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GlobalSCAPE, Inc.

Fourth Quarter and Year End 2014 Earnings Call

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CORPORATE PARTICIPANTS

Jim Albrecht, *Chief Financial Officer*

James Bindseil, *President and Chief Executive Officer*

CONFERENCE CALL PARTICIPANTS

John Rolfe, *Argand Capital*

Sam Freed, *Twins Capital*

Greg Newman, *The Newman Agency*

PRESENTATION

Operator:

Good day, and welcome to the GlobalSCAPE, Inc. fourth quarter and year end 2014 earnings call. Today's conference is being recorded. At this time, I'd like to turn the conference over to Mr. Jim Albrecht, Chief Financial Officer. Please go ahead, sir.

Jim Albrecht:

Thank you, Operator. Good afternoon and welcome to our earnings call. With me this afternoon is James Bindseil, Globalscape's President and Chief Executive Officer.

Before we begin, just a reminder that today's call, including a question and answer session, might include forward-looking statements regarding expected revenue, earnings per share, future plans, opportunities and expectations of the Company. These estimates and plans and other forward-looking statements involve known and unknown risks and uncertainties that may cause actual results to differ materially from those expressed or implied on this call. These risks are detailed in our latest Form 10-K filed with the Securities and Exchange Commission on March 27, 2014, and in other statements made by the Company. The statements made during this conference call are based upon information known to Globalscape as of the date and time of this call. Globalscape assumes no obligation to update the information we present during this call.

With those Safe Harbor statements presented, I'll move to summarizing our financial results for 2014 that we announced in a press release issued this afternoon.

Our revenue for the fourth quarter was $7.9 million, which is the highest quarterly revenue in Globalscape history, and is a 27% increase over the same quarter of last year. Revenue for 2014 as a whole also set a record at $26.8 million, which is a 10% increase over 2013 revenue.

Net income for the quarter was $1.2 million, which is almost double our net income for the same quarter of last year. Net income for 2014 as a whole was $3 million, compared to $3.8 million in 2013. When comparing those results for 2014 as a whole, we believe it important to consider that 2013 contained the benefit of an infrequent item related to income taxes. When the one-time benefit of that non-recurring tax item is excluded from 2013, our net income excluding that infrequent item was 20% higher in 2014 compared to 2013. While excluding this infrequent item is a non-GAAP measurement, we believe considering its effects are relevant when comparing 2014 to 2013.

Earnings per share was $0.06 for the fourth quarter, which is double the result for last year's quarter. EPS for all of 2014 was $0.15 per share. While earnings per share for all of 2013 was $0.21 per share, when excluding the one-time infrequent tax benefit I just mentioned, earnings per share for that year was $0.13. We believe this amount is most comparable to the higher $0.15 per share result for 2014 when assessing our ongoing operations.

These results were built on a broad base of sales. No single customer or event accounted for a significant portion of this outcome. We believe these results are built upon sales events that we can continue to replicate in future quarters.

Our deferred revenue at the end of 2014 was $14.8 million, which is a 37% increase over the 2013 amount. This deferred revenue arises from advance payments for maintenance and support services we will provide in the future. Since our M&S business typically yields at least a 12-month revenue stream at the time it is booked, we use deferred revenue to gauge our potential future revenue levels. We believe this increase in deferred revenue is indicative of a positive revenue trend in the future.

Our cash flow from operations remains strong at $8.5 million for 2014, which is almost double our $4.5 million of cash flow from operations in 2013. Even after repaying all of our notes payable during the third quarter of 2014, as well as paying a cash dividend of $0.05 per share in December, we ended the year with $14.5 million of cash and long-term investments. We are pleased to say that, other than normal trade payables, we have no debt and none of our assets are pledged. This strong financial position provides us a solid foundation for future growth.

Looking ahead, our outlook for 2015 is for sustained revenue growth in line with what we achieved in 2014. We will continue our investments in product development and sales and marketing with an expectation of achieving a net income return on sales in 2015 consistent with our most recent results. We believe with these foundations in place, we can look forward to an even more attractive revenue and income growth profile over the long term.

I will now turn the call over to James.

James Bindseil:

Thanks, Jim. Good afternoon, everyone, and thank you for joining the call today. As you heard from Jim's comments, we had a tremendous end to fiscal 2014, ending with a record quarterly revenue. Stepping back for a moment, those of you who attended the earnings call last year will remember, we began 2014 facing several challenges. We had just experienced some significant changes in leadership; our product lines needed some serious refocusing to start growing again; and we were beginning a major shift in our sales organization in moving from our traditional inbound-only demand capture efforts. While we still have much that we want to continue to expand, I am very pleased with how the Company responded, and that even in the midst of turning around a number of historical trends, we delivered the best three quarters in Globalscape history over the last three quarters of the year. While setting a new annual revenue record at $26.8 million is certainly desirable, what is particularly exciting for me is that back in Q2 we set the new highest quarter revenue in our Company history, beating a record that had stood for seven years. Now, in Q4, we set a new record of $7.9 million, more than $1 million higher than our previous record. Our Q4 performance demonstrates the momentum and predictability that we are striving to achieve at Globalscape.

There are a number of other records that were broken last year that I believe are worth mentioning as well. In Q4, we had $8.1 million in bookings. This quarter, along with Q3, are the only two times in Company history where we have exceeded $8 million in bookings for a quarter. In 2014, we had $29.9 million in bookings, which is the highest ever for Globalscape, and we had 24% year-over-year growth in total bookings and 21% year-over-year growth for new client bookings. All of us at Globalscape consider Q4 and 2014 to have been very successful, and are pleased that the changes made in our sales, marketing and product development activities are working as expected. We believe that the investments that we have made over the year have begun to show their value and will further mature in future periods.

Similar to 2014, we will begin 2015 with three key pillars that I will update you on as the year progresses. This year, these three pillars are: continue innovation of core products and introduction of enhanced collaboration and sharing tools; enhance marketing programs to expand solution awareness; and leverage and expand channel partnerships.

As was the case in 2014, continued innovation with our product lines is one of the key pillars to moving forward as a Company. We released a number of exciting product advances in 2014 for our core products that allowed us to greatly improve our new license growth. Some of these advances included high availability for EFT, integration with data loss prevention and antivirus products using the ICAP protocol, and encryption of the message body and secure e-mail attachments. In 2015, we intend to continue this drive and have several launches, such as the workspaces for EFT and the enterprise version of our secure content mobility solution, preparing to be released. As we did last year at the Annual Shareholders' Meeting, we are releasing a two-year product roadmap outlining our intentions for development of the various product lines. The updated roadmap for 2015 and 2016 will be posted on the Globalscape website by the end of today.

Enhancing our marketing programs to expand awareness for our solutions began in 2014 and will remain a key area of focus in 2015. Through both internal initiatives and leveraging strategic vendors, we were able to dramatically improve our pipeline and, as previously mentioned, this helped us to increase our new client bookings by 21% from the previous year. To begin the year for 2015, we have completely redesigned and launched a new website and are preparing to roll out a new branding effort for all of our product lines to further illustrate how all of our products work in tandem, to deliver on the brand promise of making sure our clients are securely connected. We have made changes to the structure, focus and funding of our marketing programs to further enhance the effectiveness of these operations, and expect even greater results in the future periods.

The last of the three pillars is to further leverage and expand our channel partnerships. We made great progress in 2014 identifying and onboarding some of the top solution providers in the industry. With quality partnerships, you do not launch a program and then walk away. In 2014, through an expected up-front investment in time and resources, we spent the majority of our channel efforts onboarding and training our partners' sales and technical teams. Our focus this year is to continue this drive by moving further into the enablement and optimization stage of the relationships whereby both the partners and Globalscape realize the benefits of the relationship. Some of the partnerships we began last year with, are already further down this path and seeing the benefits, and other more recent ones are still in the educational stage, but all are moving forward at a very good pace and we expect great things from our partner programs in 2015.

As in 2014, I will update you on each of these three pillars during each of the subsequent earnings calls for the year. We will still report on demand generation, bookings and revenue activities as expected, but will report on these elements as a matter of strategic reporting.

Delving deeper into some of the Q4 and fiscal year specifics, our maintenance and support recurring revenue continued to grow and rose to approximately $3.9 million for the quarter and approximately $15 million for the year. While the recurring nature of maintenance and support provides a predictable stream of future revenue, we are also working to drive greater license revenue as a higher percentage of our total revenue. Higher license sales yields not only higher license revenue, but also adds to our pool of recurring revenue, since virtually every purchaser of a license also buys a maintenance and support contract. During Q4, we achieved a 50-50 split between license and M&S, driving the ratio for the year up to 46% for license and 54% for M&S. Our maintenance renewal rates for enterprise products remain in the high 90% range and we anticipate this recurring revenue stream to continue to grow in future periods.

Our EFT suite of products continues to perform very well, providing 80% of our total revenue for the year. This was a very busy year for EFT. As mentioned earlier, we added high availability to the product line in 2014, introduced content integrity control to integrate with third party tools such as antivirus and data loss prevention technologies using the ICAP protocol, and also provided integration with SMS passcode for mobile-based two-factor authentication. As discussed on previous calls, all these features are allowing us to compete at a higher level with the largest enterprises while adding the ability for smaller companies to leverage these enterprise functions as well. We also augmented our legacy Java-based transfer client with the addition of an HTML5 client, improving not only the functionality but modernizing the user experience. We are currently competing QA on the new workspaces feature of EFT, which will move EFT to an even wider range of business uses, enabling distributed collaboration and administration similar to that found in conventional virtual data rooms, but with the automation of simplicity that our users have come to expect from EFT. For 2015, we have numerous other advances scheduled including acceleration, the introduction of enhanced reporting and activity monitoring tools, as well as expanded event rule and automation capabilities.

Mail Express also had several updates in 2014, including the addition of optional message body encryption, an enhanced user experience, enhanced administrator visibility into connective clients, ICAP integration for compatibility with third party data loss prevention and antivirus tools, and expanded international support. In the coming year, we are going to focus significant attention on the integration of Mail Express with EFT, so that our clients can benefit not only from a unified system of administration and data storage but also have the expanded capabilities that come with the automation and work flow that EFT has to offer. We believe that this will greatly increase the number of use cases for Mail Express and allow us to grow sales at an improved rate.

WAFS had three new versions released in 2014, providing faster and more reliable collaboration, greater driver stability, enhanced reporting, improved performance and added support for Windows Server 2012 R2. We are currently testing WAFS version 5, which will provide a significant upgrade to the communications of the product and expand the number of agents that can be supported. In 2015, we will be upgrading the synchronization infrastructure to a much more robust architecture and adding even more scale for the largest of clients.

Finally, on the secure content mobility front, what began with the TappIn acquisition and the intention of transforming it into an enterprise solution, has entered into the beta testing phase with several clients and partners engaged to run it in their own environments. This enterprise version of our secure mobile content management tool will provide our customers with the mobile connectivity to information and the user experience that they want with the security, visibility and enterprise integration that they require.

As you may have seen, in 2014, there were numerous high-profile cases involving the big name public cloud providers where the security of one client or one partner ended up impacting the privacy or security of a different party or, in some cases, hundreds of thousands of parties. While consumer-grade products are frequently used in ad hoc situations today, our solution will allow companies to provide this functionality on their own premises and integrate it with their own authentication systems, meaning that they can leverage their own policies and restrict access as they wish without worry of another customer compromising their security. We will be launching this software for general availability as soon as the beta phase is complete and any required customer feedback has been incorporated.

We are very pleased with the progress we made in 2014, but as always, we know there is still work to do. I am confident that the plans in place are working and should yield even higher returns in future periods. To further illustrate this confidence and as part of improving our shareholder value, I am pleased to announce that the Board of Directors have approved the initiation of a quarterly cash dividend program commencing during the second quarter of 2015. We anticipate that the initial cash dividend will be $0.015 per share, with the applicable second quarter record and payment base to be determined. The timing and value of dividends to be paid in subsequent quarters will be determined on future dates by the Board of Directors.

With our strong portfolio of solutions, the roadmap we are pursuing, and the continued enhancements we are making to engineering, sales and marketing, I am very excited about our growth potential for the future. As Jim mentioned earlier, our outlook for 2015 is to continue revenue growth in line with what we achieved in 2014. Our investments in product development, sales and marketing are designed to drive an even more attractive revenue and income growth profile over the long term, but even with these investments, our expectations is that we will continue achieving a net income return on sales in 2015 consistent with our most recent results.

In closing, I want to thank once again our partners, customers, investors and employees for their continued support and trust in Globalscape. Twenty-fourteen was a good year at Globalscape and we expect even greater things in 2015 and beyond. I look forward to updating you on our continual progress as the year progresses.

At this point, I'll turn the call back over to Jim to start our question and answer session. Jim?

Jim Albrecht:

Thank you, James. We now look forward to hearing your questions, so Operator, please open the call for questions and answers.

Operator:

Thank you. If you'd like to ask a question, please signal by pressing star, one on your telephone keypad. If you're using a speakerphone, please make sure that your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask your question. We'll pause for a moment to allow everyone a chance to signal for questions.

We'll take our first question from John Rolfe with Argand Capital.

John Rolfe:

Hi. Good afternoon, guys. Really nice quarter. It's very gratifying to see your work paying off this way. Couple of quick questions for you. One, I noticed on a quarterly basis, there was a really pretty material tick down in terms of SG&A and a corresponding, you know, really significant tick up on the R&D line, and I'm wondering if you could give a little bit of color on that. Is there any reclassification going on, you know, things that might have previously been classified as SG&A now being classified as R&D?

James Bindseil:

There's a couple things that really come into play when you're looking at both of those items, you know. First off, when part of the SG&A comes to lead generation and things like that, that are taking place inside of the marketing organization, and there is timing to when that lead generation takes place and there's some activities that take place earlier in the year or earlier in a quarter that don't necessarily take place near the end of the year or near the end of the quarter, so there is a little bit of fluctuation when it comes to some of the demand generation activities. There can also be some fluctuation when it comes to—when you're looking at one-half of the R&D line items. What you'll see is that the R&D spend is actually fairly consistent when you take into account both R&D and the capitalization of the R&D efforts but sometimes, depending upon where you are in the life cycle for a product development, it might be capitalist—be able to be capitalized and other times it can't. So it depends on whether you're working on, you know, the new features or if you're working on more maintenance releases and things like that, so. I suspect that that's where you see some of that variation when it comes to the R&D.

John Rolfe:

Okay, which makes sense, I guess, just the scale. Unless I'm scheduling my numbers out wrong, it looked like you guys had 3.3 million of R&D in the fourth quarter, which is, you know, multiples of anything you've booked in the last bunch of years, as far as I've scheduled back. It has typically run under a million, so it just seemed like a really significant bump. Then on the SG&A line, again, backing into fourth quarter numbers, it looked like it was 2.2 million in the quarter, where you've been running, you know, consistently at least over the last few quarters up above, you know, 4 million. So there was just some really, really material swings there. Again, maybe I'm—maybe my numbers aren't right the way I'm scheduling things here, but it looked like very material differences there.

My second question just on the—it looked like you guys, on a GAAP basis, booked a tax rate of about 34% for the year. Going forward, is that a reasonable assumption or were there things flowing through that this year that you wouldn't expect to repeat going forward?

Jim Albrecht:

This is Jim Albrecht. Nothing unusual in our tax rate. We're very pleased that our tax planning and the hard work we do to maximize our deductions and our credits, because we do enjoy the benefit of the research and experimentation tax credit, so. That's a number that we expect to be able to achieve going forward.

John Rolfe:

Okay. Okay, that's great. Well, I'm going to go back and just sort of reschedule my numbers out here. I may follow up with you off line on some of the line items in the fourth quarter. But thanks, and again, very, very nice quarter.

James Bindseil:

All right, thanks a lot, John.

Operator:

Again, if you'd like to ask a question, please press star, one. We'll take our next question from Sam Freed with Twins Capital.

Sam Freed:

Okay, thank you very much. I just re-entered my buttons. I don't know if I'm going to go back into the queue, but hopefully we'll address all my questions right now. First off, to the Management team, congratulations on a great quarter, a fantastic year. You've executed on everything you've talked about throughout the course of the year, so I applaud the efforts and the execution. Now, moving on to some of the questions that I have. The Board has agreed to start a quarterly cash dividend. What was the reason that the Board decided on implementing a quarterly dividend? As a shareholder I'm obviously, you know, receptive to a dividend, for any company that wants to pay, but I was just wondering if there was a decision about using the cash for a share buy-back instead or putting the money into other endeavors, and how you came upon a determination of putting the dividend front and center.

James Bindseil:

Well—yes, Sam, this is James. I won't speak to all of the necessarily—the deliberations that took place, but really it comes down to the fact that we are a very good Company at generating cash. We've got a very good cash position, and the Board has great confidence in the direction that the Company is going and the growth trajectory that we're on. It really just comes down to confidence in how the Company is growing, both just from revenue and from a cash perspective. So it is returning, you know, to the investors and demonstrating the confidence that we have in the position of the Company.

Sam Freed:

Okay. So, I've heard you mention growth a few times, and particularly revenue growth. Are you expecting revenue growth in the same range as 2014? If that's the case, can I interpret that, that you would mean somewhere around a 10% target rate?

James Bindseil:

Well, we're not forecasting specific numbers on what the growth of the revenue will be, but we are anticipating, you know, for this year, for the rate to be certainly comparable to what we've been experienced in 2014.

Sam Freed:

Okay. This is more or less a housekeeping question. I realize that you don't guide on the operating expenses. I did notice, and this may be something that the prior person was asking about or kind of alluding to or getting to; I notice that op ex was up about 15% from Q3, and back to the levels you had in Q2. How do you think I should model op ex for next year versus 2014? Are there any trends that you can sort of provide me with rather than giving specific numbers or percentages?

Jim Albrecht:

This is Jim Albrecht. Certainly our op ex can fluctuate a little bit from quarter to quarter, but in general we manage it on an annual basis. As I said in my earlier remarks, our goal is to achieve a net income profile that's consistent with what we achieved in 2014, and that's what we're shooting for.

Sam Freed:

Okay. So in other words, this looks like it could translate into higher EPS in 2015, then.

Jim Albrecht:

I'll have to leave it to you to draw that conclusion, since we don't offer specific guidance, but we certainly hope so.

Sam Freed:

Okay. Well, you've done great work in '14, so I'm looking forward to continued success in the following year. Thank you very much.

Jim Albrecht:

Thank you.

James Bindseil:

Thank you.

Operator:

Our next question will come from Greg Newman with The Newman Agency.

Greg Newman:

Thank you, Kathy (ph). Congratulations. Very nice numbers on the revenue. My first question has to do with test marketing. Every time I go to Walmart, I think about you all when I'm in the computer section, electronics, because of all the antivirus shelf material they have. Just wondered if was anything in the works for trying to test-market some of your solutions that are consumer-based, either CuteFTP or TappIn, in some of the local or city area Walmarts. I know it's just a process, they tell me, that you have to go through to get your products in there, and it takes so many months to do that. So if you could answer to that.

James Bindseil:

Yes. Thanks, Greg. This is James. You know, the—one of the pillars that I announced earlier that really is a focus for 2015 is making significant advances to our marketing organization, and all of the efforts that we're doing in the marketing team. The—you know, one of the things that is obvious, looking at our numbers and the direction that we're going, is that enterprise is certainly the much larger play, even though we do have the consumer lines. The consumer lines are absolutely a demand generation vehicle for us. But without saying whether we will or not, you know, target any one particular venue for advertising, I will tell you that the marketing team that we've got put in place now is going to look at every single opportunity to get our story out to the street and they will certainly prioritize to make sure that we are driving the—you know, the revenue and the products that we need to drive it in, so.

We're going to be very ambitious, and we've got a lot of good things that we are going to achieve with the marketing. So I think you're going to see a lot of excitement coming from there. But, you know, it really is obviously a decision matrix that we have to make on where we spend our marketing dollars for our demand generation. But, you know, as always, we certainly value hearing your thoughts on it.

Greg Newman:

The second question is more future type also. You may know I'm involved in the Recording Industry of America through Jack Newman (ph) and all of the things that he's done, and so I follow that pretty closely. They have a website, Why Music Matters, where they put it out and they connect consumers to websites that—they distribute music basically, like what you all used to do, I guess through CuteMX (ph), but there's very different types of websites that are backed by them; they support, they don't guarantee anything about those, you know, but they—it's their site, and the music industry of America with them, business association, helped build that. I wondered about if there would be a way that you all could take a look at if there's something that you all can do through one of your products, TappIn or (inaudible); I think TappIn is probably a lot better way to go about it, but—

That's my question, because it just seems like there's a really big opportunity and that—well, people that buy music, they like to spend money to hear their music. All this, the websites tied in with WhyMusicMatters.com, it's—they all—they're paying the performers. So they're making money to be able to pay the performers. So.

I guess it goes again with what you just said, that the marketing—that it's a form of marketing, that demand generation. Is there something that would clearly exclude that possibility to you, from TappIn, that you just—there's no way that you all's looked at it or it's still being looked at?

James Bindseil:

Well, I would say that, you know, moving forward, there's nothing that excludes us to looking at any avenues that will help us to drive demand. You know, I must admit that that one certainly goes much more down the consumer path and so, you know, it's certainly something that we would need to look at, to see if it actually could drive any of the enterprise demand generation activities. But to answer your question, there's nothing that's excluded that will move our revenue and move our technology forward, so. You know, we'll look at absolutely anything that helps us to achieve those goals.

Operator:

It appears there are no further questions at this time. I'd like to turn the conference back to Management for any additional or closing remarks.

James Bindseil:

Thank you, everybody, for joining the call. We appreciate your support and your questions. We look forward to visiting with you again in the spring after we complete the first quarter of the year. Everybody, have a good afternoon. Thank you.

Operator:

This does conclude today's conference. Thank you for your participation.