TECSYS INC.
Fourth Quarter FY2016 Results
Financial Analyst Call
Thursday, July 7, 8:30am

OPERATOR

Good morning ladies and gentlemen thank you for standing by. Welcome to the Tecsys Fourth Quarter and Fiscal 2016 Year End 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. Instruction will be provided at that time for you to queue up for questions. If anyone has difficulties hearing the conference please press star 0 for operator assistance at any time.

All dollar amounts are expressed in Canadian currency and are prepared in accordance with International Financial Reporting standards. 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 different materially from such statements. I would like to remind everyone that this call is being recorded on Thursday, July 7, 2016 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. We appreciate you joining us for today's call. Last night we issued our fiscal 2016 full year and fourth 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 will start by summarizing the key events for the year and reviewing our financial results. I will then close on a few comments on our outlook for the remainder of the year followed by a Q&A session.

Fiscal 2016 was another great year for us as we achieved record financial results and increased our penetration in key market vertical. Driving this was the success we had from continuing to build our leadership position in healthcare supply chain management and realigning our salesforce to reignite growth in our complex distribution segment.

As well we maintain discipline in controlling our operating costs and benefited from our efficient but highly productive R&D team.

For fiscal 2016 we increased our profits from operations to $4.5 million compared to $1.9 million for fiscal 2015.

In terms of healthcare we signed six new IDNs or Integrated Delivery Networks in hospitals last year bringing our total to the mid-30s.

That increase is partially due to the fact that a number of our standalone hospital clients have now merged into IDNs. Included in our new accounts for the year was one of the largest IDNs in the United States which we signed in Q3.

This Midwest based IDN includes over 90 hospitals is more than twice the size of our next largest IDN under contract. This was a significant win as it provided a clear validation of our offering in our healthcare space and has helped us get in front of more opportunities to win business.

In 2016 we continued our expansion in the hospitals and health systems market through an increasingly comprehensive and integrated supply chain solution.

We are finding there is strong appetite among many of our customers to significantly reengineer their supply chain. From demand planning to the operating room and right to the patient's bedside.

Our product marketing people and product managers have been highly effective at facilitating this by forging close partnerships with some of our key customers that enables them to develop solutions that truly benefit clinicians and positively impact patient care.

Broadening the addressable market within our existing customer base is an important growth pipeline for us. We believe the revenue opportunity has increased to approximately $10 million per health system within the first seven year period of a customer relationship as customers adopt more of our solutions.

Our clients are finding that the ROI for these solutions is significant with many investments paying for themselves in less than two years.

To give you an example of this we have a client in Indiana that began their journey with us back in 2010. They initially implemented our warehouse solution but have since added record storage, delivery, management of nursing station supplies and now quite recently OR.

So within a year they will be taking advantage of the suite we now refer to as plan it, house it, move it and use it. Going forward we expect to maintain our moment in landing new health system and hospital customers.

Our success will come from the position we have established as the standard setter in healthcare supply chain management and also from developments in the overall market that are driving more hospitals to adopt solutions to better manage their supply chains.

This comes from regulatory pressures such as the Drug Supply Chain Safety Act and funding pressures that require them to increase efficiency in their businesses to maintain margins.

The first phase of these improvements was the implementation of electronic health records. Many hospitals now have these in place and are now looking to further advance and add the kind of capabilities that our solutions provide.

Another important initiative in fiscal 2016 was the reorganization of our salesforce. So the healthcare and complex distribution segments are each served by their own dedicated team.

Having professionals focused on solving challenges in one vertical made an immediate impact in the complex distribution segment with two major wins including a multi-warehouse contract with potential to expand into 18 local sites.

Now looking at our financials for the quarter and the full year. Revenue in the quarter was $21.1 million, an increase of $5.4 million or 34% over Q4 of 2015.

Behind this growth was increased sales proprietary products which increased by 53% over the previous year. We completed the build cycle of the next generation of our point of use technology in the quarter which contributed to our record revenues.

While the revenue of our point of use technology is lumpy by nature we do expect it to become an important growth driver for our company.

The service revenue was also very strong in the quarter and grew by 26% to $11.5 million with professional services being a significant contributor to this growth.

Third party revenue was up 36% in the quarter to $3.1 million compared to $2.6 million largely as a result of an increase of storage products of $1.4 million.

For the full year, revenue was $67.5 million, an 18% increase over $57.3 million in fiscal 2015. We saw the largest growth in services revenue which was up 24% to $42.5 million compared to $34.3 million last year.

We started fiscal 2016 with a high backlog and a weakening Canadian dollar which combined to support the solid service revenue growth. Even without the currency swing the services growth would have come in around 12%.

Proprietary product and third party revenue came in at $13.6 million and $9.4 million respectively. Or 9% and 10% higher than the previous year. In both cases the growth was a result of increased shipments in the fourth quarter mentioned earlier.

As a percentage of revenue our products accounted for 34% in services or 63% in fiscal 2016.

About 66% of our revenue is generated in the U.S. and the strong U.S. dollar favorably impacted revenue by about $5.8 million while impacting our cost unfavorably by about $1.7 million.

Recurring revenue at the end of fiscal 2016 was $25 million about 37% of revenue. This compares to $21.3 million at the end of fiscal 2015 also about 37% of revenue.

Our goal remains to increase our recurring revenue to over 40%. We believe there is tremendous interest from our customers to purchase our point of use technology on a subscription basis.

And our One Sprint solution which will be sold on a SAS model will contribute to increasing our percentage of recurring revenue. I will be explaining One Sprint shortly.

Gross margin in the fourth quarter of 2016 increased to 55% compared to 49% in Q4 of 2015. The increase was partially driven by higher services revenue and increased revenue from higher margin proprietary products.

Services margin increased to 51% up from 38% in the fourth quarter of fiscal 2015. While this was positively impacted by the strength of the U.S. dollar, Quebec e-business tax credits and cost containment. The majority of the gain came from increased services revenue.

These same trends are seen in the increased annual gross margin of 52% for fiscal 2016 compared to 48% the previous year.

In Q4 of fiscal 2016 operating costs were $8.5 million, 13% higher than Q4 of 2015. On an annual basis, operating costs increased by 18% to $30.3 million compared to $25.6 million in 2015.

Driving the increases both for the quarter and the year were increased sales and marketing expenses as we added employees when we reorganized our sales team.

These increases were completed in the fourth quarter of fiscal 2015 and the first quarter of fiscal 2016. Hence the expense numbers are up for the year but largely flat quarter over quarter during fiscal 2016.

The jump in fourth quarter costs was due to accrual of commission and management incentives based on the exceptional quarter.

A focus throughout fiscal 2016 has been to control our operating expenses. And we believe we have reached scale in several areas. Operating expenses as a percentage of revenue have trended down over the course of the year. They were 48% of revenue in the first quarter and 40.3% in the fourth quarter of fiscal 2016.

We expect operating expenses to remain essentially flat through fiscal 2017 allowing more revenue to flow to the bottom line.

Looking at bit closer at our R&D expenses they have remained relatively flat quarter over quarter on a net basis at $2.4 million of Q4 of fiscal '16. Although up to $9.3 million for the full year.

Approximately $800,000 of that increase is due to the ending of R&D capitalization and increased amortization as the products migration project was completed.

You will now see a quarterly write down of capitalized R&D with very little new capitalization. We are delighted with the efficiency we have achieved in our R&D team and our reengineered platform that is allowing us to hold down cost while still actively advancing our product and service offering.

Included in the events made in the last year was our delivery management system. A smartphone based event tracking and delivery management system that allows management to gain control of their internal transportation operation and effectively managed delivery of volumes, turnaround times as well as logistics costs and profitability.

Also at the end of fiscal 2016 we introduced One Sprint. A complete warehouse management system that is a SAS based quick deployment solution. Designed to go-live in less time and which can be scaled up or down to meet our customers' needs.

It is delivered through a cloud based infrastructure ensuring high availability, reliability and security. The solution targets small and medium enterprises as well as rapid installs for larger organizations.

The strong sales we had in the fourth quarter combined with the controlling of our operating expenses had a significant impact on our EBITDA. Increasing to $3.8 million or 302% over the $955,000 we realized in Q4 of 2015.

On an annual basis EBITDA was $7.2 million, a 62.8% increase over the $4.4 million realized in fiscal 2015. While the results may be difficult to achieve on a consistent quarterly basis, the key takeaway should certainly be the scalability and operating leverage of our business model.

Now turning to cash and cash equivalents we ended the year with $9.7 million in cash and cash equivalents compared to $10.8 million at the end of fiscal year 2015.

The difference was mainly the result of cash used for the repayment of long term debt, the payment of dividends as well as investment in our main product line.

To summarize, as you heard today fiscal 2016 was a record year for Tecsys with advances in all parts of our business. These achievements are the result of a multi-year dedication to a vision to maintain excellence and build market leadership.

We are entering fiscal 2017 with a solid backlog and a strong pipeline. As we look forward to the rest of fiscal 2017 we are continuing to focus on building on our success and delivering great value for customers and shareholders.

With that I will open it up for questions.

Operator [Q&A instructions]

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Peter Brereton (post-Q&A)

Great. Well thank you all for your time and attention. And if you have additional questions please don’t hesitate to give Berty or I a call. And we will look forward to getting back to you after our Q1 results come out in September. Thanks. Bye for now.

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