TECSYS Inc. – TSX: TCS
Second Quarter FY2016 Results
Financial Analysts Call
Wednesday, December 2, 8:30am

Operator

Good morning ladies and gentlemen, and thank you for standing by. Welcome to the TECSYS Second Quarter Fiscal 2016 results conference call. At this time, all participants are in a listen only mode. Following the presentation, we will conduct a question and answer session.

Instructions will be provided at that time, for you to queue up for questions. If anyone has difficulty hearing the conference, please press star 0 for operator assistance at any time.

Please note that the complete second quarter report, including MD&A and financial statements, were filed on SEDAR, December 1, 2015. All dollar amounts expressed in Canadian currency, are prepared in accordance with the International Financial Reporting Standards and are unaudited.

Some of the statements in this conference call including the question and answer period, may include forward looking statements that are based on management's beliefs and assumptions. Actual results may differ materially from such statements.

I would like to remind everyone that this call is being recorded Wednesday, December 2, 2015 at 8:30 am Eastern time. I would now like to turn the conference over to Mr. Peter Brereton, Chief Executive Officer at TECSYS. Please go ahead sir.

Peter Brereton

Thank you. And good morning everyone. We appreciate you joining us for today's call. Last night we issued our unaudited 2016 second quarter financial results. A copy of those results is available on our Web site at TECSYS.com. Joining me today is Berty Ho, our Chief Financial Officer.

I'll start by summarizing the key events for the quarter and reviewing our Q2 financial results. I'll then close with a few comments on our outlook for the remainder of the year, followed by a Q&A session. Q2 was a strong quarter, both operationally and financially.

We started to demonstrate the benefits of the strategic changes we made to our sales team late last year, with impressive wins in both complex distribution and our healthcare vertical.

It was another record quarter at par with Q4 of 2015 - sorry, another record revenue quarter at par with our Q4 of 2015 and our second highest quarterly contract bookings. Also, our plan to contain, pardon me, our operating expenses, has led to EBITDA margin expansion sequentially over Q1.

Total contract bookings in the quarter were $13.4 million compared to $9.3 million in the prior year period. Of this, $2.6 million came from three new accounts.

The high contract bookings in the quarter are a strong validation of our decision to increase our investment in sales and to create dedicated complex distribution and healthcare teams, to better capture opportunities in each market in addition to the dedicated base account team we created the prior year.

We have seen a resurgence in our complex distribution pipeline with two significant new accounts signed in the quarter, most notably one is with a large multi warehouse customers. Initially these - our solutions will be in place within three of the client's facilities.

Longer term there's a great potential for us to expand to all 18 of their global sites. In the quarter we also signed a new IDN contract. It is with a premier North American health network. What is particularly exciting is that we displaced an incumbent vendor.

This was one of only a couple of hospital networks that we are aware of, that had a significant supply chain solution in place that was not ours. Our platform is the only one that enables our hospital clients to fulfill the needs of all facets of their supply chain ecosystems.

We are increasingly seeing an industrywide shift within hospital networks. The mindset of key decision makers is changing at a faster rate than we have seen in the past. They are increasingly taking a broader based look at their supply chain needs rather than looking to solve only one particular challenge.

This bodes incredibly well for our long term growth prospects. We nearly always win when healthcare networks look across their entire supply chain, to evaluate their needs. We continue to see our healthcare sales pipeline expand. However, as you know, the sales cycle is long.

It can be upwards of 24 months. As such, the total number of new IDN customers that we close in any given quarter, will vary.

Nonetheless, looking at our pipeline for the remainder of 2016, we have more than sufficient demand to maintain new account additions in line with our projections to close at least eight new health systems over the course of our fiscal year.

What is particularly exciting about our healthcare wins is that they are excellent sources of repeat business. In many cases, we believe we can see a revenue of - or we could see revenue of three times the original contract value over a four year period, as these clients continue to take advantage of our broader offerings.

Now looking a little more closely at the financials for the quarter - we grew total revenue by 16%, $15.8 million. As a percentage of revenue, our products accounted for 32% and services for 65%.

As we have discussed in previous quarters, reflecting the hedging strategy that we put in place last year, FX boosted overall revenue in the quarter, by approximately $1.6 million, as the Canadian dollar continued to weaken as compared to the US.

The stronger US dollar also impacted cost of sales and operating expenses unfavorably by approximately $550,000. Breaking down revenue a little further, services revenue was $10.2 million, up to $2.1 million compared to Q2 of 2015.

Services margins improved to 45% from 37% in Q2 of 2015, reflecting higher utilization rates. We have seen notable improvements across all of our services revenue streams, with strong gains in product adaptation services and professional consulting, compared to the same period last year.

The increase in service revenue reflects our strong backlog at the beginning of the quarter, in addition to the favorable impact with a stronger US dollar.

Proprietary products revenue defined as internally developed products, including proprietary software and hardware technology, was $3 million, down 7% year over year, largely due to the timing of new deals.

The third party product revenue increased to $2.1 million, up $365,000 or 21%, over the second quarter of fiscal 2015. The improvement in revenue over the prior year quarter, was primarily attributable to higher carousel hardware equipment volume sold in the quarter to a health system.

Overall, growth margin was flat at 49% compared to the prior year quarter. Gross profit increased by $1.2 million to $7.8 million, compared to $6.6 million recorded last year. The improvement was driven by a higher services margin of $1.7 million, offset by a lower product margin of $482,000.

Profit from operations for the second quarter, was $501,000 compared to $532,000 in Q2 of 2015. The change was the result of higher services margins that were offset by softer product margins and the increased investments in sales and marketing as well as research and development.

EBITDA remained unchanged at $1.2 million compared to the prior year, as our top line improvements offset our increased investment in sales.

Taking a look at total operating expenses for the second quarter of fiscal '16, we saw an overall increase to $7.3 million, up $1.2 million or 20%, compared to $6.1 million for the same three month period last year. We're roughly in line as a percentage of revenue.

Sequentially total operating expenses were relatively flat. We are through our major increases in investments and have reached a fairly steady go forward state for our OPEX, subject to the usual fluctuations for variable selling expenses and other incentives.

Compared to Q2 of 2015, sales and marketing and R&D expenses were higher, as we continue to strategically invest to support our long term growth.

Looking at costs a little more closely, sales and marketing expenses totaled $3-1/2 million in the quarter, approximately half a million higher than the comparable quarter last year. The increase was largely as a result of higher employee related expenses in addition to travel expenses and marketing programs.

General and administrative expenses declined to $1.4 million in Q2 of 2016, $130,000 lower than the prior year period. This was primarily the result of lower employee related expenses, incentives and consulting fees.

R&D expenses increased to $2.4 million in the current quarter, $765,000 higher than in the same quarter last year. the increase in R&D expenses was primarily driven by higher employee count in addition to higher consulting and certification fees.

This increase reflects the investments we are making in pursuit of new features and product functionality, which will assist in continuing to drive sales growth. We are winding up our R&D capitalization as well.

So included in that R&D increase over last year was a reduction in capitalization and an increase in amortization. The combination impacted reported R&D costs by $178,000.

Now turning our attention to cash and cash equivalents, we ended the quarter with $9.1 million in cash and cash equivalents, a decline of $1.7 million from $10.8 million at April 30, 2015, mainly the result of cash used for the repayment of long term debt, the payment of dividends as well as investment in capital assets.

We ended the quarter in a great position. We closed $13.4 million of business, won a new complex distribution client with significant room for global expansion. And signed a premier new IDN customer where we replaced the incumbent vendor.

Our pipeline of opportunities in both complex distribution and healthcare is growing. And while the sale cycle can be long, the potential for future contract expansion with each new deal is often immense.

This pipeline combined with our strong bookings and robust order backlog provides us with great visibility into the second half of fiscal 2016. We are confident in our ability to continue to deliver solid results while capitalizing on the many opportunities we have for growth.

We see nothing preventing us from maintaining and growing our revenue run rate, as we execute on our strong contract bookings and our order backlog, which at the end of the current quarter, totaled $47.6 million.

In addition, we expect to continue to see operating leverage improvement as we have reached a fairly steady state in terms of operating expenses. Over time, these expenses will continue to decline as a percentage of total revenue resulting in additional bottom line improvement.

With that, I will turn it over to (Tina), for Q&A. Thank you.

Operator [Q&A instructions]

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Peter Brereton (post-Q&A)

Great. Well thank you for all your time and interest. And, you know, if you have any additional follow up questions, don't hesitate to give us a call. And we'll look forward to talking to you next quarter. Thanks. Bye for now.