



Globalscape, Inc.

First Quarter 2015 Earnings Call

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CORPORATE PARTICIPANTS

Jim Albrecht, *Chief Financial Officer*

James L. Bindseil, *President and CEO*

CONFERENCE CALL PARTICIPANTS

Jason Burack, *Hawk Capital Management*

John Rolfe, *Argand Capital*

Sam Freed, *Twins Capital*

Greg Newman, *Newman Agency*

PRESENTATION

Operator:

Good day and welcome to the Globalscape Incorporated First Quarter 2015 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 the 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 the call. These risks are detailed in our latest Form 10-K filed with the Securities and Exchange Commission on March 30, 2015, 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 the first quarter 2015 that we announced in a press release issued earlier this afternoon.

Our revenue for the quarter was \$6.9 million, which is a 20% increase over the same quarter last year. Net income for the quarter was \$815,000, which is a 53% increase compared to the same quarter last year. Earnings per share was \$0.04 for this latest quarter compared to \$0.03 for the same quarter last year.

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 events that we can reasonably expect to continue to replicate in future quarters.

Bookings is a business metric we use to measure the ongoing leadership of our products in the marketplace and the success of our sales and marketing programs. Bookings are a combination of transactions for which we will recognize revenue immediately, such as sales of our licenses to use our products, as well as transactions for which we will recognize revenue in future periods as we deliver those services, which is the case for our maintenance and support and professional services. Our bookings for the first quarter of this year were \$6.3 million as compared to \$5.6 million for the first quarter of 2014.

Our 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 as a leading indicator to gauge our potential future revenue levels. Our deferred revenue at the end of Q1 was \$14.3 million, which is up from \$10.7 million at the end of Q1 2014. We believe this increase in deferred revenue is indicative of a positive revenue trend in the future.

Each time we sell a software license, we typically create a maintenance and support recurring revenue stream that is anywhere from 20% to 30% of the price of the software license. With our M&S renewal rate in excess of 90% due to our customers' satisfaction with our products and support, this recurring M&S revenue stream continues to prove to be quite sustainable. For Q1 this M&S revenue grew to \$4 million as compared to \$3.6 million for the same quarter last year. If you add that to the fact that our license revenue that yielded that revenue stream grew to \$2.5 million in Q1 2014 as compared to \$1.9 million last year, the prospects for continued growth of this recurring revenue stream are good.

Looking ahead, our outlook for 2015 continues to be for sustained revenue growth in line with what we achieved across 2014 and into 2015. We will continue our investments in product development and sales and marketing with an expectation of achieving a net income return on sales during 2015 that is consistent with our 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.

We ended the quarter financially strong with \$15.5 million of cash and investments and no debt other than our normal trade payables.

I will now turn the call over to James.

James L. Bindseil:

Thanks, Jim. Good afternoon everyone and thank you for joining the call today. As you heard from Jim's comments, we are off to a very good start in 2015 and excited to share the results of the first quarter with you.

Last year we began a number of programs to drive towards longer-term sustainable revenue growth. As discussed in the previous earnings call, these programs have been updated to include the following elements in 2015: continue the innovation of our core products and the introduction of enhanced collaboration and sharing tools; enhance marketing programs to expand solution awareness; and leverage and expand our channel partnerships. The financial results over the past several quarters, and continuing into the first quarter of 2015, indicate that these initiatives are working. First quarter revenue was \$6.9 million, which represents a 20% increase over Q1 of 2014. Maintenance and support revenue was \$4 million, which is the highest in our Company history; our new license bookings grew 41% over Q1 of 2014; and we have ended the first quarter exceeding \$15 million in cash and continue to have no debt.

Specifically from a product innovation perspective, we have introduced two product releases including a significant new module for EFT and the enterprise version of our secure content mobility solution. The workspaces module for EFT is a file sharing module that allows employees to create their own groups and assign permissions for those groups, much like a virtual data room, to provide access to files for which they themselves have access on the EFT server. This functionality is accomplished without compromising the security, control and governance of those files.

The concept of providing end users with the flexibility to collaborate with other users without having to involve IT and without increasing security risks is also a primary theme with the second product release this year. scConnect is our new on-premises enterprise file synchronization and share solution. scConnect provides users secure content mobility with the ability to share and access data any time on any device. At the same time, scConnect provides IT department administrators with the tools necessary to maintain the security of sensitive enterprise information and to control and monitor user access and activity. Designed to replicate today's cloud experience without the risk, reliability or confidentiality concerns of shared infrastructures, scConnect enables secure collaboration and content mobility without involving third party servers. Created with both the IT team and end user in mind, scConnect offers benefits that exceed many cloud-based file sharing services.

In addition to our product releases, enhancing our marketing programs to expand awareness for our solutions continued in the first quarter of 2015. Through both internal initiatives and leveraging strategic vendors, we were able to increase our pipeline by 65% compared with Q1 of 2014 and, as previously mentioned, this helped us to increase our new client bookings by 41% from Q1 of 2014, providing a solid foundation for potential future sales.

Our last pillar focuses on expanding, supporting and taking advantage of our channel relationships. In 2014 we made major strides to identify and bring several key solution providers into our program. Maintaining a mutually beneficial relationship with these important channel providers is critical to our success. This is also the reason why we made a significant investment of time and resources to train and develop each of these partners' sales and technical teams on the full Globalscape portfolio and differentiation points. This year we are focusing on empowering and strengthening these initiatives by moving them into the enablement and optimization phase, providing a greater understanding of the relationship with Globalscape. A significant portion of our partners in conjunction with the Globalscape sales teams are actively engaging their customer base and creating new opportunities for Globalscape. As is normal with any program of this nature, we have some partners that are far along in the process and able to take advantage of the benefits of our relationship, while others are in need of more training and education. The program continues to make significant progress and we are expecting 2015 to be an important year in the development of our channel. In fact, in March Globalscape was awarded the five-star partner program rating from CRN, which is given in recognition of an elite subset of companies that offer solution providers the best partnering elements in their channel programs. This validates the steps taken to set the foundation in 2014 and is only the beginning of what we think will be an incredibly successful year for the channel program.

I will continue to update you on each of these three pillars during subsequent earnings calls for the year.

Delving deeper into some of the Q1 product line specifics, our maintenance and support recurring revenue continued to grow and, as I mentioned earlier, exceeded \$4 million for the quarter for the first time in our Company's history. As is indicated by the growth in new license bookings for the quarter, we are working to drive greater license revenue as a higher percentage of our total revenue. Higher license sales yields not only higher license revenue immediately but also adds to our pool of recurring revenue, since virtually every purchaser of a license also buys a maintenance and support contract. As Jim indicated, having the addition of 20 to 30% for M&S added to each license sale benefits us not only in the

short term but for the longer term as well, and we will continue the efforts to drive these percentages higher.

Demand continues to be strong for our EFT suite of products while providing 78% of our total revenue for the quarter. For the remainder of 2015, we have numerous advances scheduled including acceleration, the introduction of enhanced reporting and activity monitoring tools, as well as expanded event rules and automation capabilities. As a reminder, the current two-year road map for EFT and all of our other products are published on the Globalscape website at www.globalscape.com in the Investor Relations section.

Also in Q1, in addition to making several minor improvements, Mail Express saw a number of notable enhancements as well. Support for the ICAP protocol was added, allowing for data loss prevention and antivirus scanning of files seamlessly with the product. Internationalization support was further extended to include both Portuguese and Italian languages. Finally, web browser support to enable large file uploads without requiring client-side software was implemented. Each of these advances enables Mail Express to be used in the largest high-security deployments as well as increased international alliances.

WAFS version 5 is nearing completion and will provide a significant upgrade to the communications of the product and expand the number of agents that can be supported. Twenty-fifteen will be a very big year for WAFS innovation. We will be upgrading the synchronization infrastructure to a much more robust architecture and adding even more scale and performance for the largest of clients.

We are very pleased with the progress we made in the first quarter, but as always, we know there is still much to do. I'm confident that the plans in place are working and should yield the higher returns in future periods that we have been working towards. With our increased deferred revenue, strong portfolio of solutions with 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 in the future. As discussed on the previous earnings call, our outlook for 2015 is to continue revenue growth in line with what we achieved in 2014. We are pleased with how we have started the year and remain confident that we can achieve this goal. Our investments in product development and 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 expectation is that we will continue to achieve a net income return on annual sales in 2015 consistent with our most recent results.

As always, I want to thank our partners, customers, investors and employees for their continued support and trust in Globalscape. We are off to a great start in 2015 at Globalscape and we will continue driving towards even greater successes in the future. I look forward to updating you on our continued 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 are now pleased to take questions, so Operator, please open the call for our listeners.

Operator:

Ladies and gentlemen, if you'd like to ask a question at this time, please press star, one on your phone. If you are using a speakerphone, please make sure the mute function is disabled. Once again it's star, one if you'd like to ask a question. We'll pause for a moment to give everyone a chance to signal.

We'll take our first question from Jason Burack with Hawk Capital Management.

Jason Burack:

Hi. Good afternoon.

James L. Bindseil:

Hi, Jason.

Jason Burack:

Congratulations on the great quarter. I just had a random question about the Tappin Pro white label solution. Can you just talk about that in terms of, you know, where you see it gaining traction? I know you had that deal with Toshiba. Have you seen any near the same size as that deal, and what have you seen in the marketplace?

James L. Bindseil:

Well, what we've been focused on really is the enterprise capabilities of going to the secure content mobility solution with what we introduced last week with scConnect. That is the enterprise big brother of the Tappin Professional, and so there has not been much in the way of activity from the consumer brand which is the Tappin Pro that you're referring to, and all of the upside potential and everything that we're focusing on is taking that to the enterprise. We're very pleased that we've got scConnect launched, but it's—from a consumer brand we really don't see that continuing to grow in any significant fashion. It's really more demand generation for the enterprise efforts that we're pursuing.

Jason Burack:

Okay, great, and then my last question was what was the cash flow for the quarter? Cash flow from operations.

Jim Albrecht:

This is Jim Albrecht. Our cash flow from operations was \$1.4 million.

Jason Burack:

Okay. Super. Thanks. Thanks for taking my questions.

James L. Bindseil:

Thank you.

Operator:

We'll go next to John Rolfe with Argand Capital.

John Rolfe:

Hey guys. One question for me. Within what's been a very nice overall growth trend recently, the Company has a fair amount of variability quarter to quarter on the top line, and you know I think that's driven in large part by a fair amount of movement quarter to quarter in license sales. Can you talk a bit

about the drivers of that variability and whether there are any sort of consistent seasonal trends that you guys experience on a regular basis?

James L. Bindseil:

Yes, there's a number of factors and you're absolutely right, there is some seasonality built into that. The end of the year is obviously a big time for a lot of companies and we're certainly no exception to that. Q3—excuse me, Q2 is typically historically been a good quarter for us as well. One of the things that I believe we're proving out as we discussed last year is really trying to get more to that sustainable growth, and while I think there is some variability we are working very aggressively with our demand generation efforts and with our partnerships that we're putting in place to make those a little more predictable, if you will, and actually be able to see where those trends are as opposed to just whether or not there was a slump in buying patterns. There's all types of things that can be affected by that. But there are some seasonalities, but we are working to smooth out the ripples, if you will, through our demand generations and our partnership efforts.

John Rolfe:

Okay, that's great. Thanks very much, guys. Nice quarter.

Operator:

Once again it is star, one if you do have a question at this time, star, one. We'll go next to Sam Freed with Twins Capital.

Sam Freed:

Okay, thank you. First, congratulations, gentlemen, on another great quarter. Several questions. First, how many resellers and distributors have you added in the last year, and what are your plans for this area over the next year?

James L. Bindseil:

Well the only number that we've disclosed is that over the last few we've added over a hundred new partners. Beyond that we haven't disclosed anything. We are constantly adding new partners. You know, you said it right, it's partners and distributors, it's resellers, there's varying sizes all the way up to the largest of distributors down to the couple of people, value-added reseller shops. So each one of these partners has different needs and has different growth potential for the Company. But from a macro answer, we really do envision these partnerships to be one of our primary growth vehicles. We are growing our organic sales and we will continue to drive that, but there's only, you know, so many feet you can put on the street, and so we actually see our channel efforts as, you know, once again our primary growth vehicle. So we will continue to add the right partners and we will continue to nurture those partnerships and to make sure that they're able to see the value in Globalscape and bring that value to their clients.

Sam Freed:

Yes, I think that's a sound strategy. You certainly hear that a lot from companies of your size and much larger, so I can appreciate that. So as a follow-up to that area of work, do you see your sort of SG&A incrementally going higher, to support the increased level of resellers and distributors that you're supporting?

James L. Bindseil:

There's always going to be, I think, a little bit of that to where it will go up, but one of the things that we disclosed last year is that the increase, last year and this year, is higher than you should expect the increases to be in the future because we're establishing the programs. Once the programs are completely established and working and we continue to nurture those partnerships once again, you know, there'll always be an increase but it won't be of the magnitude that it's been last year and this year with actually establishing the programs and the partnerships. So the answer to your question is yes, there will be increases, but it won't necessarily be of the magnitude that it has been in getting the programs put into place.

Sam Freed:

Very good. Okay next question. Your M&S revenue was up nicely. How should I think about the—you know, the M&S revenue growth for the rest of this year? Meaning will it grow at a higher or lower rate than license revenue?

James L. Bindseil:

Well, the fact of the matter is maintenance and support revenue is always a trailing indicator, if you will, of the new license sales. So since we've had several quarters now of increased new license sales then it just follows mathematically that the maintenance and support will continue to grow as well at a faster rate than it has in the past, for maintenance and support, because we've added the new license. But as far as whether or not it will outpace new license sales, that depends upon those new licenses for that quarter and so I—we don't provide guidance on what those new sales will be in the future quarters, but I can tell you that because of the recent performance on new license sales you should expect to see the maintenance and support increasing at a faster rate than it has in the past.

Sam Freed:

Oh, terrific. On the operating expense line, we covered some of the—you know, the increase or the minimal increase in costs to support the higher distribution and reseller channel efforts. Beyond that, do you see any incremental moves up in your operating expenses to support the higher revenues, or are we getting closer to a sort of steady state?

James L. Bindseil:

I would say we're getting closer to a steady state but that doesn't mean that there won't be increases. Kind of to my earlier point, there will always be growth associated with it; you need partner account executives to nurture those accounts. You need the marketing, sales, support, engineering functions to actually support the business as it grows. But the—but there are a number of initiatives, as we disclosed last year, that we began last year that will not continue to grow at the same rate as they have.

Sam Freed:

Okay. In terms of the revenue, you mentioned the growth rate was similar to last year. Can you remind me what the revenue growth rate was in 2014?

Jim Albrecht:

Pardon me. This is Jim Albrecht. For the entire year?

Sam Freed:

Yes.

Jim Albrecht:

If you'll hold for just a moment I will get you that specific number.

Sam Freed:

Just to the nearest percentage point would be fine. I just want to get a sense.

Jim Albrecht:

I know. I don't want to misspeak, and I don't have the—after we've achieved them I'm always looking to the future, so I don't always walk around with the specific number in mind, so let me refresh my memory. We went from \$24.3 million in 2013 to \$26.7 million, so about—so roughly about 10%.

Sam Freed:

(Inaudible) Great. Okay. Terrific job. Things look like they're really moving along nicely, so thanks very much for the effort and for the conference call today.

Jim Albrecht:

Thank you.

Operator:

We'll go next to Greg Newman with Newman Agency.

Greg Newman:

Thank you. Congratulations on the quarter. Looks good. I have a question for you, for a friend, investor, who wants to know about appShield, including your options to get it developed on a contingency basis, reusing the code for future Globalscape products, or to sell the code to interested parties. We haven't heard for a while on appShield so we wanted an update. Thank you.

James L. Bindseil:

Okay. Well, we obviously do still own that asset. We haven't seen any opportunities that really would allow us to leverage that asset, nor is appShield, as it stood at that point, something that we are pursuing at this time. We're really focused on the core lines of the business and that's our projection for the near-term future. That doesn't mean that if we find an opportunity to where we could sell that IP to somebody that we wouldn't take advantage of it, but the right opportunity certainly has not presented itself yet.

Greg Newman:

Thank you. You mention clients and partners have been beta-testing your enterprise Tappin, the scConnect. Could you please elaborate a little bit on what type of partners and clients those are? Distributors, resellers, OEM partners, or what have you? Thank you.

James L. Bindseil:

Greg, you pretty much described it. They're primarily resellers, people that sell our EFT for the most part and so they're familiar with who we are and the kinds of customers that we service, and so they were, as a part of that relationship, providing assistance to us in the beta of that. We obviously did just release that last week and we did that receiving feedback from those partners.

Operator:

Ladies and gentlemen, that does conclude our question and answer session. I'd now like to turn the call back over to James for any additional or closing remarks.

Jim Albrecht:

Thank you everyone for joining the call. We look forward to visiting with you later in the summer to review our second quarter results. Everybody have a good day. Thank you.

Operator:

Ladies and gentlemen, once again that does conclude today's call. Do appreciate everyone's participation.