**GlobalSCAPE, Inc.**

**Second Quarter 2016 Earnings Call**

**July 28, 2016**

## CORPORATE PARTICIPANTS

**Jim Albrecht**, *Chief Financial Officer*

**Matt Goulet**, *President, Chief Executive Officer*

## CONFERENCE CALL PARTICIPANTS

**Reese Cunningham,** *Private Investor*

**James Brown,** *Private Investor*

**Greg Newman,** *The Newman Agency*

## PRESENTATION

**Operator:**

Good day and welcome to the GlobalSCAPE, Inc. Second Quarter 2016 Earnings Call. Today's conference is being recorded, and 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 very much and thanks to everyone for joining the call today. With me this afternoon is Matt Goulet, GlobalSCAPE's President and Chief Executive Officer. On the call today, we will discuss GlobalSCAPE's 2016 financial results through the second quarter, which are set forth in our earnings press release that crossed the wire about 15 minutes ago. We've also posted on the Investor Relations section of globalscape.com an updated Investor Fact Sheet, frequently asked questions and product roadmap.

Before we begin, just a reminder that today's call including the question-and-answer session might include some 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 & Exchange Commission on March 3, 2016, 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 that having been said, I'd like to turn the call over to Matt.

**Matt Goulet:**

Thanks, Jim. Good afternoon, everyone. In today's technology landscape, the management and movement of data is more important than ever and we're confronting it head-on by helping new and existing customers address their data transfer challenges. GlobalSCAPE's opportunity in the market has never been stronger. Data transfer needs across all industries continue to grow, creating an increasing demand for the products and solutions we sell. GlobalSCAPE had a good second quarter, with revenue of $8.3 million, which is an increase of 5% to Q2 of 2015. Q2 was also the first quarter in history that we achieved over $8 million in revenue outside of a fourth quarter. Year-to-date revenue of $15.7 million is a 6% increase over last year. Our net income of $954,000 for Q2 and $1.4 million year-to-date means that we have been profitable for 15 consecutive quarters. On top of that, our cash and short-term investments have increased over $1 million during 2016 and now exceed $20 million even after continuing to pay quarterly dividends to our Shareholders. Despite these results, they're not up to our expectations. In a few minutes, I'll talk about the evolution of our Company strategy as it relates to three key areas of growth for GlobalSCAPE in both 2016 and beyond. But before I do, I want to speak to our revenue trends and specifically our license revenue.

Over the past few years, we've developed and offered individual product line that include EFT, Mail Express, WAFS, CuteFTP and TappIn. Each of these product lines addresses distinct needs in the marketplace. While some customers purchase products from more that one of these product lines, for the most part, customers in a particular market or vertical have needs that are addressed by only one of these products and therefore purchase only one product. We're pleased that each of these products contribute to overall revenue profile and produce positive contribution margin. However, that revenue in those contribution margins come in varying degrees. Our EFT product line produces over 90% of our revenue and yields the largest contribution margin by far. The remaining 10% of our revenue and the associated contribution margin is split among all of our other products. During my two and a half months as CEO, I've led a renewed look at our product strategies and the way we spend resources, particularly with respect to product research and development. What we've learned and now believe is that the amount of time and attention paid to our products other than EFT has not been aligned to the fact that EFT is what we do best.

This has led us to conclude that we've been spending a disproportionate share of our product development resources on product lines other than EFT that are a small part of our overall revenue profile. The unfortunate result has been that our license revenue trends have not been up to our expectations and in fact have declined year-over-year for the past three quarters now. To reverse this trend, we are addressing the challenge head-on and have made immediate changes to our product strategy to refocus efforts on our core and most profitable technology, EFT. This action will allow us to introduce new features and functions at a pace that equips our Marketing and Sales Teams with the technologies necessary to sustain and increase our revenue growth at the desired level. While this means that in the future we will dedicate fewer resources to our other products, we believe we can safely do so and continue to realize revenue and positive contribution margins from those products. Our future is in the enterprise-level managed file transfer market and EFT is key to that growth.

Now, I want to emphasize that we are not increasing our overall expense load; what we are doing is redirecting resources we already spend to be focused primarily on the EFT. Today, we are officially unveiling new product roadmap that speaks to our updated product strategy that was detailed in my most recent blog post. We believe this updated strategy is the best way forward to achieve the growth we desire. It allows for a clear technology pathway and provides focused use of our resources to achieve the highest return on our investment. With the renewed sense of purpose and a clear technology direction, we see a greater potential for GlobalSCAPE to tackle the management and movement of data for both our existing and new customers.

There are three primary growth drivers for GlobalSCAPE as we target the almost $1 billion managed file transfer market: number one, the stronger focus on our core technology EFT; number two, developing and acquiring technologies to broaden our EFT platform capabilities and allow expansion into markets that are adjacent to or complementary to managed file transfer; and number three, continued investment in channel and demand-generation activities. The overall concept with the refocusing on what we do best is to develop and innovate on our existing and most profitable core platform, EFT, while at the same time closely watching new customer segments and listening to our customers in the market in which we play, capitalizing and leveraging EFTs advantages along the way. This will allow us to penetrate new market segments as well as continue to meet and exceed the needs of our existing customers.

Previous versions of our technology roadmap were based on a standalone product approach, covering multiple market segments or disciplines. With our new approach of focusing on the MFT market and specifically EFT as a platform, we're able to further expand on our existing technologies and the product ecosystem that we've developed and refined. We believe this is the right approach to leverage some of the existing technologies we've been developing in conjunction with EFT because we believe we can make those features more attractive to customers by integrating them with EFT. Expansion into adjacent and complementary market segments is our second driver for growth. We will develop and/or acquire technologies that address broader used cases for information exchange and that appeal to new groups of customers. What will evolve from this initiative is a strong emphasis on EFT always being the core platform to deliver those new features. We made a lot of advancements in our core technology over the years and as part of our evolution, our EFT platform incorporated functionalities that expands product far beyond in managed file transfer. We want to be able to leverage things like auditing, controls, compliance reporting, and other great capabilities of the EFT platform in all of the new technologies and features that we incorporate. For example, this strategy will enable us to evolve a technology like scConnect to become part of and provide additional capabilities within the EFT platform so that we can maximize the return on our investments in products like that. We believe that this approach enhances our ability to anticipate potential challenges faced by future users while also helping us to better transition customer feedback into capabilities and address what's most important to our users for both their current and future needs.

Integrating and innovating new technologies as part of the EFT platform also allows us to go after new market segments more quickly and efficiently. This strategy doesn't just benefit us, it helps our customers decrease their costs associated with deployment, setup, configuration, and training. We believe this sets us up for longer-term success by keeping our existing customers satisfied and happy while strategically seeking out new users and new segments. Investment in our channel activities and demand generation programs across the Company will remain a key driver for growth as GlobalSCAPE moves forward in 2016. We are continuing to see an uptick in channel activities across the board, including pipeline growth, deal registration and sales. This further reiterates that the investment and commitment we made to the channel over the last two years is beginning to pay off. In addition to our investment in the channel, our investment in demand generation activities has allowed us to build an incredibly healthy sales funnel, setting us up for success in future periods.

Delivering Software-as-a-Service in a cloud-based environment is a migration that's becoming commonplace in the software industry. All of the perspectives and strategies I have just covered apply equally to all of our products and methods of delivering them, whether that is by customers purchasing our products and installing them on their premises or choosing to subscribe to our EFT cloud Software-as-a-Service, for which they pay us a monthly usage fee. Either way, our customers can enjoy the benefits of the EFT platform. In the managed file transfer market, we're seeing a shift to SaaS that is moving more slowly than what appears to be occurring in other software environments. Today, revenue from EFT cloud services is less than 10% of our total license revenue, however that revenue during 2016 is already more than 30% higher than it was for the same period last year. We're excited to see this continuous revenue stream grow and we're confident that our EFT cloud services will meet that demand. However, we're also aware that customers purchasing SaaS subscriptions instead of licenses for on-prem installation can have a dampening effect on revenue growth over the near-term as has been pointed out across the enterprise software industry. We're closely watching this shift to ensure we optimally manage its impact.

With all that said, it's an exciting time to be at GlobalSCAPE. Our entire GlobalSCAPE Team is working with a renewed sense of urgency and intensity that hasn't previously been seen. Our market is growing and we expect it'll continue to grow, and the industry analysts agree. We also have a great platform to provide outstanding services but ultimately it's our people that make us special. Our market leadership, new product strategy, and continued momentum give us confidence that we'll continue to meet previously communicated expectations with respect to growth and revenue.

Now, I'll turn it back to Jim.

**Jim Albrecht:**

Thanks, Matt, and as many of you have seen, our full set of financial statements are now released and out there for your reference, and for now I will summarize and highlight some of the financial results for the quarter. First quarter of—actually, the second quarter of 2016. So as I share these results with you, the percentage changes I mention are year-over-year changes relative to Q2 2016 and the six-month results compared to those same six-months' period in 2015. Our revenue for Q2 was $8.3 million, an increase of 5%. Revenue for the first six months was $15.7 million, an increase of 6%. Diving into the components of revenue, maintenance and support revenue increased 13% for the quarter and 12% year-to-date. As the install base of our products and our Customers' mission-critical business processes continues to increase, and as those Customers remain highly satisfied with our level of customer service, we expect this predictable recurring revenue stream to continue growing.

Our Professional Services revenue increased 49% for the quarter and 53% year-to-date. We continue to experience increasing interest in our Professional Services as customers install our products in more varied and complex settings. License revenue for the quarter was right at $3 million, compared to $3.3 million last year. Year-to-date license revenue of $5.3 million compares to $5.7 million last year. New product license sales decreased 11.8% for the quarter due to the factors that Matt previously mentioned as well as the non-linear nature of enterprise sales with some deals moving between quarters.

Moving on to operating margins, our gross profit for the quarter and year-to-date remains strong at 79% of revenue. Increased amortization of past development calls for new capabilities we've introduced over the past year, has trimmed some points from our license margin, but they remain solid at 73% of sales. As usual, gross margin on maintenance and support revenue continued strong at about 91%. The rapid growth and the demand for our Professional Services caused us to continue to need to engage third-party service providers to ensure we maintain our high standard for delivering quality results on time. However, with that came some additional costs that have reduced those margins this year, although we have begun to see some recovery in those percentages in Q2 compared to Q1.

Year-to-date, operating expenses are running at 66% of revenue, which is up about 4% compared to last year, but the raw dollar spend is in line with our plans and expectations. Most of that increase is in sales and marketing as we continue developing new programs and engage personnel needed to achieve our objectives. With respect to overall resources expended to improve our existing products and to develop new products, the combination of our research and development expense on our income statement and capitalized software development cost added to our balance sheet ran at about 14% of revenue, which is in line with our expectations and also in line with industry norms as we conceive and create new offerings for the market.

All of these results yield a net income for the quarter of $1 million or $0.05 per share, compared to $1.3 million dollars or $0.06 per share last year. Year-to-date results of $1.4 million and $0.07 per share compare to $2.1 million and $0.10 per share last year. Year-to-date EBITDA of $2.7 million is down from

$3.6 million last year as a result of the factors that Matt and I have just discussed. However, our cash flow remains substantial and allowed us to end the period with over $20 million of cash and short-term investments on hand for the first time ever. In addition to supporting us continuing to pay a quarterly dividend, we believe this cash balance places us in a good position to consider business alliance or other combination opportunities that might add to our product offerings and increase our revenue and net income in the future.

We have indicated that we expect our revenue growth rate for all of 2016 to equal or exceed the 15% growth rate we achieved in 2015 and that we expect our net income for all of 2016 to be approximately 15% of revenue, which would also be consistent with what we achieved in 2015. Our revenue growth and net income for the first half of the year were below these levels, but with the total of Q3 and Q4 usually being the stronger part of the year for us, we believe we can make up the ground necessary to be on track with achieving those annual targets.

So with Matt and I having shared those thoughts with you, we'll now open it up to questions and answers, so Operator, you may start that session.

**Operator:**

Thank you. Ladies and gentlemen, if you would like to ask a question, please signal by pressing star, one on your telephone keypad. If you're on a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Again, that is star, one for questions. Pause for just a moment to assemble the queue. At this time, we'll take a question from Reese Cunningham, Private Investor.

**Reese Cunningham:**

Hi. Am I online?

**Matt Goulet:**

Yes, you are, Reese. Please go ahead. Thanks for joining us.

**Reese Cunningham:**

Thank you very much. Certainly. This question is directed at Jim, the CFO. I represent a client who I believe has been in contact with you. Our primary question is the use of capitalization and the period over which that's spend, whether it's a pure R&D or a software play, and what the longer view is from the opinion and perspective of Jim on the use of such capitalization. Thank you.

**Jim Albrecht:**

Sure. So in accordance with and as mandated by General Accepted Accounting Principles, as we develop new products along with new features and functions for existing products, we capitalize the cost of that investment, and the reason why that's done is to recognize the fact that those investments will yield future benefits to us in the form of future revenue. So in accordance with GAAP, we accumulate those costs until the project is completed and then we begin amortizing that to expense, which is something I spoke to just a moment ago as I was speaking to our gross margin, which allows us to properly recognize that cost and expense against the revenue that it generates in the future.

**Reese Cunningham:**

Okay. That makes a lot of sense. In the context of your product line, with a renewed focus on EFT and integration of those technologies into EFT, when you look at products like WAFS or scConnect that have been capitalized aggressively, how do you see that playing out as far as integrating that technology with EFT? That's my final question. Thank you, Jim.

**Jim Albrecht:**

Yes, you bet. Thank you very much, and I noticed you used the word aggressively. I wouldn't characterize it that way. We are conservative in everything we do, and capitalization of software development is always subject to ongoing assessment as to whether or not those capitalized costs will be realizable through future revenue streams; that can be a very complex assessment and involves a lot of factors from all areas of the Company. We do that all the time with all of the projects that we have undertaken and for which we capitalize cost, and we are confident, I might say along with our third-party auditors, that the capitalized amount is appropriate, is realizable in the future, and will be properly matched to revenue in those future periods.

Appreciate the call. Thank you very much. Operator, next question please.

**Operator:**

The next question will be from James Brown, Private Investor.

**Jim Albrecht:**

Hi, James.

**James Brown:**

How're you doing?

**Jim Albrecht:**

We're well. Thank you.

**James Brown:**

Congratulations on a good quarter, gentlemen. This message is for Mr. Goulet. As far as the impact of existing customers for, like the previous gentlemen had mentioned, for WAFS and CuteFTP, what is the impact going to be on existing customers for shifting those resources away from those different products?

**Matt Goulet:**

Yes. So, we're certainly going to continue to support those products as they (inaudible) development. What we're excited about is the opportunity to focus on our existing customer base and answer what they've been asking us for quite some time in the way of features and capabilities, and that's a big driver as to why we're going back to invest in our core. It's going to allow us to bring those features back to market quicker, allow our customers to take advantage of them, deploy them in their environment; and so it's not only going to help us with new customer acquisition but it's certainly going to help us with our retention of our existing customer base and making our current customer base happier.

**James Brown:**

All right. That was my final question. Thanks so much.

**Matt Goulet:**

Thanks, James.

**Jim Albrecht:**

Thank you very much. Operator, next question, please.

**Operator:**

Again that was star, one for questions. We'll move now to Greg Newman with The Newman Agency.

**Jim Albrecht:**

Hello, Greg.

**Matt Goulet:**

Hello.

**Greg Newman:**

Hi. I was in agreement with the move for the EFT integration of everything; the way you're talking about that sounds great. So that answered that question. Cash balance of $20.3 million, could you elaborate how you might use that cash a little bit more? What y'all are looking at (inaudible).

**Jim Albrecht:**

Sure. So we get that question a lot and that's a very—I'm glad you asked it, Greg. It's a very good question. One of the common questions we get is, "So why don't you do a share buyback?" Well, we think that the greatest return on investment for our Shareholders is to invest in the future of GlobalSCAPE, which we believe entails investing in the development of new products, new sales and marketing techniques, targeting new markets, and on, and on, and on. So we look forward to have to maintaining that cash balance in our quiver as we look for potential opportunities in the marketplace that might be complementary to what we're doing today in an effort to grow the Company to be even bigger and stronger.

**Matt Goulet:**

Greg, I would just add onto that that we've (inaudible) we've begun the process of identifying what those adjacent markets look like, the companies and technologies that are available within those markets, and we're building a shortlist, and the conversations with those potential partnerships have already begun.

**Greg Newman:**

All right, thank you. My other question, and then I'll get off the queue, but—was just about alliances, like F5 (phon), Seagate. We just had news on F5, so if you could just elaborate a little bit on that. It looks like you're expanding what we knew about it. You're going to be doing a show with F5 this next week, so it would be a good opportunity to speak to that.

**Matt Goulet:**

Certainly. Yes, partnerships take on all different shapes and sizes. Some are resale agreements, some are long-term technology partnerships, and some collide, some are in the middle. We're excited about our alliances and what the capabilities of GlobalSCAPE to reach into some of these industry giants and to have relevance within them. We're excited to be able to do the interoperability testing along with F5. It's put our customers at ease when they're deploying our software solutions in the F5 environment, and so we are going to continue to work with companies like F5. You'll hear more from us in the way of alliances going forward with some of these larger industries. You saw a press release (inaudible) that we're going to be supporting a show. We reference customers back and forth. We're targeting similar partners. So it's going to be a natural progression.

Sometimes things like this don't move as quickly as possible and so usually the largest opportunities take the longest amount of time. So we're excited about our alliances program, and stay tuned for some future announcements along those lines.

**Greg Newman:**

Thank you.

**Jim Albrecht:**

Thank you, Greg. We appreciate it very much. Thanks for calling, as always.

**Greg Newman:**

You're welcome, and good to hear James Brown on the line.

**Matt Goulet:**

Thank you.

**Jim Albrecht:**

Thank you very much. Operator, I see that we don't readily have anybody in the queue. So if is there's anyone who'd like to jump back in, we'll pause for a moment. Okay. Operator, that looks like all of the questions that we have, so I'll turn the call back over to you to close after I thank everybody for being a part of the call.

Thank you for your support of GlobalSCAPE, and we look forward to visiting with you at the end of the third quarter. Everyone have great day.

**Matt Goulet:**

Take care, everybody. Thank you.

**Operator:**

Once again, this does conclude today's conference call. Thank you all for your participation.