

05-Aug-2021

GTY Technology Holdings, Inc. (GTYH)

Q2 2021 Earnings Call

CORPORATE PARTICIPANTS

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

TJ Parass

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

OTHER PARTICIPANTS

Joshua Reilly

Analyst, Needham & Co. LLC

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

MANAGEMENT DISCUSSION SECTION

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

Thank you. Good afternoon, everyone. I am John Curran, GTY's CFO. And I'd like to welcome you to our Second Quarter 2021 Earnings Conference Call.

With me on today's call is TJ Parass, GTY's CEO. We will be presenting 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 is also available on the GTY website and contains additional information about our financial results.

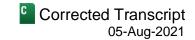
Any forward-looking statements we made in the earnings release or any that we may make during this call are based upon information that we believe to be true as of today. Things often change, however, and actual results may differ materially from those projected or anticipated. Please refer to our cautionary 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, 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 and in the Appendix of this slide deck.

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

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TJ Parass

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

Thank you, John. Good afternoon, and thank you all for joining us. For those that are new to GTY, GTY provides cloud-based platforms that help government organizations transform the way they engage [ph] systems (00:02:16) and manage their operations.

While the common perception is that government lags behind private sector, GTY was formed based on the founders' vision that governments were starting accelerate their digital transformation.

Even before the pandemic, governments were moving away from heavy, monolithic, on-prem solutions to modern cloud/SaaS applications. And this trend has gotten even stronger in the wake of the last year. State/local governments' modernization represents a massive opportunity for native cloud and SaaS-based platforms.

Here's how we're going about it. We're providing our best-of-breed cloud technologies through five product suites that cover the front and back offices of state and local governments. Included in our primary target sectors are municipalities and counties, colleges and universities, K-12 school districts, public healthcare agencies, public utilities like water and power, transportation and transit, state governments and federal agencies. As of today, we have over 1,800 clients and over 370 employees across our business units, with both of these numbers increasing weekly as we start leaning into growth.

To add some color to the size of our opportunity, in 2021, state/local government in the US is expected to spend just under \$120 billion in IT, and that's 10% higher than 2020, a healthy underlying growth rate. As our customers are starting to modernize their infrastructure, GTY is well positioned to capture the opportunity that the transition to the cloud represents.

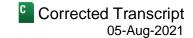
Let me unpack that a bit for you. Before I describe the product suites themselves, it's important to understand that GTY products have three broad characteristics that position us for success. First, they are cloud and largely SaaS. This means high recurring revenue streams with remarkably low churn off, [ph] often (00:04:20) multi-year contracts and strong gross margins and predictable cash flows.

Second, each of our product suites were created specifically for government's unique requirements and are considered leaders in their respective functional areas. This leads to high win rates against older gov tech competitors as well as against horizontal players that often struggle to meet compliance or government-specific future requirements.

Finally, combined, our product suites allow us to access a full spectrum of [ph] sizes and segments (00:04:50) of our customers, from \$10,000 to \$1 million and higher price points, and across our all eight subsectors from small municipalities all the way up to large state governments and federal agencies.

So, let's meet the products and business units. First is Bonfire, our next-generation sourcing and procurement platform. Second is CityBase, our payment platform that helps centralize the citizen interface of a government agency. Third, eCivis provides a grant management system that helps governments stay on top of one of their most important sources of funding. Fourth, Open Counter streamlines government permitting, which is one of the major touch points with citizens. And finally, rounding out our product suites are our budgeting platform companies, [ph] Questica (00:05:36) and Sherpa, which we collectively call GTY Budget. Budgeting is a core and mission-critical financial activity of all levels of government. Combined, these product suites give GTY a strong starting position to capture the opportunity ahead.

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With that context for the newcomers of GTY, let's turn to Q2. GTY reported another strong quarter with Q2 exceeding expectations across all key operating metrics. The economic environment for our customers continued to improve despite challenges that persist from the new Delta variant of COVID-19. The core strength of our business unit is our ARR, which remained robust in the quarter. Our ARR growth rate of 24% in Q2 was slightly below both the prior quarter as well as Q2 of last year due to timing of certain deals.

Turning to bookings, Q2 wasn't as strong as Q1 due to some large deals that were pulled forward into Q1 and a few other Q2 deals that pushed out into Q3. However, these pushed deals have already closed in Q3 and are a good leading indicator of how the back half of the year is shaping up.

While recurring revenues as a percentage of total revenue can move around based on the timing of hardware installations and other services, they continue to grow at a faster rate than total revenue. For Q2, recurring revenue is at 79% of total revenues, a record high for us. We added 86 new clients with wins across all eight of our target sectors as well as many customer expansions.

Within our CityBase business, we are working with New York City to expand in-person payment citywide, and at KC Water, we introduced new utility payment kiosks. Another new CityBase customer is a prominent energy provider in Michigan, who is improving their customers' payment processes with 43 new payment kiosks, which will be installed starting in Q3.

Moreover, two prominent customers we announced in the fall of 2019, the City of Denver and City of Austin, have been implemented and are now processing payments.

Our cloud-based budging tools, [ph] Questica (00:07:44) and Sherpa, have been selected by a wide range of organizations such as the City of Spokane and the City of Bellevue, Washington as well as the State of North Dakota and the Central Ohio Transit Authority.

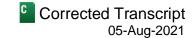
Our grant management platform, eCivis, continues to move upmarket from small nonprofits to larger state and local governments. One recent example for eCivis is the Florida League of Cities. There are 410 incorporated cities throughout Florida, and we have signed up over 120 cities under the program, which includes all cities with access to our research.

The new arrangement provides preferred, pre-negotiated pricing to expand into all of our management products. Furthermore, key state agencies responsible for ARPA funding have been promoting the eCivis partnership and plan to roll out a program to execute those grants in the coming months. While still very early in the process, we are pleased with the high level of engagement.

Additionally, our procurement platform, Bonfire, added a new approval functionality that helps organizations track processes online. This feature in addition to the rich feature set in the Bonfire platform supports the work from home reality.

Finally, we continue to invest in our leading cloud-based sector solution suites. In July, we announced general availability of our next major release of our flagship budgeting solution. Questica Budget was developed to reduce friction and foster a more collaborative experience throughout the public sector budgeting process, and this new release includes major enhancements to our collaboration tools and overall user experience.

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Turning to our financial position, our P&L continues to strengthen. And in Q2, we saw strong year-over-year improvements in gross profit and operating loss. John will provide more details on the financials in a few minutes, but I feel good about our progress to date and how we are positioned for the future.

Turning to our outlook. We believe there are several macro drivers that are providing tailwinds for our business. Our customers and prospects are becoming more comfortable with their budgets and their outlook. We're supporting this, first, a continued economic recovery as more Americans are vaccinated and the economy opens up; second, budgets for 2021 and 2022 are less negatively impacted than initially feared; and finally, the American Rescue Plan Act of 2021, or ARPA, includes provisions that will help state/local municipalities get more comfortable creating long-term investment planning, knowing additional funding will be there to support it.

In response to the positive market dynamics, increased sales productivity and expanding pipeline of opportunities, we are investing in our sales and marketing capacity as well as our recruitment engine. The market for experienced salespeople is very competitive compared to prior years and requires an enhanced recruitment and retention strategy.

We are already in the process of expanding our recruitment team to meet our goal of hiring at least 20 new sales and marketing staff in the second half of the year. While our attrition is in line with other technology companies, we are striving to be better and are using this time to highlight our unique employer brand.

In conclusion, we are excited to have multiple tailwinds supporting our business and look forward to executing on our growth initiatives. Thank you. Back to you, John.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

Thank you, TJ. As TJ mentioned, Q2 was another strong quarter, highlighted by strong growth in recurring revenues and continued improvements in gross margin.

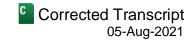
For Q2, our GAAP revenue increased 28% to \$14.3 million compared with \$11.2 million in Q2 of 2020. On a non-GAAP basis, revenue was \$14.4 million for Q2 of 2021 compared with \$11.3 million in Q2 of 2020, an increase of 28%. A reconciliation between our GAAP and non-GAAP results is included in Exhibit 2 of our press release and in the Appendix of our slide deck. We'll provide a more detailed explanation of the change in revenue on the subsequent slides.

Our second quarter 2021 GAAP gross profit was \$9.1 million or a 64% margin compared with \$6.8 million in Q2 of 2020 or a 61% margin. Our second quarter non-GAAP gross profit increased to \$9.6 million or 66% margin compared with \$7 million or 62% margin in Q2 of 2020. Continued growth in our recurring revenue is driving the improvements in our gross margin.

Turning to our operating expenses. We saw a \$200,000 or 2% increase in our operating expenses in Q2 of 2021 compared with Q1 of 2021. We saw about \$150,000 of currency impact in the quarter. And if you recall, we had \$240,000 in taxes related to RSU vesting in Q1 that didn't repeat in Q2. Excluding the impact of currency and RSU taxes, we had about \$300,000 of expense increases in the quarter, related primarily to additional head count and corporate costs.

Our second quarter 2021 GAAP operating loss was \$7.9 million compared with a loss of \$8.1 million in Q1 of 2021 and a loss of \$7.8 million in Q2 of 2020. Our second quarter non-GAAP operating loss decreased to \$1.1 million compared with \$1.5 million in Q1 of 2021, driven primarily by improvements in gross margins.

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Consistent with prior quarters, 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 11% on a quarter-over-quarter basis and grew by 33% on a year-over-year basis. Adjusting for seasonality in our payments business, our quarter-over-quarter recurring revenue grew by 9%. Services and other decreased by 4% on a quarter-over-quarter basis, but increased 9% from an abnormally low services quarter in the year-ago period.

In Q2 of 2020, service delivery was impacted by the early days of the pandemic and the transition to remote work by our customers. Our current services backlog remains strong, and we expect our services revenue to increase slightly in the second half of the year due to the delivery of large state deals for our budget and grants management business units.

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

Continue to expect recurring revenue to grow in the mid to high 20% range for the year and expect our services and other revenue will grow by roughly low double digits compared with 2020. We will be delivering a large number of kiosks in the second half of the year, which will cause a temporary increase in our one-time revenue. Our recurring revenue growth should continue to be higher in percentage and dollar terms than service and other revenue as we continue to forecast growth in our base of subscription business.

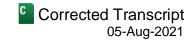
Taking a look at our balance sheet. There are three areas I would like to discuss. First, change in our receivables increased by \$1.3 million this quarter, driven by higher renewal invoicing. The second area is a decrease of \$300,000 in accounts payable and accruals in the quarter, primarily due to invoice timing. The third area is deferred revenue, which increased \$1.2 million, also due to renewal invoice timing. This increase represents the amount we've invoiced in excess of the amount of revenue we earned in the quarter.

From a cash perspective, start of the quarter was \$17.9 million and ended with \$15.4 million in cash. From an outflow perspective, our operating burn was roughly \$700,000 this quarter, a \$500,000 decrease from \$1.2 million in Q1 of 2021. We also paid out \$500,000 of interest in the quarter and the change in working capital was an additional \$1.2 million outflow. We completed the severance payments against our 2020 restructuring program last quarter. So that outflow is now behind us.

As you may recall, during the second quarter of 2020, we received \$3.1 million in loans as part of the Paycheck Protection Program. As announced at that time, those funds allowed us to limit our head count reductions and retain more of our very talented workforce. We're pleased to report that we fulfill the terms of the program and our loans were forgiven. Based on our reduced burn rate and our current forecast, we believe we have sufficient cash to support our growth initiatives as well as our ongoing operations through 2022 and beyond.

Turning to our outlook for the third quarter and full year 2021. For the third quarter of 2021, we expect total revenue to be in the range of \$15 million to \$15.5 million or approximately 20% year-over-year growth at the midpoint. For the full year 2021, we expect total revenue to be in the range of \$59 million to \$60.5 million or approximately 22% year-over-year growth. ARR is expected to grow faster than overall revenue growth as we continue to build our base of recurring business.

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As TJ mentioned, we're seeing some improvements in the market outlook, and we anticipate a modest level of increased investment in the coming quarters to support increasing demand. However, given the ramp time for our new resources, we don't expect to see any material benefits to our top line in 2021.

Given these investments, our operating expenses will be increasing as we move into the second half of the year to fund our 2022 growth initiatives. Obviously, this will affect our operating cash flow forecast for 2021, which we now expect to be negative in the \$1 million to \$2 million range depending on investment timing.

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

TJ Parass

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

Thank you, John. In summary, we are very pleased with our second quarter with GAAP revenues up 28% in the quarter and ARR growing 24% [ph] over year (00:19:16). As we enter the second half of the year, we are starting to feel the tailwind supporting our growth and look forward to increasing our investments to meet the needs of our customers in 2022 and beyond.

Thank you. Operator, please open the line for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question comes from Joshua Reilly from Needham & Company. Joshua, your line is now open. Please proceed with your question.

Joshua Reilly

Analyst, Needham & Co. LLC

Hey, guys. Congrats on the strong quarter. Thanks for taking my questions. Maybe let's start with some more color on the pushed deals that you mentioned into Q3. Which business unit were those deals in? Maybe how many were there? And was budget timing issue with closing the deals or was there some other factor?

TJ Parass

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

Hi, Josh. It's TJ here. Actually, it really does boil down to one deal, state-level deal with eCivis. It was well aligned for Q2, but the final contracting process just took a little longer than we anticipated, and it just pushed over to Q3. In fact, it closed in the first couple of weeks of Q3.

Joshua Reilly

Analyst, Needham & Co. LLC

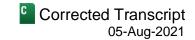
Okay, great. So, there was only one deal and it didn't seem to impact the Q2 numbers. So that's good. What are you seeing in terms of transactions bouncing back for CityBase? Can that materially impact growth in the second half, either positively or negatively depending on what happens with the Delta variants here?

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.



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Josh, it's John. Yeah, we've seen some recovery in transaction volumes in CityBase. I think it's still early, early days, but we have seen an improvement in Q2. That's part of kind of our stronger revenue story in the quarter. And as long as things hold up with – from a pandemic perspective, we anticipate that volumes will continue to recover in the second half.

Joshua Reilly

Analyst, Needham & Co. LLC

Okay, great. And then maybe just one more. Are you seeing any return of the face-to-face selling events like trade shows and demos, which I know are historically important to you guys before the pandemic?

And then second on that point, how can these impact your sales head count needs given you pare down maybe some of this personnel when the crisis started a couple years ago or last year?

TJ Parass

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

Right. A short answer to that, Josh, is that we're not seeing any significant return back to face-to-face, certainly not in the conferences and those kind of things. We have some business units that are back out traveling. We prefer to do as much of our selling we can face-to-face. However, we're still being quite effective on the phones.

And in terms of next year, we expect a little of that to recover and get back to a bit more of that. But in terms of our [ph] AEs (00:22:44), they're pretty effective selling out of their offices and homes offices. So, we're sticking with that plan for now.

Joshua Reilly

Analyst, Needham & Co. LLC

Got it. Thanks. I'll pass the queue here. Thanks, guys.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

Thanks, Josh.

TJ Parass

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

Thank you, Josh.

Operator: Thank you. Our next question comes from Jeff Van Rhee from Craig-Hallum Capital Group. Jeff, your line is now open. Please proceed with your question.

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

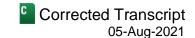
Great. Great. Thanks for taking the questions. Hi, guys. A couple for me. Maybe just on the bookings front, with that one transaction pushed. Had it closed in Q2, would we've been up in bookings for Q2 over Q1?

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.



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We would have – it's John. Hi, Jeff. We would have been, I guess to confirm – we still would have been a little behind Q1 had it closed in Q2.

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

Okay.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

As we mentioned, we also saw – Q1 was a good quarter because we saw North Dakota come forward into Q1. We were originally expecting that to close in Q2. So, it really made Q1 a tough compare. But with that deal that pushed into Q3, Q2 would be very consistent with our recent performance.

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

Yeah. You obviously messaged in a number of ways strength and conviction about the second half outlook in particular. You said, I think, pipeline, I think the words you might have used were substantially increased. Can you put a little more precision around that? I mean, quantifiably anecdotal, anything you can give us a sense of. What is this substantial? I mean, how much of a change is what you're seeing in the pipe for the second half versus maybe what you saw coming into, call it, the first half?

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

I'll take a crack at that, TJ. So, we're seeing – in terms of our forecast [ph] or commits (00:24:46) coming in from the sales teams, we're seeing that volume in the second half materially higher than the first half. Kind of a qualitative aspect of that, as you can imagine, again our branch management business with this additional stimulus funding coming into view, there's a significant interest in grant management, right? So that inbound interest from customers, that's one of those tailwinds that we've been talking about.

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

Okay. And then on the employee churn, I mean, obviously, it's tough to get the messaging around [ph] doing a lot of sales head and (00:25:30) adding infrastructure to go recruit them. And then, I think you also referenced somewhat higher than historical churn because of mobility workforce. Is that the gross churn in heads that you experienced, was it concentrated in any particular business segment?

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

We thought – obviously, we have – a couple of our business units that are materially larger than the others. So, obviously, on a numbers basis, the organization is seeing kind of a higher impact. But it's been pretty even between US and Canada is one data point. But we've seen attrition kind of across the business unit.

TJ Parass

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

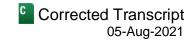
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Jeff, I would add the attrition – sorry. I would just add the attrition is up. It's in line with what [ph] being generally (00:26:22) in the tech sector, but we're intending to [ph] do really closely a lot of initiatives (00:26:27) in our HR to keep bringing in the bodies we need.

Jeff Van Rhee Analyst, Craig-Hallum Capital Group LLC	Q
Yeah.	
John J. Curran Chief Financial Officer, GTY Technology Holdings, Inc.	A
Yeah, we	
Jeff Van Rhee Analyst, Craig-Hallum Capital Group LLC	Q
Fair enough. And then just – no, go ahead, John.	
John J. Curran Chief Financial Officer, GTY Technology Holdings, Inc.	А
Yeah. We did net increase our head count in the quarter. We added 13 heads. So, we are interest, the ability to hire and bring in folks, which is going to really ramp up that effort given environment to be able to drive growth in our head count.	
Jeff Van Rhee Analyst, Craig-Hallum Capital Group LLC	Q
Got it. And then maybe just a very quick flyby of each of the businesses. I mean, those the sure in any given quarter, you see some exceed and some either meet or fall short of what Maybe a little color along those lines.	
John J. Curran Chief Financial Officer, GTY Technology Holdings, Inc.	A
Sure. So, Bonfire continues to kind of lead the pack. Their year-over-year growth was conwe saw in Q1. CityBase, as mentioned earlier, we're seeing their growth rates step up. It win terms of performance in the quarter. Budget consistently strong. That group is doing ve (00:27:52), they're doing – they're improving. Every quarter, they're getting better, but they our top three at this point. Permitting is continuing to kind of languish, I guess. So, I would slowly.	would be kind of second ry well. And [ph] grant is y haven't jumped up into
Jeff Van Rhee Analyst, Craig-Hallum Capital Group LLC	Q
Yeah. Okay. Fair enough. I'll leave it there. Thanks for taking my questions, guys. I appre	ciate it.
John J. Curran Chief Financial Officer, GTY Technology Holdings, Inc. Thanks, Jeff.	A

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TJ Parass

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

Thank you, Jeff.

Operator: [Operator Instructions] Just allow a few moments here for any last questions. We have another question from John (sic) [Jeff] (00:28:50) Van Rhee from Craig-Hallum Capital Group. Jeff, your line is now open. Please go ahead.

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

There we go. Yeah. There we go. Thanks. Yeah, I'll take another swing at it if nobody else is there. On the payments side, it's interesting. I think you mentioned Austin and Denver. You've made some bookings and you got a super compelling roster of wins that you're waiting on adoption. Just talk about anything we can read into those two [ph] funds (00:29:18) getting live and starting to ramp their volumes? Do you think the path from signing to actual ramping in usage and transactional volumes, is that timeline changing? Is your execution changing? I know you're changing contract structures, trying to drive faster adoption. Just maybe a little more color, particularly on payments.

TJ Parass

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

Hi, Jeff. Yeah, overall, looking at CityBase and the work they've been doing on, from signing to getting their customers up and running, has been improving significantly. They're really tightening up on how the builder [ph] is taking some (00:29:51) work, clarity on the various different pieces they have to put. They're working on onboarding pieces upfront and then continuing on versus trying to get everything up and running at once. So, be really good at it.

So, overall, we're seeing them shortening the cycle from sale to up and running. It's hard to draw like overall conclusion because each deal is different and the size of the deals are different, the amount of people they have. But if we think about from that first sale to the first set of transactions starting to flow through, the last couple that they've got up and running here have been in the six- to nine-month range, which is a significant improvement from the prior years.

Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

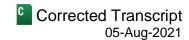
Yeah. And then, I guess just last for me then on the sales and sales execution side. I know it's something you watch and work on a lot. How would you grade the execution here, progress areas that need work? Just put it in context how you feel about the sales and sales execution.

TJ Parass

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

I think overall, we have work to be done, and there's always improvements. It's actually an area of focus as we've been working quite a bit in the last quarter on, is analysis and preparing for 2022. A lot of this is building into our plans and how we're going to expand our sales and marketing function. So, we've done a lot of analysis on that. Without getting down to breaking it down, I think we still have areas that we can improve on significantly, but it's a big area of focus for us.

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Jeff Van Rhee

Analyst, Craig-Hallum Capital Group LLC

Yeah. Okay. I'll leave it there. Thanks, guys.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

Thanks, Jeff.

A

Operator: There is no further questions on the line. I would now like to hand back to the host for any closing remarks.

John J. Curran

Chief Financial Officer, GTY Technology Holdings, Inc.

Yeah. We'd like to thank everyone for joining us today, and have a great rest of your evening. Thank you very much.

TJ Parass

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

Thank you, everyone. Take care.

Operator: This concludes today's call. Thank you for joining. You may now disconnect your lines.

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