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GTY Technology Holdings, Inc. (GTYH)

Q3 2020 Earnings Call

CORPORATE PARTICIPANTS

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TJ Parass
President & Chief Executive Officer, GTY Technology Holdings, Inc.

OTHER PARTICIPANTS

Joshua Reilly
Analyst, Needham & Co. LLC

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, thank you for standing by, and welcome to the GTY Technology Holdings, Incorporated Q3 2020 Earnings Call. [Operator Instructions] I would now like to hand the conference over to your speaker today, John Curran, please go ahead.

John J. Curran
Chief Financial Officer, GTY Technology Holdings, Inc.

Thank you, and good morning, everyone. I'm John Curran, GTY's CFO, and I'd like to welcome you to our third quarter earnings conference call for 2020. With me on today's call is TJ Parass, GTY's CEO. We will be presenting to slides on today's call and encourage you to view the presentation found on our website at www.gtytechnology.com.

Please note that our earnings release and quarterly report on Form 10-Q are available on the GTY website at www.gtytechnology.com. Both contain additional information about our financial results. Any forward-looking statements we made in the earnings release or any that we may make during this call are based upon information that we believe to be true as of today.

Things often change, however, and actual results may differ materially from those projected or anticipated. Please refer to our cautionary statements in the earnings release under the heading Forward-Looking Statements.

You should also refer to our SEC filings, including our most recent Form 10-K and our subsequent SEC filings for a list of risk factors applicable to GTY, including risks associated with COVID-19. As you will hear in our comments today, the pandemic is impacting our business today and for an undetermined time into the future.

During the call, we may refer to non-GAAP financial measures, if we believe they are useful to investors or if we believe it will help investors better understand our results or business trends. You can see a reconciliation of our non-GAAP financial measures to their nearest comparable GAAP financial measure in Exhibit 2 of the earnings release.

With that, I'll turn the call over to TJ.

TJ Parass*President & Chief Executive Officer, GTY Technology Holdings, Inc.*

Thank you, John. Good morning, and thank you all for joining us. Before we dig into this quarter's great results, I want to let you all know that GTY is focused to modernize governments and make them more efficient.

GTY was formed to bring best-of-breed cloud technologies to state and local governments with a twofold focus: first, to improve and modernize the citizens' experience with their government front offices; and second, to bring modern solutions to government employees so they're able to work more efficiently. Currently, we offer five product lines.

Our front office solutions from CityBase and Open Counter are used by citizens, such as you and me, to figure out what permits we need and then process those permits online. These permits can be as simple as a tree cutting permit, to as complex as helping someone start a new business by walking him through the many permits that will be required.

CityBase solves the often complex process of how you make payments at your government by ensuring the citizen's experience is very simple and quick. They offer many ways to make payments from seating at home to paying out of kiosks. Our back-office solutions are used by cities and towns to run their operations.

For example, our Grants Management Solutions by eCivis is used to help governments manage and distribute grants. Governments have lately been using eCivis' products to help manage and distribute COVID funding. Our budgeting and planning businesses, which is made up of Sherpa and Questica, are very busy right now as they work with governments who are updating budgets as they deal with the effects of economic changes.

Our sourcing platform by Bonfire helps governments with the challenges of dealing with multiple vendors, complex RFP processes and compliance. All of our business units have been growing this year. Turning to recent highlights. It's been a busy quarter, and we're pleased with the results.

In Q3, we achieved double-digit revenue growth, remain disciplined in cost management, added 77 new customers, maintained high customer satisfaction scores and experienced continued strength in growth in the govtech market. Our GAAP revenues increased 44% from Q3 2019 and 40% year-to-date. We became cash flow positive for the quarter.

We experienced continued levels of strong demand for GTY's product offerings. And finally, we have concluded our review of potential strategic alternatives that we announced at the beginning of this year.

Given the continuing uncertainties arising from the pandemic and the positive developments in the company's financial performance over the past few quarters, we believe it is in the best interest of the GTY stockholders to focus on executing the company's stand-alone business plan.

Although the process has concluded, the company will continue to evaluate all opportunities to drive growth and enhance shareholder value. To update you on the COVID market environment, as mentioned earlier, GTY is experiencing excellent growth and opportunity with our strategy and offerings.

However, COVID is a factor in our market in some positive and negative ways. Our customers, state and local governments, are facing headwinds such as budget cuts and ensuring resources are deployed to COVID response. At the same time, COVID-related changes are creating tailwinds. COVID has challenged the public sector by highlighting the deficiencies that legacy systems face where they are not cloud-enabled.

This is a positive for our business because GTY offers cloud-based solutions for governments. As you recall, when the lockdown hit, we took immediate action and announced a COVID emergency response program to help governments. Legacy technology gets swiftly to the cloud so they can operate remotely. We offer free use of our products for a period of time as a means to be helpful while also furthering awareness of our products.

The program has now come to an end, having generated nearly one million of additional client opportunities across more than 85 new potential clients. We are currently forecasting the program to generate more than \$0.5 million of ARR by year-end. We are pleased to have helped hundreds of public sector organizations with this program, inclusive of nonprofits, and we welcome those that have joined us as new customers.

To provide insight to what COVID means to our business planning and visibility, COVID is both a push and a pull to our business that remains dynamic, unpredictable, with a positive long-term outlook. We've had some prospects delayed because their budgets have been cut or they needed to redirect resources to COVID-related challenges.

While in other cases, we've had deals closed faster than normal because of deadlines associated with grant funding or to adjust for remote operations. Overall, it is clear the market appreciates the value of moving to the cloud more now than ever, and we expect this trend to continue. Turning to the next slide, our CFO, John Curran, will now review the financials.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

Thank you, TJ. This was a great quarter, and we remain on track for more than 20% growth in 2020, as outlined at the onset of COVID-19. Q3 is seasonally our strongest quarter for invoicing and collections. Other important highlights include the achievement of free cash flow positive for the quarter and the conclusion of our evaluation of strategic alternatives.

Moving on to our financial results for the quarter. Our GAAP revenue increased 44% to \$12.6 million in Q3 of 2020 compared with \$8.8 million in Q3 of 2019. On a non-GAAP basis, revenue was \$12.7 million for Q3 of 2020 compared with \$9.8 million in Q3 of 2019, an increase 30%. A reconciliation between our GAAP and non-GAAP results is included in the Exhibit 2 of our press release.

We'll provide a more detailed explanation of the change in revenue on a subsequent slide. Turning to our operating expenses. We saw our total non-GAAP operating expenses remain essentially flat compared with the prior Q2 of 2020 period. Our third quarter 2020 GAAP operating loss narrowed to \$7.3 million compared with \$7.8 million in Q2 of 2020 and a loss of \$9.6 million in Q3 of '209.

Our third quarter non-GAAP operating loss decreased \$1.4 million compared with \$2.8 million in Q2 of 2020, an improvement of 49% driven primarily by our quarter-over-quarter growth in revenue and gross profit. Consistent with last quarter, we wanted to provide a little more color on the change in non-GAAP revenue. As you can see in this chart, our recurring revenue grew by 6% on a quarter-over-quarter basis and grew by 32% on a year-over-year basis.

Our service revenue can vary from quarter-to-quarter due to the timing of large projects, and we expect professional services to decline as a percentage of revenue as our base of recurring revenue continues to grow. Other revenue includes sales of kiosks and software license sales that we also to expect -- that we also expect to decline as a percentage of revenue over time.

We expect to see recurring revenue growing by more than 25% for the year and expect our services and other revenue will grow by roughly 5% compared with 2019. Our recurring revenue will continue to be higher in percentage and dollar terms than service and other revenue as we continue to grow our base of subscription business.

Taking a look at our balance sheet, there are three areas I would like to discuss. The first is the change in our receivable, which decreased by \$500,000 this quarter, driven by strong collections. We experienced some delays in collections in Q2 in the early days of the pandemic, but we have seen collection timing improve in Q3.

The second area is an increase of \$300,000 in AP and accruals in the quarter due to timing. The third area is an increase of \$3.1 million in contract liabilities associated with our subscription billings. This increase represents the amount we have invoiced in excess of the amount of revenue we earned in the quarter. Combine this with our strong collections, and you can see why we had a good cash quarter.

From a cash perspective, we started the quarter with \$6 million and ended with \$6.2 million in cash. From an outflow perspective, our operating trend was roughly \$1.7 million this quarter, down from \$2.4 million in Q2.

We also paid out \$700,000 in severance, \$600,000 in CapEx and \$400,000 in interest in the quarter. From an inflow perspective, our seasonably high billing quarter and strong collections were the primary drivers behind our change in working capital of \$3.2 million. We also received about \$400,000 in stimulus funding evenly split between U.S. payroll tax deferrals and Canadian wage subsidies.

Based on our current view of sales activities, our ability to implement our products, the low churn rates we have experienced to date and a cost reduction efforts, we believe we have sufficient cash to carry us into 2021.

Turning to outlook. We still see the ability to grow revenue and ARR by more than 20% in 2020. We remain concerned about material reductions and the budgets for our customers and don't expect improvements in our business environment in the near term.

Our renewal invoice volume in Q4 is lower than both Q2 and Q3. Combined with our very strong collections in Q3, we don't expect the same level of cash inflows from operations in Q4. As a result, we expect to be cash flow negative in Q4. We remain focused on growth and improving our profitability as we finish the year. Looking to 2021, we expect an economic climate that will be similar to 2020. We continue to expect we could be cash flow positive from operations in 2021.

With that, I would like to turn things back to TJ.

TJ Parass

President & Chief Executive Officer, GTY Technology Holdings, Inc.

Thank you, John. Before we take your questions, I wanted to provide you some color from our business units because while the company's scoreboard is interesting and important, the game itself is on the playing field. I'm impressed by how quickly our business unit CEOs and their teams pivoted in March to ensure our staff were safe, and our customers continue to have the level of service they expect.

To accommodate for lack of travel and events, our business units made very quick decisions on how to manage their teams during COVID. As a result, we've seen some great success in our online efforts with customer town halls and webinars as well as the simple effort of picking up the phone and calling prospects.

Our offerings span from state level right down to small towns in North America, and I'm encouraged by the success we are seeing and the focus to expand to the mid-market. At the state and large cities level, we continue to have the success against large ERP companies. Governments are embracing the cloud and looking to move out of monolithic systems and toward best-of-breed solutions.

This is why GTY was formed. Every business unit at GTY is strongly engaged in seeing success. Bonfire has 60% revenue growth this quarter versus Q3 2019. Their NPS score was over 73, just amazing customer satisfaction. Phoenix went live with our Sherpa budgeting solution, on time and under budget.

The state of North Dakota selected our Sherpa budgeting solution, and overall, the GTY budgeting team added 26 new logos this quarter. Fort Worth joined our expanding list of customers that are deploying Open Counter's permit discovery solution. eCivis added 20 new logos this quarter as demand for the grant management solutions continues to remain strong.

Recently, eCivis was recognized in Gartner's management software market guide for state and local government. Austin selected CityBase for their payments vendor. CityBase's innovative solutions were a very clear front-runner in the RFP selection process.

I want to take a minute to thank everyone at GTY for their efforts over the last quarter. It's been a big adjustment with COVID, and our staff have risen to the challenge. In summary, it was a great quarter, and we achieved top line double-digit growth, demonstrated strong cost management, achieved high customer satisfaction and experienced continued strength by government's transition to the cloud.

GAAP revenues were up 44% in the quarter and 40% year-to-date. We had cash flow positive for the quarter. We saw continued levels of high demand for GTY products, and we concluded a review of strategic alternatives. Thank you, operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: [Operator Instructions] Your first question comes from Joshua Reilly from Needham & Company. Your line is open.

Joshua Reilly
Analyst, Needham & Co. LLC

Q

Hey, guys. Congrats on the strong quarter. Let's start off with a macro question. How should we think about the ongoing impact of COVID-19? You've already given some color, but maybe expand on it a bit more. Do you expect budgets to be dependent on another round of stimulus in 2021 or a vaccine being widely available?

And then are you hearing from customers that are waiting to spend more broadly until a vaccine is widely available?

TJ Parass
President & Chief Executive Officer, GTY Technology Holdings, Inc.

A

Hey, Josh. How're you doing? So we've been looking at this pretty intensely and we did a lot of reading and following the various publications. We're not -- the way we're looking at the business right now is it could be a lot like 2020 is unfolded, especially the last two quarters. So for instance, the bookings this year in line with what we saw in 2019, we're expecting that to go into 2021.

We're not building the business around stimulus and expectations of stimulus. In 2020, the government saw a little bit of a downfall in revenues that were covered by stimulus. And while the government may come out with some future stimulus, I think that you'll see the market be largely [indiscernible] (00:17:51) in the last two quarters of this year.

Joshua Reilly
Analyst, Needham & Co. LLC

Q

Okay, great. And then moving on, you mentioned in the prepared remarks about being cash flow positive in FY 2021. Maybe can you provide some more color on what trends in your business or operating structure give you confidence in that target for next year given the uncertain macro?

John J. Curran
Chief Financial Officer, GTY Technology Holdings, Inc.

A

Yeah. Josh, its John. So, we're as TJ said, we're kind of assuming 2021. Right now, we're assuming that it's going to look a lot like the back half of 2020 from a market and economic perspective. So, given that assumption, we feel that we can be cash flow positive next year.

Just from a trend perspective, we do see a seasonal flow to our invoicing, just as we experienced in Q3, stronger levels of invoicing and collections. Our flow is weaker first half, stronger second half. But when you sum up the year next year, we expect to be positive.

Joshua Reilly
Analyst, Needham & Co. LLC

Q

Okay, great. And then maybe moving on to sales force productivity. Obviously, you've taken some cost actions here over the last couple of quarters and had to shift to a virtual selling environment. It appears the mix of business in the quarter was heavy towards new logos or customers. How should we think about the mix of upsell versus new logos going forward? It seems the shift here has been a little bit more toward new logos.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

A

Yeah. So, our mix actually this quarter has been reasonably consistent with our experience in Q2. We only have kind of two-quarters of experience in the pandemic environment. But mix has been pretty consistent. In terms of new ARR generation, the majority will come from new logos. That's our expectation.

We do have a decent flow of upsell activity, so we do have net positive churn. So we're growing our renewal base quarter-on-quarter. But our mix is going to be of new business is going to be predominantly from new bookings and new customers. And we anticipate that continuing here.

Joshua Reilly

Analyst, Needham & Co. LLC

Q

Okay, great. And then just one more question for me. It seems your cloud-based solutions are a nice competitive advantage here in the current macro. Is the ability to complete implementations on a fully remote basis exceed selling point when you're going in with customers versus many of your on-premise competitors? Are you hearing that as a key point here?

TJ Parass

President & Chief Executive Officer, GTY Technology Holdings, Inc.

A

Hey, Josh, yes. This is TJ. Yeah, for sure. I mean, our team has already had many years of doing implementations remotely. All we did is shift from doing remotely from the office to doing it remotely from home. So very little change to our existing customers' experience.

And it is definitely one of the advantages that GTY has is the ability to onboard customers quickly with our solutions. We've got that kind of down to a well-oiled machine.

Joshua Reilly

Analyst, Needham & Co. LLC

Q

Okay, great. Thanks, guys. Congrats on the success here.

TJ Parass

President & Chief Executive Officer, GTY Technology Holdings, Inc.

A

Thank you, Josh.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

A

Thanks, Josh.

Operator: [Operator Instructions] There are no further questions. I'll turn the call back over to the presenters for closing remarks.

TJ Parass

President & Chief Executive Officer, GTY Technology Holdings, Inc.

Okay. I just want to thank everybody for joining us today and stay safe, and we'll talk to you guys again next quarter.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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