Sylogist Ltd.

Earnings Call for Third Quarter 2023

Conference Call Transcript

Date: November 9th, 2023

Time: 8:30 AM ET

Speakers:

Bill Wood
President and Chief Executive Officer

Sujeet Kini
Chief Financial Officer

Operator:

Thank you for standing by. This is the conference operator. Welcome to the Sylogist Limited Earnings Call for Third Quarter 2023.

As a reminder, all the 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 star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an operator by pressing star, then zero.

I would now like to turn the conference over to Jennifer Smith with LodeRock Advisors. Please go ahead.

Jennifer Smith:

Thank you, Gaylene, and good morning.

Joining me to discuss Sylogist Q3 fiscal '23 results are Bill Wood, Sylogist President and Chief Executive Officer; and Sujeet Kini, Chief Financial Officer. This call is being recorded live at 8:30 a.m. Eastern Time on November 9, 2023.

Our Q3 press release, MD&A, financial statements and accompanying notes have been issued and are available for download on SEDAR plus. Please note that some statements made on the call may be forward-looking. Actual events or results may differ materially from those expressed or implied, and Sylogist disclaims any intent or obligation to update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. The complete safe harbor statement is available in both our MD&A and press release, as well as on sylogist.com. We encourage our investors to read it in its entirety.

We are reporting our financial results in accordance with International Financial Reporting Standards, or IFRS. And before, we will also discuss non-GAAP performance measures, which should be viewed as supplemental. The MD&A contains definitions of each one used in our reporting. All of the dollar figures expressed on this call are Canadian unless otherwise noted.

I'll turn it over to Bill, first, for opening remarks, then Sujeet will review our Q3 financial performance, after which Bill will conclude the scripted remarks with outlook. At which time, we will open it up for questions.

With that, Bill?

Bill Wood:
Thank you, Jen, and good morning, everyone, and good afternoon to those listening overseas.

If you've been following the steady progress of our transformation over the last six quarters, then you've undoubtedly heard me say that Sylogist is just getting started, and that the value creation opportunity we see ahead is large, very large.

Three years ago today, I joined Sylogist because I believed that the public sector landscape was changing and that there was an opportunity for a new major provider to emerge. Since then, I've had the privilege of working alongside incredibly experienced, determined, and talented colleagues, not just on the management team, but across the entire company. Individuals who share the same vision and collectively moved mountains to recognize it.

We cut no corners in our commitment to developing unmatched fast platforms for the public sector and re-earning the trust of our customers. We were willing to endure the short-term discomfort and questions we knew would come our way. I'm incredibly proud that the results are now showing up consistently in our customer satisfaction, our financial performance, and the leverage opportunity we see ahead.

Our third quarter's performance is again the result of our team's effective execution in chasing our goals and shaping the Company's foundational attributes. We've moved the needle from momentum on the horizon to now consistently evidenced in our results. Our Q3 results speak for themselves and better than any longer explanations Sujeet and I can give.

We had record revenue of $16.8 million, representing year-over-year organic growth of 18%; 26% year-over-year SaaS ARR growth to $27.7 million; 108% year-over-year SaaS net revenue retention; 5x partner-driven bookings growth year-to-date; a repeat of last year's strong Net Promoter Score of 51 on our 2023 all customer survey that was just completed in September; and revenue per employee growth of 21% year-over-year. The transformation that's taken place, and subsequent ignition of organic growth, has been achieved profitably with a 26% Q3 EBITDA margin, again, underpinning our rule of 40 plus posture.

Our bookings pipeline is growing, and upgrades, cross-sells and new logo wins in Q3 matriculated at a strong rate as evidenced by the 26% quarter-over-quarter increase in Q3 bookings to $7.7 million. At the end of September, our backlog of committed future revenues stood at $32.2 million, an increase of 12% from the end of Q2. We're also pleased to report that 74% of our project service revenue in Q3 was tied to our IP, a further strengthening of an important leading indicator of more high-margin SaaS ARR ahead.

Before handing it over to Sujeet to review our Q3 financial performance in more detail, I'd like to share a few highlights relating to our three strategic growth platforms. The SylogistMission platform for nonprofits and NGOs, which includes Mission ERP and Mission CRM, remained our primary growth driver so far. Essentially, the overall revenue and SaaS ARR growth you're seeing today doesn't yet reflect the growth we see ahead in our government sectors, and our SylogistMission thesis is proving out with more new logo and customer opportunities desiring a seamlessly integrated 100% SaaS fundraising and finance solution, which we uniquely offer.

On SylogistGov front, cities in Canada and the U.S. are queuing up to transition to our completely new SaaS platform SylogistGov ERP. I'm pleased to report that our first customer went live yesterday. Feedback from users has been exceptionally positive, and we expect their advocacy, combined with expanding go-to-market activities, will act as a catalyst for a wave of both new and existing customers to move forward with SylogistGov ERP in 2024.

Also on the SylogistGov front, our unique fully SaaS victim services suite, or SylogistGov VSS contributed in Q3 with another state, Oregon, going live last week. We see an expanding pipeline for that solution that includes a significant number of statewide opportunities we're tracking, expected to make a purchase decision over the next three years.

On the SylogistEd side, we're all systems go with our 2024 expansion strategy with the successful validation of our lift and shift from Oklahoma to North Carolina. We're seeing new logos and wallet share growth in Oklahoma, several other North Carolina school districts are now leaning in, and we expect to accelerate in sale in both, along with strategic other states and provinces in '24 and '25.

Building out a high-performance partner channel has been one of our top priorities as it needs to expand both sales and delivery capacity in a leveraged manner. As I mentioned earlier in my remarks, we've seen a 5x growth in our partner-driven bookings year-to-date. Even so, we're only scratching the surface of our partner channel potential and are confident its impact will contribute materially to the future growth and profitability.

We remain committed to our capital allocation strategy, refining our focus on accretion and recognizing the high ROIC associated with the material organic growth opportunities we've created, exercising and now renewing our stock buyback or NCIB, also reflects the companies we have in the business, while also creating shareholder value.

Like buying back our stock, the $4 million paydown of our revolver credit facility in Q3 continues to offer us another value creation lever to pull on, as Sujeet will detail. Make no mistake, we remain ready to move on strategic acquisitions that make sense. Our tracker is expanding and discussions with strategic targets are ongoing, and we see valuations getting more interesting.

Now I'll hand things over to Sujeet to take you through our final performance in a little more detail. Sujeet?

Sujeet Kini:
Thank you, Bill, and good morning, everybody.

Q3 continues to demonstrate the successful execution of our profitable growth plan. The revenue for the current quarter continues to be strong at $16.8 million, up $2.5 million or 18% relative to Q3 2022 and 16% on a constant currency basis. Recurring revenue grew 12% year-over-year, with balanced growth across all our verticals. This increase was attributable to growth in SaaS revenue, which grew by 17%, driven primarily by growth in SylogistMission, supplemented by strategic growth in SylogistEd and SylogistGov.

Project Services revenue grew by 20% year-over-year, primarily due to customer upgrades and new implementations in SylogistMission. Project Services revenue attributable to our software continues to be strong, coming in at 73% this quarter, up from 64% at the end of Q2 2023. We expect that Project Services will slow down in Q4 '23 on account of the seasonality impact of the U.S. Thanksgiving and December holiday periods.

Over the past two quarters, our revenue from hardware was higher than our run rate. This increase was due to a periodic hardware order that has occurred every three to four years.

Our backlog, as Bill mentioned, continues to be strong at $32.2 million compared to $28.9 million in Q2 2023. Our gross profit margin remained stable at 61%. Total OpEx was stable at 35% of revenue compared with 34% during the same period last year.

As we have indicated, we are continuing to make investments in our sales and marketing function with a focus on go-to-market initiatives, including partner-related expansion, and we have enhanced our spending on sales and marketing conferences and events. These initiatives are beginning to pay off, as we now see an increase in our partner attached bookings as well as continuing strength in the growth of our bookings overall. Product and development spend was lower this quarter compared to the prior quarter and the same period last year on account of additional R&D projects eligible for capitalization.

Adjusted EBITDA was $4.4 million, resulting in an Adjusted EBITDA margin of 26.0%, up from 25.7% in Q2 2023. We believe these results demonstrate our ability to continue to strategically invest in our business, while at the same time grow profitably. As we continue to maintain a strong and disciplined balance sheet, we utilized $4 million of the cash generated from our operations to pay down a portion of our revolving credit facility. At the end of Q3, we had $13.8 million in cash, which would have been $17.8 million, absent the pay down of the revolver. This level of cash is in line with the seasonality of our business and our customer renewal cycles. Our revolving credit facility balance was $17.2 million at the end of the quarter.

To continue to allow us to allocate our capital in a measured and thoughtful way, our Board of Directors has approved the renewal of our current NCIB, which is set to expire on November 16, 2023. This renewal remains subject to TSX approval.

With that, I will hand the call back to Bill for some final thoughts. Back to you, Bill.

Bill Wood:
Thanks, Sujeet.

Let me end with some thoughts on the exciting big picture we see ahead.

Sylogist is largely de risked at this point. The significant technology investments we've made have resulted in now ready-for-market modern 100% SaaS offerings, we're confident we'll disrupt our target markets. Our customers are happy and are advocating on our behalf, and maybe most demonstrative of how far we've come in a short period of time. There's incredible excitement and energy across the Company with all three of our strategic platforms now live. That's a huge milestone for us and a testament to the strong execution and determination of the entire Sylogist team that's made it happen.

As you've heard me say before, speed of execution is what keeps me up at night, meaning are we hitting our marks fast enough to seize the opportunity. I'm proud to say we are, and our time is now. We intend to step on the gas in 2024 go-to-market wise to further recognize our three-pronged strategy. While things may fluctuate somewhat quarter-to-quarter due to the seasonal nature of our markets, we see mid-double-digit increasingly profitable year-over-year organic growth exiting 2024 and in the years ahead.

With that, let's take some questions.

Operator:
Thank you. We will now begin the question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You'll hear a tone acknowledging your request. If you're using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, press star, then two.

Our first question is from Amr Ezzat with Echelon Partners.

Amr Ezzat:

Good morning. Congrats on the quarter. Can you update us on the North Carolina opportunity on the Ed side. Firstly, how has been the feedback so far from clients there? Then the strategy was for you to start slow to ensure success before growing in that market more aggressively. Where do we sort of sit now?

Bill Wood:

Thanks, Amr. Great question and a good opportunity for me to kind of bring everyone up to date a little more fulsomely. The North Carolina school district that we targeted as the first implementation, which is Durham, is now fully live on the platform. Because of the problems that some other vendors had created and have had in the space over the last year and half, relative to some payroll issues, the state has asked our customer with us to run parallel with its payroll for the next few months, actually through the end of the year. But effectively, the system is entirely live.

Our first tie out of the payroll was 100% spot on. So we feel very good. And the onlookers are very excited relative to what's going on there.

You're absolutely right. We've walked the walk. We have slow rolled back to the degree that we wanted to gain the trust of the state districts that were kind of trying to get their feet underneath them about the go forward, and we feel we're very well positioned now, as I mentioned in my remarks, with many of the school (inaudible 18:35) that are leaning in and queuing up, both existing customers and new logos to go live here in 2024.

Amr Ezzat:

Okay. So, to be clear, you are currently working with other districts in North Carolina for 2024 go lives?

Bill Wood:

We are in discussions with them, both existing and new, relative to timing, as we do that. But yes, we're in those discussions now.

Amr Ezzat:

Fantastic. You guys had rewritten the code to allow like for flexibility to deploy in any state. So, I was just wondering, outside of Oklahoma and North Carolina, where are you guys? Or is the focus just let's make sure North Carolina is a success story like Oklahoma before tackling other states?

Bill Wood:

We felt we needed to get out ahead of that confirmation to ensure that the hardwiring of Oklahoma, specific, not only was adapted and changed for North Carolina, but elsewhere. So, we used our existing customer clouds of legacy customers to have those conversations outside of North Carolina into other strategic states. Those are ongoing right now, but going very positively relative to the work that we've done not only will meet those other state requirements as we choose to move in and upgrade those customers and seek new ones, but also the state requirements in a couple more states. Those conversations are ongoing and going well.

Amr Ezzat:

Fantastic. On SylogistGov, you mentioned the go-live yesterday, was that one of the old customers that was transitioning to the new platform?

Bill Wood:

It was. We chose to take a (audio interference) that we weren't venturing into a new logo. We started with one that we felt that we had a good understanding of, to make sure that the functionality crossed over well. So yes, it was an existing customer that is now upgraded. An amazing lift by our team to introduce a completely new platform, to be able to move the data of an old, old, old legacy system into a new platform and make sure that the users feel empowered to be able to go forward and not only go about the work the way that they knew it, but ultimately have the opportunity to have new innovation in the platform as well. A huge kudos to the team for that success, just yesterday was a big deal.

Amr Ezzat:

Fantastic. In your prepared remarks, I think you spoke to your partner’s channel. You mentioned it's 5x year-to-date. Did I hear that correctly? And when you're saying like 5x year-to-date, what are we talking about?

Bill Wood:

I don't know if we've quantified it, but, again, we're starting from a low number, but it's now on its way to being a 7-figure number here as we clocked in for Q3, and we feel that, as I mentioned in the remarks, it's just scratching the surface relative to the interest we're getting from partners. And not just the interest, but are we effectively screening them and onboarding them to make sure they're empowered to deliver the same level of quality and commitment to the customer that we do directly. So, that is going well as well. Again, we feel that the upside there is significant for us, both in terms of expanded opportunity for bookings, but also leverage in the delivery of service.

Amr Ezzat:

Would you guys disclose what your partner bookings in Q3 would be as a percentage of your total bookings?

Bill Wood:

It's small now, but I see it as something that we'll be comfortable to be able to share as we go forward. I think just a little more data is going to be more informative. To that end, I think here in the next quarter or two, it's something we'll be comfortable sharing.

Amr Ezzat:

Fantastic. Then maybe just one last one for Sujeet. I missed your comments on capitalized R&D. We still see healthy-ish sort of amounts in the quarter. Did you give guidance or anything on how we should expect that to evolve going forward?

Sujeet Kini:

Good morning, Amr. Thanks for your question. Two parts to your question, and I'll break it up into how we saw the capitalization of R&D shake out, if you will, for this quarter, and maybe quickly touch on the guidance side of things.

In terms of the incremental impact of capitalized R&D in the current quarter, it was primarily on account of the tail end of the investments being made in the education space, tying back to the comments that Bill made. We did see a larger number of eligible projects in the education space and also a level of projects around the rollout of our victim services suite. So, that was kind of the impact, if you will, in the current quarter.

We're not really guiding in terms of where cap R&D will be for future periods. But what I'm not uncomfortable saying is we will see probably an elevated level of capitalized R&D going into the end of this year. Going into next year, we believe it will settle back to more of our standard run rate levels because, by and large, from an incremental investment in the platform and so on, most of the investments have happened. We are currently obviously working through our budgeting cycle for 2024, so going into next quarter and beyond, we'll definitely have further information in terms of capitalized R&D.

But the umbrella comment is one would expect a continued elevated level of cap R&D in Q4, and it will settle down to normalized levels in 2024.

Amr Ezzat:
Fantastic. If I look at your total R&D spend that is like both your capitalized R&D and the expense to R&D, you guys have been running at $2 million a quarter for the past four or five quarters. Is that still a good sort of number to use going forward?

Sujeet Kini:
Yes. I would approach it more from the point of view of an overall R&D spend since the impact of cap R&D in that 12-ish% to 13% of revenue range. Yes, I would be not uncomfortable saying that.

Amr Ezzat:
Great. Thank you. I'll pass the line.

Operator:
The next question is from Doug Taylor with Canaccord Genuity. Please go ahead.

Doug Taylor:
Yes. Thank you. Good morning. I see you're providing ARR and net retention rate numbers here with more consistency, which is very welcomed. Can I get you to speak about—you've got 26% SaaS ARR growth, what's standing in the way of your reported subscription revenue growth migrating higher towards that kind of growth as well? Perhaps as part of that, you can walk us through kind of how and when you translate your bookings into ARR growth so that we can understand the timing impacts.

Sujeet Kini:

Yes, I can take that, Bill.

Doug, in terms of the transition, if you will, of the bookings into ARR from a SaaS perspective, not to kind of get into the economic side of things, but essentially that happens as the customers go live. Depending on the size of the customer, the complexity of the implementation and so on, that go-live, if you will, from a bookings perspective into revenue can happen anywhere between three to nine months. That, I believe, is the first part of your question. I'll stop there and then get to the second part. Does that answer your question?

Doug Taylor:

It does. Just an understanding when your overall subscription revenue growth should approximate your ARR growth?

Sujeet Kini:

Okay. I believe I don't know that we'd ever get to a point where all of our revenues would move to sort of 100% SaaS. Currently, the data points I will point to is in June '23 at our IR Day, subscriptions revenue as a percentage of overall revenues was 63%. Today, it is at 66%. So, we do look at that onward or if you will, upward trajectory as a good data point, and we do expect that, that will continue to go upwards.

That being said, as you are aware, we do have a cohort, if you will, of legacy customers where there is valuable ARR. We are in the process of transitioning them to the SaaS offering. But at the same time, it's a good business, it's good recurring revenues, and that will continue until we eventually get them to transition. So really, the goal is to get to an 85-ish kind of range, which is a very healthy metric from a SaaS company perspective. But I don't know that the north star is to eventually get to 100%, because one does not want to, if you will, lose the existing recurring revenue in terms of the legacy customers.

Doug Taylor:

I understand that. Just to maybe put a finer point, or as an example, you just go live yesterday in your government sector with one of your legacy government customers, that would increase your SaaS ARR, but you wouldn't necessarily see the same growth in your subscription revenue because you'd be converting some of the existing recurring revenue. Is that a fair characterization?

Sujeet Kini:
That is a fair characterization. What I would add to that is on an overall basis, the growth in SaaS revenues is significantly higher than the growth in maintenance and support. The second comment I would make is the overall growth in SaaS is also significantly higher than the overall growth in total recurring revenue. There are, if you will, puts and takes in terms of the conversions when they happen, but on a net basis, two things are growing. One is overall recurring revenue's growing and overall SaaS revenue is growing faster than overall recurring revenue, if all that makes sense.

Doug Taylor:
It does. Then maybe a question for Bill. You've maintained your outlook overall of low- to mid-teens organic top line growth. You put up some numbers in excess of that over the last number of quarters now. I guess what I'm asking here is to gauge whether this is just a balance of conservatism on your part or whether there are other factors that may be slowing purchase decisions down as we've seen in certainly in the more enterprise-focused software names. I'm just trying to reconcile that against what is clearly an expanding TAM as you roll out your more modern solutions for the government and education verticals.

Bill Wood:
Overall, Doug, my thoughts would be some of the seasonality that always can come into play in our space. As Sujeet said in his prepared remarks, we do see and have seen some slowdown in our Q4 because of the holidays, the ability for our customers to work at the pace that they do in the other quarters is sometimes limited as well as our team resources in terms of availability.

We do feel, and I do feel comfortable with that mid- to low teens organic growth. It's again, on a higher number, but as we continue to move forward, we feel that is a good range for people to be thinking about as we think about our overall year-over-year as we exit 2024.

Doug Taylor:
Okay. Thank you. I'll pass the line.

Operator:
Once again, if you have a question, please press star, then one. Our next question is from Gavin Fairweather with Cormark Securities. Please go ahead.

Graham Smith:

Hi. This is Graham Smith on for Gavin Fairweather. Thank you for taking my question. My first one is just on how is the partner channel building for municipal and K-12 verticals?

Bill Wood:

Graham, good morning. It's building well, and it's building thoughtfully to that same consistency of what I shared in the remarks. It's not just about numbers, but it's about the right partners. But undoubtedly, on the Gov side, it is our thesis that a majority of that will be 100% here in the future where a good portion of that is accomplished by our partner channel.

On the inside, there's more regionality in some of that in terms of how and what we think about the partners. So, I think that will be a slower process for us to get to the kind of density of partner activities, taking the majority of that off of our plate. But undoubtedly, in those two markets, we see the large portion of booking attachment as well as the idea of service delivery growing in '24 and '25.

Graham Smith:

That's great. Thanks. More generally, I just was curious sort of how RFP activity and win rates are kind of trending, especially across with Mission and your other products?

Bill Wood:

The RFP activity is gaining, and I think it's reflected in our overall pipeline. It's up quarter-over-quarter and has been on a pretty consistent basis now, so I think that bodes very well. If we're winning at a rate, are these coming into our pipeline and not matriculating, two things are really helping us along that.

We're very focused on that ideal customer profile thesis that I've shared since I joined, which is everything about who is a customer, who do we sell to, where are we going to be successful and where are we going to ensure that they're going to be successful once they bring our (inaudible 35:05).

To that end, I think our lens is continuing to refine relative to the ICP, what our thought leadership, what our messaging, what our content is oriented to is, who's right for us, and we don't want them knocking on our door if we can help them self-select if they are or aren't. To that end, I feel very good about our overall sales pipeline continuing to build, and our win rate is continuing to strengthen. I think that's a very good tell-tale for not only the strength of our platforms, but the efficacy of our process to get them through the RFP and into a decision in our favour.

Graham Smith:

That’s great. Thanks. I’ll pass the line.

Operator

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

Bill Wood:

Yes. I just want to thank you all for joining today's call and for your continuing support. It's been an incredible three years since I joined, and I couldn't be more excited about the next three years that I see ahead for Sylogist. Again, thanks for joining today's call, and have a great day. Bye for now.

Operator:

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