



GlobalSCAPE, Inc.

Fourth Quarter and Year End 2016 Earnings Call

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C O R P O R A T E P A R T I C I P A N T S

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Alvin Brown, *Private Investor*

Greg Newman, *Newman Agency*

P R E S E N T A T I O N

Operator:

Good day everyone and welcome to the GlobalSCAPE Incorporated Fourth Quarter and Year End 2016 Earnings Conference Call. Today's call is being recorded. Now, your host your today's conference, Mr. Jim Albrecht. Mr. Albrecht, please go ahead, sir.

Jim Albrecht:

Thank you Operator and good afternoon everyone. Welcome to our earnings calls. With me is Matt Goulet, GlobalSCAPE's President and Chief Executive Officer. On the call today, we will discuss GlobalSCAPE's 2016 financial results as presented in our earnings press release, which crossed the wire about 15 minutes ago. We have 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 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 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 and we assume no obligation to update the information we present during this call.

With all that having been said, I'll now move on to summarizing our financial results for the fourth quarter for 2016. Our revenue for Q4 was \$9 million, a new record high quarter and a 7% increase over the same period last year. That gave us revenue of \$33.3 million for the year, an 8% increase over 2015. In

1

a moment, Matt will elaborate on our new focus and initiatives implemented beginning the second half of the year.

So, in anticipation of those thoughts, it is notable to point out that while our revenue for the first half of 2016 was substantially flat year-over-year, our revenue for the second half of 2016 increased 10% over the same period of 2015. Now, turning to license revenue, our total software license revenue for all of 2016 was flat year-over-year. However, it's important to look inside that result at license revenue from our core product, our EFT platform, which is over 90% of our business.

While that license revenue increased 5% for all of 2016, we believe it is more notable that EFT platform license revenue increased 14% during the last two quarters of the year. This result gives us good momentum in our core product line moving into 2017. License revenue from all other products was down, but that is consistent with our expectations as we move forward with our emphasis on the EFT platform.

We are very proud of the recurring revenue stream from our maintenance and support that is highly sustainable in light of the over 90% renewal rate we see from our customers. That revenue delivered steady growth across all quarters, culminating in over 13% growth for the year.

As the installed base of our products and our customer's mission-critical business processes continues to increase, and as those customers remain highly satisfied with the performance of our products and the level of our customer service, we expect this predictable revenue stream to be highly sustainable and to continue growing.

Turning to professional services that revenue increased 21% for the year as we continue to see increasing interest in those services as our customers rely on our products in more varied and complex settings.

Moving onto operating margins, our gross profit for the quarter and year-to-date across all product and service offerings remained strong at over 80% for the year. With respect to our margin on license sales, increased amortization of past software development cost for new capabilities we have introduced over the past year, has trimmed some points from that margin, but they remain solid at 74% of revenue. As usual, gross margin on maintenance and support continued strong at about 92%.

During Q4 we refined the allocation of some of our expenses to our professional services to better match costs to the work performed. We took that opportunity to move some sales engineered expenses, previously presented as calls to professional services to what we believe is a more appropriate classification as part of sales and marketing expense.

On that improved basis, we are now seeing gross margins from our professional services that are holding steady at over 37%. Operating expenses for the year were about 63% of revenue, which is consistent with the last year. Our commitment to discovering and developing new products remain steadfast as we have built our software engineering group to over 30 people, but even with that increased in-house resource, our spending dedicated to our research and development efforts, which consists both of R&D expense on our income statement and capitalized software development cost added to our balance sheet was \$4.1 million for 2016, compared to \$4.5 million for 2015.

We were able to lower these costs by trimming our reliance on more expensive third-party contract software engineers. All of these results yielded net income for the year of almost \$4 million, as compared to \$4.5 million for 2015. Again, looking at second half results in light of our midyear change and strategy, net income for the second half of 2016 was up 7%. Our EBITDA for the year was \$7.1 million, which is comparable to the prior year results. Again, 2016 as a tale of two halves (phon), during which EBITDA for the second half of 2016 was \$4.5 million, as compared to \$3.7 million during the second half of 2015, which is a 21% increase.

Our cash flow remains substantial and allowed us to end the period with over \$24 million of cash and readily accessible investments. 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 combination of opportunities that might add to our product offerings and increase our future revenue and net income.

With that overview having been done, I'll now turn the call over to Matt.

Matt Goulet:

Thanks Jim and good afternoon everyone. Appreciate you joining us today. As you just heard from Jim, Q4 was the best quarter in Company history with revenue of \$9 million, an increase of 7% when compared with Q4 of 2015, beating our previous best quarter Q3 of 2016 by over \$300,000. Revenue for the year was \$33.3 million, an increase of 8% over 2015. Although revenue for the first half of 2016 was effectively flat year-over-year, our revenue for the second half of 2016 increased 10% over the same period of 2015.

It's also worth noting that over 50% of our revenue was a recurring as it comes from our maintenance and support contracts. Our net income from Q4 was \$1.3 million, which means that we have been profitable for 17 consecutive quarters. On top of that, our cash and short-term investments increased throughout 2016 and now exceed \$24 million. We've also continued to have a zero debt. Twenty sixteen was really a tale of two halves for GlobalSCAPE.

Positively, we saw data exchange, management and security needs continue to be a priority for companies of all sizes. As a result, we saw increasing demand for the products, solutions and services that we sell. However, we recognized that changes needed to happen within the organization to continue to move us forward. Midway through the year, we re-examined our priorities as an organization and initiated changes to focus on areas that would have an immediate impact on the Company, while helping to guide and shape GlobalSCAPE for the future.

Throughout the last half of 2016, the Company was focused on three key areas of growth. They were, one, a stronger focus on our core technology, EFT; two, developing and acquiring technologies to broaden our EFT platform capabilities and to allow for expansion into markets that are adjacent to or complimentary to manage file transfer; and three, continued investment in channel and demand generation activities.

Now, I'd like to take a look at Q4 in a bit more detail. With our enhanced focus on our flagship product, the EFT platform, we delivered new technology to market in Q4 that continues to help customers with their data security, compliance, and visibility challenges. Our net launch included a new Advanced Authentication Module that increases the interoperability of EFT with multiple authentication methods. This technology continues to make EFT an important mechanism to protect and control an organization's data.

We also introduced a new work spaces outlook plug-in that provides customers with the reporting and automation features that they love in EFT and combines them with the simplicity and security of sending files with Mail Express. The integration of the two products takes the best features in Mail Express and incorporates them into EFT.

During Q4, GlobalSCAPE also added a number of global customers such as RSA, a leader in the cyber security industry for more than 30 years; Capgemini, UK, one of the world's foremost providers of consulting technology and outsourcing services; and the Army National Guard, a citizen reserve organized to protect American families and towns. In addition to acquiring these customers, our sales pipeline continued to grow and has never been stronger.

Expansion into adjacent and to our complimentary market segments is our second driver for growth. We know that EFT is a platform that will help us launch into new areas, which will help GlobalSCAPE alone.

Leveraging and expanding on our EFT platforms data integration and management and security capabilities allows us to go after new market segments more quickly and efficiently.

Again, we strongly believe this sets us up for long-term success by helping meet the ever-changing needs of our existing customers, while strategically seeking out new customers in new segments. During Q4, GlobalSCAPE joined the Hewlett Packard Enterprise Partner Ready for OEM program. GlobalSCAPE's R&D team is currently working on a solution to address organizations struggle to manage and secure data at rest or in motion. More will be shared publicly on this effort in the coming months.

Moving to the cloud know, GlobalSCAPE continues to be on the forefront of capitalizing on the transition to the cloud to manage file transfer software. We continue to see our cloud business grow with the delivery of our EFT platform as a SaaS solution. That recurring revenue stream grew 36% in 2016.

EFT cloud services provide the full features and functions of our EFT platform through a SaaS delivery method without materially impacting our perpetual license sales. This variety in the delivery of the platform allows us to address a full range of customers, whether they prefer a SaaS solution or an on premises solution. This is all done without negatively impacting our ability to appeal to and earn revenue from both.

During Q4 one of the ways we continued the expansion and reach of our EFT platform was with EFT becoming a Microsoft Azure certified application along with its availability in the Azure marketplace. Needed support for popular infrastructure as a service platforms like Amazon web services and Azure is an important pillar of GlobalSCAPE's cloud strategy as it gives our customers who have sophisticated security requirements, the ability to retain full control of their underlying infrastructure, while getting all the benefits of EFT in the cloud. Shortly I will detail how the cloud fits into our future corporate strategy.

Our third key area for growth in 2016 remained our investment in our channel activities and demand generation programming. During Q4, we saw a healthy increase in closed deals, as well as overall activity in the channel, including deal registrations leading to pipeline growth for 2017. Along with our investment in the channel, we have also continued to refine our demand generation programming, which produced and is continuing to yield a significant positive impact to the sales pipeline.

As I mentioned, 2016 was really a tale of two halves for GlobalSCAPE. We managed through a large staff change, while continuing to grow both revenue and bookings. We also increased headcount across many departments, including product management engineering, support, sales, and marketing. We were able to capitalize on things that were going well while refocusing the Company on the technologies that have become the foundation of who we are and what we offer our customers. It is upon that foundation that we will build for the future.

Until recently, GlobalSCAPE has been a solely focused managed file transfer organization. We believe we've done a very good job in the highly competitive and mature space, but it is time to build upon our EFT platform. So, looking ahead, adjacent markets such as data integration and security will be key to extending our technology portfolio, as well as helping to shape the continued evolution of the Company.

GlobalSCAPE is on a path to becoming an innovative cloud organization that develops solutions to help its customers address the data-related challenges of today and the future. We will do it by creating innovative technologies in three areas that are key to the data management strategy of any IT organization: data movement, data integration, and data security.

I'm now going to touch on three key areas that will help move GlobalSCAPE forward. Accelerating our organic growth is the first key area. According to a recent IDC worldwide cloud IT infrastructure market forecast, in 2017 spending on IT infrastructure for off premises cloud deployments will experience double-digit growth. We are finally seeing the shift to cloud impacting middleware. The growth opportunity in front of us within the cloud is much greater than and incremental to our on premises growth.

Cloud data integration is a natural extension of what we do extremely well today in the managed file transfer market. Focusing on data management in the cloud allows for future expansion of EFT as a platform with the bedrock residing in MFT. It will also allow GlobalSCAPE to innovate better and faster, increasing customer satisfaction and retention while capitalizing on the recurring revenue streams associated with deploying this kind of technology. Does this mean that we are abandoning our on premises technology? Absolutely not. In fact, we will be working diligently to continue to maintain and improve our existing EFT platform to meet the data management needs of our customers.

We will also be looking to capitalize on an underutilized segment as we launch into the mid-market. This includes repackaging our existing on premises midmarket size offering and releasing a new targeted cloud services solution to meet the needs and the price point of medium-size businesses.

Expanding our focus partnerships is the second key area we will be executing on moving forward. Partnerships can come in all shapes and sizes, but we will primarily focus on investing and developing our technology alliance partners, our cloud platform partners, the system integrators, our license and OEM technology partners, our national service providers and value added resellers.

We also believe strongly that increasing the number of our focus partnerships and strategically selecting certain types of partners puts us in a good position to consider business alliance or combination opportunities that might add to our product offerings and increase our revenue and net income.

The third key area is technology acquisition. We will continue to develop and/or acquire technologies that address broader used cases for data movement, data integration and data security that will allow GlobalSCAPE to expand our customer base by appealing to new groups of customers in adjacent and complementary market segments.

By concentrating on technology acquisition, it allows our existing resources to stay focused on the core technology, while helping to compress our time to market by building upon the foundation of an already established data management platform.

To reiterate, looking forward we will be focusing focused on accelerating our organic growth, expansion of four focus partnerships and technology acquisition. As we reflect back on 2016, it's amazing to see how much we help our customers accomplish in their infrastructures. Everything from helping to provide a layered approach to data security, to an increase into the visibility of their data, to the integration of this barren systems, both within the cloud and on premises. The used cases for our technology are incredibly diverse.

As we continue into 2017, I can assure you that GlobalSCAPE will remain steadfast in our commitment to our customers, showing them the value that we help bring to their organization and solving their most unique data management challenges. We strongly believe that the GlobalSCAPE of today has an incredible foundation to build upon and we look forward to the continued evolution of the Company.

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

Operator:

Thank you, sir. Ladies and gentlemen, if you would like to ask a question, please signal by pressing the star key, followed by the digit one on your telephone keypad. If you're using a speakerphone, please make sure that your mute function is disengaged to allow your signal to reach our equipment. We also ask that you please limit yourself to one question and one follow-up question. Again press star, one to ask a question, and we will pause for just a moment to allow everyone the opportunity to signal for question.

For our first question, we go to Jason Burack with Hawk Capital Management.

Jim Albrecht:

Hi.

Jason Burack:

Hi Jim, hi Matt.

Matt Goulet:

Hi.

Jason Burack:

Hi. This one I guess is for Jim. It looked like your income from operations was up notably, if I had it right about 24%, if that's true, I would have highlighted that in the press release. Is it just the provision for income taxes that made the earnings per share look more the same year-over-year versus the operating income?

Jim Albrecht:

Our effective tax rate was a little bit higher in 2016 due to some R&D credit dynamics. So yes, that was most of the difference to put a little bit more pressure on the bottom line, but yes our operating margin continued to be really strong.

Jason Burack:

Okay. Then Matt, I know you kind of said you were going to share more about the Hewlett Packard arrangement as it evolves. Can you provide any color about how material you think its potential is, or is it too premature, and what exactly—how would you monetize something like that, even just sort of more broadly?

Matt Goulet:

Yes, I think it's too premature to give any kind of specifics around monetization. So, we announced the previous quarter that he joined the program. We have an opportunity there to incorporate HPE's award-winning leading technology with our EFT platform. So, the agreement really was just closed in November. We can't tell you that the technology that we're working on is still in the early stages, and we'll have some announcements here in the coming months, hopefully even within Q1, but I can tell you that we do expect to announce that a part of our cloud offering will be powered by HP hardware, as well as an appliance based off of HP hardware and our EFT platform. So, we are excited about that and some of those announcements will coincide with more around the mid-market launch that I touched on in the introduction.

Operator:

For our next question, we go to Alvin Brown.

Alvin Brown:

Back on the Hewlett Packard matter, your original press release indicated that there will be some bundling with the server, and I just wondered if Hewlett Packard will do any marketing for you with regard to selling EFT along with its servers?

Matt Goulet:

So, that's the ultimate goal Alvin, thanks for your question. Obviously we're working with several groups with how have Hewlett Packard and having multiple conversations, but yes our expectations are that there is some level of cross functional marketing going on. We can't commit to that at that time and obviously it's a long process with HP. So, more details to come on that, but we are excited about what can be.

Alvin Brown:

I would assume that they would want their server data to be protected, so there is a natural fit between your software and what they are selling, and I just assume, or I have assumed that they would want to market the EFT.

Matt Goulet:

Yes, I think that's a safe assumption. What we have to keep in mind is HP is one of the, if not the leading technology companies in the market. So, there is a lot of software companies that they are working with and their desire is to work more closely with HP. They can't be all things for all people. So, this is a great first step with the us and them, we are excited about some of these announcements that are coming up here in the next couple of months, but we're looking forward to that, as well as some future announcements that we're going to be making with our platform providers and other technology companies. It is a big part of four focus going forward. The partnership is going to be key to our growth.

Operator:

As a reminder ladies and gentlemen, that is star, one to ask a question. Again, if you are on a speakerphone, please make sure that your mute button is disengaged so that your signal can reach our equipment. Once again that is star, one to ask a question.

For our next question, we go to Greg Newman with the Newman Agency.

Greg Newman:

Hi guys, good quarter.

Matt Goulet:

Hi Greg, thank you.

Greg Newman:

You're welcome. I wanted to ask you about HP also and the other partnerships. I didn't quite understand when you said about a launch. Maybe I didn't hear everything, but the partnerships seem to be pretty key and it makes a lot of sense. So, if there is anything else you can say or at least explain about the product launch that you were talking about, is that just a GlobalSCAPE EFT development or are you talking about HP, and I was going to ask you about other, you keep touching on it, I don't know if there is anything else you have to say about the other players in the market. I think that's all I have to ask?

Matt Goulet:

Okay. I will do my best. When I mentioned launch, I was referring to—in my introduction when I talked about us launching into the midmarket, a large portion of our revenues come from enterprise customers and we think that the midmarket has been underserved. So, we're going to be repackaging some of our existing solutions, as well as rolling out new solutions around the cloud, around the appliance, and things that the channel really gravitate towards that we can push into the midmarket.

So, when I was referring to the launch, that's what I was talking about. The HP announcement is really going to allow us to dovetail those two together and you will hear more about that in the coming months.

As far as the other technology alliances, partners, these tend to be larger companies that we are working with. They are multifaceted. Partnerships come in all shapes and sizes and flavors. So, they don't have it quickly, that said.

We certainly think that they are worth the effort. We're working with certainly over a dozen in some way shape or form, their industry names not unlike HP and F5 that you've heard from us will be premature to name names because of various degrees of NDA and things like that, but I can assure you that we're pursuing them wholeheartedly and we'll continue to make further announcements through the year and going forward. It's going to be a big part of our growth plan and our strategy going forward.

Greg Newman:

Thank you.

Matt Goulet:

Thank you.

Operator:

As a final reminder ladies and gentlemen, that is star, one to ask a question.

With that, we have no further questions on our roster. Therefore Mr. Albrecht, I will turn the conference back over to you for any closing remarks.

Jim Albrecht:

Thank you Operator, and on behalf of Matt and myself, we would like to thank you for taking the time to join the call today. We appreciate your ongoing support of GlobalSCAPE and look forward to visiting with you again at the end of the first quarter. Thanks very much. Have a great day.

Operator:

Again, ladies and gentlemen, this will conclude today's conference. Thank you for your participation. You may now disconnect.