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GlobalSCAPE, Inc.

First Quarter 2016 Earnings Call

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CONFERENCE CALL PARTICIPANTS

Andrey Omelchak, *LionGuard Capital Management*

John Rolfe, *Argand Capital*

Greg Newman, *The Newman Agency*

Jason Burack, *Hawk Capital Management*

PRESENTATION

Operator:

Good day and welcome to the GlobalSCAPE Incorporated First Quarter 2016 Earnings Call. If you'd like to ask a question, please signal by pressing star, one on your telephone keypad. If you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Today's conference is being recorded.

At this time, I would like to turn the conference over to Mr. Jim Albrecht, Chief Financial Officer. Please go ahead sir.

Jim Albrecht:

Thank you. 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 revenues, 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 3, 2016 and in others 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 of 2016 that we announced in a press release issued earlier this afternoon.

Revenue for the quarter was $7.4 million, an 8% increase compared to the first quarter of 2015. Our growth in Maintenance and Support revenue remains solid at 11%. With our renewal rate for M&S continuing to be above 90% due to our customer satisfaction with our products and support, this recurring M&S revenue strength which is $0.20 to $0.30 on the dollar for most of the software licenses we sell continues to prove to be quite sustainable, particularly in light of the continued increase in our deferred revenue balance relative to this time last year.

We enjoyed ongoing growth in our Professional Services revenue with a year-over-year increase of 58%. We are pleased to see more of our customers taking advantage of this service to enhance their experience with our products. Our license revenue for the quarter was $2.3 million compared to $2.5 million for the comparable quarter last year. License revenue from our EFT product line, which is about 84% of the total, increased 2%. We saw lower license revenue from our last product for which the market has been anticipating an updated release. In December 2015, we released WAFS 5.0, which make Q1 a period during which customers were learning about and assessing its updated features and functions prior to making their buying decision.

We also saw a decrease in CuteFTP and other licenses revenue which echoed the trend we previously saw for all of 2015 as we continued to focus our time and resources on growing our lead family of EFT products.

Moving on to margins, our gross margin on M&S continued strong at 91%. This margin, which we earn on this 60% component of our revenue, continues to prove to be quite sustainable. We experienced some pressure on Professional Services margin as we engaged additional resources to address the increased demands for these services. We are looking forward to those margins recovering as we adjust our staffing to meet those demands. Our margins from software license were lower this quarter as new products came online and amortization of the cost to developing those products commenced. We expect these margins to improve overtime as revenue from these new product releases increases.

Our operating expenses, the majority of which support our product development and sales and marketing activities to drive revenue, remained at a level of comparable to those expenditures last quarter, which is consistent with our expectations. Our overall cost of developing our products, which is a combination of our research and development expense and our capitalized software development costs decreased slightly year-over-year. We are pleased with this result as it stems from our efforts to reduce our use of higher-priced third-party software development resources while sustaining our pace of product development using our own personnel.

Net income for the quarter was $405,000 or $0.02 per share. While those results are behind where we were at the same time last year, our outlook for 2016 as a whole continues to be for a sustained revenue growth in line with what we achieved for all of 2015 along with an expectation of achieving net income as a percent of sales for 2016 that is consistent with our results for 2015 as a whole. After continuing to pay a quarterly dividend, we ended the quarter financially strong with $19.6 million of cash and investments and no debt other than normal trade payables.

I will now turn the call over to James for further comments.

James L. Bindseil:

Thanks, Jim. Good afternoon, everyone, and thank you for joining the call today. As Jim has just outlined for you, we had when compared to most competitors in the managed file transfer space and to our past, what would be consider a good quarter. We grew revenues at 8% over Q1 of last year, which was equal to the growth rate for the Company in 2014 with revenues at $7.4 million. As we discussed on our previous earnings call, we have very aggressive growth plan for 2016 and while the year-over-year revenue growth for Q1 was relatively modest when compared to recent quarters, we believe that the growth objectives we outlined are still very much achievable.

I will briefly now add additional detail regarding our Q1 operating results, including some of the key drivers which impacted our performance. I will then address where we are headed to achieve increased result in Q2 and throughout the remainder of the year.

Starting at the top, bookings for Q1 grew 22.5% year-over-year from Q1 in 2015. Bookings is a business metric we use to measure the success of our sales and marketing programs and the effectiveness of our sales and marketing teams. As discussed in the past, bookings impact revenue in four primary ways. The first is product sales where a license is sold as a perpetual license and immediately recognized this revenue. Secondly, maintenance and support contracts, which typically range between 20% and 30% of the license cost depending upon the level of support coverage purchased. Our booked and net revenue is recognized over the life of the contract.

The third way is when our professional services work, which has been mutually agreed upon with the client is recognized as revenue when the work is performed, has been accepted by the client. Lastly, cloud services in a manner similar to M&S is booked for a specific period of time and then recognized ratably over the period of the contract.

A positive trend that has started to take shape in Q1 was an increase in Cloud Services bookings and while Professional Services and M&S that are usually sold in conjunction with the license sale, where there is an immediate lift in license revenue as well, the Cloud Services deals are frequently booked in lieu of the license sale. What this means is that we will have an increased bookings number as we do for Q1, but we will not immediately see the increase in recognized revenue for product licenses. Another positive trend in bookings from Q1 is that we are starting to see an uptick in our channel sales. We had a 59% year-over-year increase in channel-initiated bookings for Q1 with the pipeline continuing to grow at all-time high levels.

Moving onto revenue, revenues for Q1 grew 8% compared to the same period in 2015 due largely to increased M&S from license sales from previous periods and an increased contribution from Professional Services. While EFT licenses grew slightly year-over-year, overall new product license sales decreased 6.4% due partly to the previously mentioned increase in Cloud Services adoption, a decrease in the sale of Mail Express and CuteFTP and the non-linear nature of enterprise sales with some deals moving between quarters.

That said, productivity increases in our channel sales, expansion of the sales team, diversification of our demand generation activities, scheduled product enhancements, and our robust pipeline give us confidence that we will continue to see significant improvements in new product license sales in Q2 and throughout the rest of 2016.

Additionally, one of the keys to achieving the accelerated growth rates we as the Management Team expect to attain is that we have to continually find, sell and service new customers, which requires nearly constant expansion of our capabilities. Beginning in Q4 of 2015 we expanded the sales team to add extra capacity and we made adjustments to our demand generation efforts to increase the amount of opportunities being introduced into the funnel. These expansions were necessary investments in our future designed to provide the continued growth of revenue potential. We believe these investments will ultimately have a positive impact on both revenue and earnings in future periods. However, we did not yet see the benefits of these investments reflected in our Q1 numbers. While the revenue is still growing, we saw a temporary reduction in the earnings due to the higher expense associated with these expansion measures. We believe that we will start to see the positive impacts of the expanded sales team beginning in Q2, but even more so in third and fourth quarters.

The bottom line is that while 8% is not the growth rate that we are targeting for 2016 as a whole, the expansion of the sales team and marketing initiatives produced somewhat of a transition quarter, but the pipeline continues to grow at unprecedented levels. We absolutely believe that the growth and earnings that we envision for 2016 are within our reach and we continue to make all of the moves necessary to make it happen.

Following the pattern from the last several years, I will now review the three pillars that we began the year with and provide stats (phon) for each. This year, these three pillars are continued innovation of core products, expanding into broader segment of the market; expansion and creation of emerging technologies into existing and adjacent work spaces; and continued evolution of enhanced demand generation, including marketing, customer-facing and partner-facing programs.

As has been the case in recent periods, continued innovation with our product lines remains a key pillar to moving forward as a Company. To ensure that we maintain our current traction while also making sure we build for the future, we will be addressing the innovation in two different areas. The first area of innovation is all about making sure that our core technology, primarily in the managed file transfer space, continues to advance both in breadth and depth. By focusing on the breadth of the product, we will be pursuing different segments of the market to make sure that we have proper offerings that meet to need the small and medium businesses, but also scale to meet the demands of the largest enterprises. This will require new features and packages to be released to these audiences and we believe that we will be able to capitalize on these advances for the foreseeable future.

Increasing the depth by adding new features that further enhance the product will allow us sell even more to our existing client base by helping them solve additional problems within their organizations. Q1 examples of innovation in our core technology include the inclusion of three new automation modules released for our EFT SMB customers, which allows them to add incremental enterprise capabilities to their MFT deployment. Additionally, we launched EFT Enterprise with the EFT Accelerate module, which is designed to provide extreme file transfers with increases to the speed, efficiency and reliability of data as it moves across high latency environments.

The second pillar continues with product innovation but extends beyond pure MFT into adjacent market segments and technologies. We have made investments in several opportunities with emerging technology and we will be focusing this year on determining which areas of the business will be able to contribute to the future success for the Company, that we need to—which we need to further mature and whether there are areas that need to be expanded or contracted. Primary areas of focus in this area include incorporating feedback from key customers and partners identified in the limited release for scConnect and customer feedback related to the integration of Mail Express functionality into EFT to increase adoption.

We recently published our updated product roadmap on the Investor Relations page at www.globalscape.com outlining our intentions for the development of our various product lines for the remainder of the year and looking forward into 2017.

The last of the three pillars will continue to drive for world-class execution of our demand generation efforts, including sales, marketing and the channel. We now have mature proactive and reactive lead generation programs in place that has resulted in the record revenues and bookings that we have been delivering. This year, our channel efforts will continue to focus on enabling our channel partners and engaging their customers and prospects. We will enhance our partner program to reward our partners who participate in our sales and technical certifications and drive new opportunities for GlobalSCAPE.

We have made significant changes to our channel organization and its alignment to the national resellers over the last quarter and have seen positive momentum from these changes. As indicated previously, this allowed us to achieve 59% year-over-year growth from channel-initiated bookings when compared to

Q1 from 2015 and CRM's 2016 Partner Program Guide has also just given our channel program a Five Star rating for the second year in a row.

In terms of marketing during Q1, we also launched (phon) the study conducted by Forrester Consulting showing the projected ROI of EFT to be 782%, further showing the true value that we are providing to our EFT customers. Additionally, we're capitalizing on demand generation programs both digitally and in person where our sale team is able to directly connect with our key buyers. As in years past, I will update you on each of these three pillars during subsequent earnings call for the year.

I'd now like to address the specifics on our overall product line. Our EFT suite of products continues perform very well, providing 89% of our total revenue for the quarter. There were a couple of notable activities for EFT to begin year. As mentioned previously, we released new modules for our SMB version of EFT, which allows customers of this version to add incremental enterprise capabilities to their existing deployment, and we also just released the Accelerate Module for EFT Enterprise. During Q1, EFT was also awarded two Info Security Product Guide Awards, including taking the Gold and BYOD Security category and the Silver in the Compliance category. For the remainder of 2016, we have numerous events scheduled around enhanced authentication packages as well as the expansion of our EFT suite to provide greater scalability of users and the introduction of ETL capabilities to the product portfolio, adding greater interoperability with databases and enterprise operations. We will also the expanding our business insight tools with EFT to allow for deeper visibility and work flow management.

Mail Express is a product that received its last major update early in 2015. This software provides the means for end users to securely send and receive large files, leveraging their existing email client. However, customer feedback has shown us that tighter integration into EFT is what core audience needs for wider adoption. For this reason, we've added the outlook plugin functionality into the EFT roadmap as a priority item for 2016. We believe this person to person information sharing capability included into our core MFT product will help to increase adoption in this critical area.

scConnect, which was released previously in a limited capacity, is our on-premises enterprise file synchronization and sharing application to provide our customers with a mobile connectivity end user experience that they want with the security, visibility and enterprise integration that the IT team requires. We got a great feedback from our trial customers and are currently examining what features and adjustments need to be addressed to move to a broader release for general availability.

WAFS version 5, which was released in the latter part of 2015 continues to be enhanced through an improvement option within the marketplace. Specifically, we will continue improving the infrastructure to handle larger data stores and to enhance security and scalability.

Lastly, our Maintenance and Support recurring revenue continue to grow and rose to approximately $4.5 million for the quarter. As discussed in the past, while the recurring nature of Maintenance and Support provides a predictable stream of future revenue, we have been focused on driving greater license revenue as the higher percentage of our total revenue. Higher license sales yields not only higher license revenue, but also adds to accrual of recurring revenue since, as Jim pointed out, virtually every purchaser of a license also busy a Maintenance and Support contract.

During Q1, 39.3% of our revenue was from licenses and services and 60.7% was from M&S. Our maintenance renewal rates for Enterprise Products remain in excess of 90% and we anticipate this recurring revenue stream to continue to grow in future periods.

In closing, I sincerely want to thank our partners, customers, Investors, and employees for their continued support and trust in GlobalSCALE. We remain confident that the strategies that we have in place will continue producing annual growth in income at least in line with the 2015 fiscal year. This month, we were named by Texas Monthly Magazine as One of the Best Companies to Work For in Texas for the sixth year in row and we celebrated our 20th on anniversary as a Company, something any technology company should be proud of and it is very exciting to see how far we have come and how bright the future is where we are going. I remain more positive than ever that the best is yet to come.

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

Jim Albrecht:

Thank you, James. We will now take your question. As we begin, if you could limit yourself to one initial question and a follow up and then if you have additional questions you would like to ask, please get back in the queue. Operator, you may open the line for questions.

Operator:

Thank you. As a reminder, if you would like to ask a question, please signal by pressing star, one on your telephone keypad. Again, if you are using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, press star, one to ask a question. We will pause for just a moment to allow everyone an opportunity to signal for questions. Once again, that is star, one to ask a question.

Thank you and our first question comes from Andrey Omelchak with Lionguard Capital.

Andrey Omelchak:

Hi, guys. My question is with respect to the 22.5% year-over-year bookings growth, when can we expect this to translate into the revenue for the Company?

James L. Bindseil:

Hi, Andrey. This is James. Thanks for joining. As I laid out a little bit earlier, some of that depends upon the nature of the service, now because this is a booking that is not immediately translated to revenue, that indicates that it's not a license. So that means that it will be like a cloud service where will get the revenue ratably over the life of the contract and/or a professional services engagement where we will recognize the revenue once the work has been completed by the client and so, in some cases, it will be just—starting immediately we will see incremental revenue from it, and in the case of professional services, that will be once work is completed and accepted by the client. So, there is going to be immediately—immediate uplift, but it's not exactly a division by 12 factor, depends upon the nature of the service that's been sold.

Andrey Omelchak:

Okay, understood and my follow up question with respect to the sales team. You alluded to the fact that Q1, the benefits weren't realized yet, and most it will be a back-end loaded in Q3 and Q4. Can you just give a bit of color as to how the new team is shaping up and the nature of the conversations they're having with the clients?

James L. Bindseil:

Yes, well, there is always a sales cycle that begins. First off, how is it shaping up, the sales team is doing remarkable. Over the last couple of years, we have really, I think, worked on building a professional organization and the new additions are just as spectacular, the ones that we've added over the last couple of years. What we have done is we've expanded the number of people so that we can have more reach into more clients. So they are doing a great job. The not immediate impact in Q1 that I was referring to is really just a matter of the normal sales cycle and so, we'll start seeing benefit in Q2 and we'll see further benefit in the out-quarters. But it really is just in the normal nature of quality sales people coming in and getting into the sales funnel and then processing it through.

Andrey Omelchak:

Okay, great, thanks.

James L. Bindseil:

Thank you.

Operator:

Thank you. Our next question comes from John Rolfe with Argand Capital.

John Rolfe:

Hi, guys. Just a follow up to the prior question, so just to clarify how you define bookings, am I correct to assume that when you're talking about bookings that you have a signed contract for a certain dollar value?

James L. Bindseil:

That is correct.

John Rolfe:

Okay, and then your additional commentary is just based on the nature of those contracts depending on whether they are cloud, whether they are license or whether they are services, there might be some differentials terms of how those flow into revenue over time.

James L. Bindseil:

That's exactly right. The only reason that we provide that level of clarification is to explain that when that revenue gets—when that booking gets recognized into revenue, it's dependent upon different factors based upon what kind of service it is.

John Rolfe:

Okay, great. Thanks very much, appreciate it.

James L. Bindseil:

Thank you, John.

Operator:

Thank you. Once again, that is star one to ask a question. We move next to Greg Newman with The Newman Agency.

Greg Newman:

Hi. Congratulations everybody on 20 years.

James L. Bindseil:

Thanks, Greg. You've been with us for quite a bit of it. Thank you for being with us that long.

Greg Newman:

Thank you very much and for all the other Shareholders, I thank you too. Your resources indicate your clients and partners contributed a lot to you roadmap and with that in mind, would you discuss the growth opportunities from the current customer base and the new customer base opportunities that you are looking for, for your new product modules, and I was looking at the ELT on the roadmap, ELT modules, ELT, excuse me, and scConnect, but of course you've got the others acceleration, automation, SMB advances, I wanted to just get a feel, I will let you discuss with client and partners on that, you've got some big partners and big clients.

James L. Bindseil:

Okay, well, you are exactly right. We do work a lot with our clients, our existing client base in establishing our roadmap, but we also triangulate that with the partners on what it is that they can sell, as well as triangulating the third part of it is what we've got in the market, and so, as Peter Merkulov and his Team are working with all of these different entities, they really are examining a variety of ways that new development efforts will impact the organization where some of the development efforts, for example, one that I gave earlier, the new enterprise or automation modules that we added to SMB solution suite in this past quarter, that gives us an ability to go and reach out to every single SMB customer that we've ever sold and give them additional capability and enabling further upselling within accounts and so, that's certainly one way that we can generate additional revenue and bookings in the future whereas the other module that I mentioned with acceleration, that does give us an opportunity to sell into our existing client base, but it also gives us the ability to sell into even larger customers because now we can get into those larger data sets in the high latency environment and things like that. So, everything that we've got on the roadmap is really specifically targeted at either maintaining a competitive edge, allowing us to go deeper penetration into our existing client base, or enabling us to move into additional clients that we haven't seen before. So, I hope I'm answering the question what you were seeking there, but the bottom line is that yes, our customers are a part of it, they let us know what they'd like to see added to the product. But we also examine the market to make sure that we are able to attract new customers as well, and so, the roadmap is actually crafted and prioritized based upon all of those factors and how we can best serve our existing clients and serve the clients of tomorrow.

Greg Newman:

Thank you. My follow up would be just along the roadmap. I see there is—there used to be on the roadmap a streaming video and then there was appShield, sometimes or that comes up any of the technology that might be used with that, and then even technology alliance, as you mentioned, Peter Merkulov. So if you all might look at technology alliance for streaming video or you're all still going to try to develop that in-house or if you could touch on those kind of, appShield and…

James L. Bindseil:

Well, the streaming video is certainly not that is immediately on the roadmap, as you can see. As we like to say with the roadmap business happens and that's not something that we are seeing great demand from our current customer base for. That said, you are exactly right, we examine every technology alliance that we can to make sure that we are meeting the needs every single time, we've mentioned this in the past in conversations that we've had, every single thing that we look at, we make a buy, build or partner decision, and we've announced some pretty exciting technology alliances this year and some of those are going to be alliances that can provide us additional capabilities to the software and some of them are going to be alliances that give us new routes to mark, and so, I think you are spot on, those are areas that we consistently look at to make sure that we are meeting the needs of the roadmap both today and tomorrow.

Greg Newman:

Thank you. Appreciate that.

James L. Bindseil:

Thank you, Greg.

Operator:

Thank you. It appears there are no further questions at this time. Mr. Albrecht, I'd like to—oh, we do have a follow-up question that came from Andrey Omelchak with Lionguard Capital.

Andrey Omelchak:

Hi, guys. I am just looking at your comment on the net income over sales ratio and this you said it will be comparable to the year 2015, just looking at the financial statement, full year 2015 I think that margin was 14.9%. We have the numbers of course for the Q1 2016 and that implies that the balance of 2016 it will be at around 18%. I am just trying to understand what will drive this net income margin expansion for the balance of 2016. Thanks.

Jim Albrecht:

This Jim Albrecht. As James mentioned, we are looking forward to addressing some of the pent up demand that we are seeing for our products that didn't come to fruition from a revenue perspective in Q1 and our bookings numbers in Q1 and the bookings numbers we can see subsequent to Q1, certainly are indicating that. So we expect that our cost structure will stay substantially the same throughout the year, which we've spoken to before such that when we enjoy the benefit of those higher revenue numbers as the year goes on, we look forward to achieving results for the entire year that are consistent with what we saw for 2015 on a percentage basis.

Andrey Omelchak:

Okay, great, thank you.

Operator:

Thank you. We move next to Jason Burack with Hawk Capital Management.

Jason Burack:

Hi, thanks for taking my question. This is just a second follow-up. So if you were to take 2016 in its entirety compared to 2015, you expect to grow your earnings per share. Is that what the net margin expansion would imply?

Jim Albrecht:

Yes, this is Jim again. Yes, what we like to tell our Investors is that from an earnings—from a revenue growth and an earnings profile relative to revenues, we expect 2016 to look at least as good as 2015 looks.

Jason Burack:

In terms of growth or in term of the absolute results or both?

Jim Albrecht:

Both, in terms of revenue growth and in terms of the relationship of net income to the resulting revenues.

Jason Burack:

So you expect to exceed $0.22 per share as you achieved in 2015?

James L. Bindseil:

Yes, we don't actually provides specific guidance on what the amount is, what—to echo Jim, what we have said is that we expect at least what we produced in 2015, that's all that we really go. As you know, we don't really go down specific guidance. So you can infer based upon the results from 2015 that we're expecting at least that end results for 2015 as our expectation.

Jason Burack:

Okay. Thank you very much.

Operator:

Thank you. We have reached our allotted time for this question-and-answer session. At this time, I will now turn conference back to Management for additional or closing remarks.

Jim Albrecht:

Thank you very much, Operator, and thank you everyone for joining the call. We appreciate you interest in GlobalSCAPE and we look forward to visiting with you at the end of the second quarter. Everyone have a good day. Thank you.

Operator:

Thank you. This does conclude today's presentation. We thank you for your participation.