A file moving along. And our new CFO, Mark Bentler, you know, starts in just over a week.

And, you know, after a transition period, Berty will be back to sort of full-time on the M&A file. So, he is (the Chief though) so it makes it hard to get a deal done sometimes.

Justin Kenwood

Okay. Thank you very much.

Peter Brereton

Okay. Thanks.

Operator

Our next question comes the line of Blair Abernethy from Industrial Alliance. Your line is open. Please proceed.

Blair Abernethy

Thanks. Peter, I'm just wondering if you could give us a little more color on the pharmacy solution particularly in charge - in the sense of how is it progressing in the pipeline? Are you getting more interested in it? Just maybe a little more color around how that product is progressing.

Peter Brereton

I mean, yes, we are - you know, there's a - as you can imagine, you know, our customer base is looking at it with a great deal of interest. We've actually got a couple of opportunities where we're in fairly advanced discussions. By and large though nobody wants to pull the trigger until (UW) is actually gone live.

So, you know, that's where we're anxiously looking forward to seeing the - our first account go live on the product and to then try to see if we can wrap up agreements with the other, you know, with the other networks that want to get moving on.

Blair Abernethy

Okay. And what do you think the typical or average deal size might be for the pharmacy solution.

Peter Brereton

Wide range, right? We're - I mean, we're licensing it really on the basis of the number of pharmacists. So, it very much ties to sort of size of hospital, size of network, how much of the services they're going to do, and how much we're going to do, but typically those deals look like they're in the - anywhere from the sort of million-dollar to, you know, several million dollar size.

Blair Abernethy

Okay. And then, just a question on your backlog, I just wonder if you can give us some more color into the makeup of the backlog or consistency of the backlog in terms of how much of it is really tending towards, you know, professional services versus product versus any recurring contracts in that backlog figure that you provide.

Berty Ho

Sure. In terms of the breakdown, about 55% or so of the backlog is recurring and I would say that the professional services piece is probably somewhere around, you know, 40% also, and the rest really is product.

Blair Abernethy

Is product.

Berty Ho

Yes.

Blair Abernethy

Okay, great.

Peter Brereton

And we always include, Blair, the next 12 months of recurring revenue in that backlog number.

Blair Abernethy

Yes. Okay. Okay and last question for me is just you commented about looking at adding headcount to - or more resources into the healthcare side of things. So, is that headcount coming out of the complex distribution side or is this net additional headcount that you're looking at?

Peter Brereton

I mean, ultimately it will be some net additional headcount. You know, we have had some - mentioned some sort of overall attrition and so we've ended up with the headcount remaining, you know, quite steady. But, ultimately - I mean the complex distribution business is actually - I mean, last year it grew a few percentage points, it continues to grow. So we'll need to continue to add there, but as I say if you look at sort of overall where we plan to invest in the next 12 months, the lion's share of it is actually in the sales and marketing where we feel like it's, you know, it's time to sort of crank that up, and we really haven't increased our sales and marketing spend in a couple of years.

Blair Abernethy

Okay. That's great. Thanks very much, guys.

Peter Brereton

Okay.

Berty Ho

Okay.

Operator

Ladies and gentlemen, as a reminder to register for a question on the phone, press the 1-4. And there are no further questions on the phone lines at this moment.

Peter Brereton

Great. Well, thank you everyone for taking the time to join us today. As always, if you have any additional questions, please feel free to give us a call and we look forward to talking to you in late November to discuss our second quarter results. Have a great day. Thanks.

Operator

Ladies and gentlemen, that does conclude the conference call for today. We thank you for your participation and ask you to please disconnect your lines.

***** END *****