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MARKET ANNOUNCEMENT
Investor Conference Call Transcript

Sydney, September 4, 2019 – Integrated Research ("IR") (**ASX: IRI**) advises the following is a transcript (excluding Q&A) of the Investor Conference Call held on 22 August 2019 at 9:00am. The Conference Call was conducted via the Open Briefing format of Orient Capital. *References to slides are to the slides contained in the Results Briefing released to the ASX on 22 August 2019*.

Start of Transcript

Operator: Thank you for standing by and welcome to the Integrated Research LTD Fiscal Year 19 Full Year Results Investor Conference Call. All participants are in a listen only mode. There will be a presentation, followed by a question and answer session. If you wish to ask a question, you will need to press the star key, followed by the number one on your telephone keypad. I would now like to hand the conference over to Mr John Ruthven CEO, and Peter Adams CFO. Please go ahead.

John Ruthven: Good morning and welcome to the FY19 results briefing for Integrated Research. My name is John Ruthven, and I am the CEO of IR. With my today is Peter Adams, our Chief Financial Officer, and previously the acting CEO for the second half of FY19. This morning we posted our results presentation to the ASX website, which I will be talking to during this call. Please take this opportunity to download the presentation, if you have not already done so.

The agenda for today's call will follow closely the presentation and I will refer to each slide as we progress. Firstly, I'll provide a summary overview on results, and a brief on my background and observations as the new CEO, and then Peter will take you through a detailed analysis of our financial results for FY19. We'll close out the session with a look at the key growth vectors for FY20, and finally take some of your questions. We anticipate the call will close at about 9:45am Sydney time. Please now move to slide 2, the key financial metrics.

We've delivered strong results in both revenue and net profit after tax. In fact revenue surpassed $100 million for the first time, coming in at $100.8 million, and exceeded $20 million NPAT for the first time, coming in at $21.9 million. Our total revenue was up 11% over the prior year of $91.2 million. This result was underpinned by very strong growth in licence sales, of $62.8 million, up 19% on the prior year. The quality of these earnings continues to improve, with the recurring portion up a further percentage point on the prior year, at 89%. Our profit after tax of $21.9 million, represents a 14% increase over the prior year.

Peter will talk shortly through the details and mechanics of these results. These strong results have been achieved at a time when we're also making strategic investment to drive long term sustainable growth. If you now move to slide 3, I thought I'd share with you some observations as the new CEO, literally day 34 on the job. These observations will also inform as to my decision to pursue the CEO opportunity at IR. I come from a strong background, with nearly 25 years in enterprise software across both infrastructure and applications. I've held global executive roles with large multinationals, including a four year posting in New York, a silicon valley pre-IPO start up, and most recently with an ASX listed software company TechnologyOne.

Over this time I've established an extensive global network of peers and customers, many of whom are IR customers and partners today. My success has been the unique leadership blend of people and technology. My conversations with the board during the extensive interview process galvanised my view that both my ambition and experience would be rewarded and valued at IR. Against this backdrop, let me share a few experiences and observations 30 days in.

IR is truly a global multinational, with an incredible customer base, and whilst in the US recently for our global kick-off, I extended the trip, as is my passion, and met with a number of customers, large global brands. It reinforced my view at IR's solutions are mission critical, the products are sticky, in software speak, and customer relationships are strong. Executive access with the customers is also very evident, with a clearly understood value proposition that extended to the customer's customer. Let me explain.

With a large payment [processor], much of the conversation was about how IR offered a differentiated experience for their customers who are big companies, some of the largest retailers on the planet. With a Unified Communications, or UC provider, it was about how IR is critical to the managed service that they provide to a large number of mid-market companies, and the experience that their customers' users and customers have on voice calls, or call centre interactions.

Interestingly, across three major product segments – Payments, UC, and Infrastructure – there is a trend of disruption, and what's exciting is that this disruption has the market moving towards IR. To our core capabilities of real-time assurance, and ultimately improving the customers' customer experience. The underlying market dynamics of increasing payment transaction volumes and call volumes, make IR's value proposition even more compelling, and when assessing our enviable market position, there are clearly understood vectors for growth. Whether applying a geographic, product, or usage filter.

The last of my observations is that we are investing, and well placed to innovate around our business model. Subscription revenue is a very small part of our mix today. We're developing our next gen platform, which will be cloud-based, and this provides us with an exciting opportunity to differentiate, not only from a technology standpoint, but with our business model as well.

If you move to slide 4, I want to share an anecdote from visiting customers on my recent trip. If you look at the slide it's a very impressive grouping of some of the world's best known brands. In fact, I met with four of those customers on the slide. One customer I met was a very large payment processor, and they process something like a third of all credit card transactions in the US, trillions of dollars. When you go into their operations centre and you look up at a massive ceiling to floor 20 metre wide screen, the whole screen is Prognosis. In fact, what you're watching live, are thousands of credit card transactions a minute, being processed by large retailers, all being monitored by our software. They use our software to differentiate their service to their customer. We're changing the experience for our customers' customer.

Let's move over to slide 5 and talk a bit about the IR opportunity. This slide is not a one year, or current year view. Rather it provides a perspective on the strategic planning horizon, that has two vectors for assessing growth, market and product. It's based on the well-known Ansoff model. Having achieved our first $100 million in annual review, our aspiration is to double that and to do that, we need to do three things, and do them really well. We need of course to maintain the base. As already described, we have such a large, high-quality customer base, with a retention rate of great than 95%. We have a coverage model that is designed to build and sustain high touch customer relationships, and is extended through partnerships to create reach.

To supplement the revenue in the base, there is an inherent growth in payment transactions, call volumes and the like, that achieve capacity growth. Added to this, we continue to innovate and bring new functionality onto the Prognosis platform.

Second, we need to grow the base, and we've invested in our product management leadership and capability significantly, to achieve a strategic approach to product lifecycle management. Not only does Prognosis remain mission critical and relevant for existing customers, 26 new logos were added in FY19. In fact, 28% of licence sales came from new business in FY19. Again, new modules like Merchant Portal and Dynamic Thresholds allow us to grow our revenue with existing customers. Increasingly, we're executing successfully on cross-sell, where customers now have at least two of our solution areas, across Payments, UC and Infrastructure.

And last, the next generation platform. Over the last 12 months we've been developing our next generation platform. It's a modern architected scalable platform, that allows us to extend our capability into new markets, as well as offering existing customers a path to cloud. We've developed this leveraging an agile and lean methodology, and expect to come to market with the first product in FY20. Importantly, our R&D gross spend, as a percent of revenue has remained at 19%. This is during a period that we have been developing the new platform, as well as keeping Prognosis current, with 11.7 expected in the first half of FY20, and 11.8 in the second half.

In addition to these three things, our coverage model and business model are enablers for growth. Our coverage model, where we continue to innovate the model to focus on new logo acquisition, increasing our field productivity, and to drive growth across all three of our regions, APAC , Europe and the US. Lastly our subscription revenue, over the strategic planning horizon, we anticipate a shift in what our revenue mix will be and we think it will move to subscription revenue. It's too early to be precise, but the planning is well underway, which will support innovation with our business model.

I ask you to move to slide 6 before I hand over to Peter, as I reflect on FY19 performance. A few things, mostly highlights. Payments growth in FY19 was outstanding, 92% up. Even when normalised over the last seven or so years, it's 25% CAGR. In FY19, nine new payments logos were added, including the third and ninth largest banks in the world. In fact 30% of payment licence fees came from new customers. UC was down 7%. This was disappointing and largely a result of patchy execution. Good news is it's in our control, and we've already started to address it. Our FY20 pipeline looks strong, and with new leadership in the US and Europe, we expect to be back on the growth path.

Europe was up 19%, as a result of new leadership, reorganising our coverage model to be more effective, and good execution on large deals. It's worth noting that in FY20 we've implemented new logo territories in Europe to really grow that business. Our customer events are called Summit, a great endorsement of the strength of our customers relationships and the engagement we have. A validation of this is their attendance at summit and last year that was up 36%. This year's events in the US are in October, and in Europe and the UK in November. Leadership talent. This was one of the key things that attracted me to joining IR. The leadership at a senior level is experienced, broadly skilled and very well balanced. Please now turn to slide 7 and I'll hand over Peter Adams to talk through the detailed financial. Over to you Peter.

Peter Adams: Thanks John. We are on slide 7, headed Results Summary. It gives me great pleasure to share in the message of achieving $100 million in revenue, and $21.9 million in profit. These numbers are more than double what they were seven years ago, and following a significant evolution of the business. The past is illustrative of our capability to move with changing market dynamics, and evolve to meet the needs of our customers. Comparing the current year results to the prior year provides an insight on the consistency in our margin performance. The company achieved a 10% increase in EBITDA to $40.2 million, and with that, retained an EBITDA margin of 40%.

The company achieved a 14% increase in net profit, to $21.9 million, and with that, a profit margin of 22%. This margin consistency incorporates an approach to development, spend, and a disciplined approach to opening new markets. You can see some of this longer term consistency in the 10 year analysis that is in the appendix of this presentation.

Cash generation was comparable to the prior year, at $21.2 million, with significantly less debtor factoring, which I'll talk about later. The board declared a fully frank final dividend of $0.0375 per share, taking total dividends for the year to $0.0725, compared to $0.065 for the prior year.

Slide 8 provides detail on our key performance metrics. These measures include term recurring revenue, new customers, pipeline renewals, and retention rates. Over 89% of our revenue was of a recurring nature. This number excludes one time through revenue, such as perpetual licence sales, and profession services. Term licence sales are recognised upfront in the year of sale, and have a recurring event at the commencement of each term. This intermittent recurring nature of the revenue creates some sort term cyclicality to the revenue streams, but with a 95% maintenance retention rate, provides management with confidence over the cycle.

For those that are interested, the appendix at the back of the presentation provides an alternate view of revenue performance, showing subscription revenue on a pro forma basis. As John mentioned earlier, the pipeline for Unified Communications renewals is stronger than the prior year, which provides a growth platform for the revenue stream going in to FY20.

Turning to slide 9, headed High Quality Revenues. This slide provides further insight into the diversity and commitment of the customer base. As can be seen from the chart on the left hand side, customers typically sign up for a three to five year period, on a term-based licence. The top 10 customers for FY19 represented less than one third of the company's overall revenue, demonstrating that singular customer dependency is of low risk. Airbus, Visa, Banner Health and Westpac, were some of the key deals closed in the second half, and demonstrate the diversity of business closed during that period, whether that be classified on industry, geography, or the products that were purchased.

Slide 10 provides the revenue contribution by geography. Starting from the left, the Americas remain the highest contributor to our overall revenues. The Americas' contribution was comparable to the prior year, and the results within the region were broadly mixed. Whilst Payments and Infrastructure revenues were up on last year, the Unified Communications numbers were disappointing, and provide an opportunity for improvement going into FY20. We're tagged line this slide, the return of Europe, with the middle chart demonstrating this fact. After a significant contribution in the first half, supported by the closure of the Barclaycard payment deal, the region continued its strong performance into the second half, to finish up 19% on the prior year.

Worthy of call out is the Airbus deal, that was a Unified Communications deal, closed early in the second half. The European business is now under new leadership, and we believe there is opportunity to grow the business over the coming year, to which John has already referenced.

Asia-Pacific has achieved consistent growth for several years, and FY19 was no different. Revenue growth for FY19 was 14% up over the prior year, driven primarily through Payments and Infrastructure sales. The strong result was achieved from a combination of account management, through renewal and capacity selling, but more importantly, signing new customers.

Turing to slide 11, we see the revenue by product portfolio. Revenue from Payments grew 92% over the prior year, to $16 million. We saw a continuation of growth form the first half, in to the second, with contributions to the product line from every region. The grown rate of 92% easily outstripped the Infrastructure growth rate, illustrating the performance was more than a cyclical upswing. Importantly, nine new customers were added to the fold. New business represents over 30% of overall licence numbers, to which John has already referenced.

Unified Communications revenues were down 7%, to $51 million, when compared to the prior year. Similar to the themes communicated at the half year, we saw growth in Cisco being more than offset by declines in Avaya and Microsoft. The overall portfolio is now much more weighted to Cisco than Microsoft and Avaya. This fact, combined with a stronger renewals pipeline, bodes well for the coming year, to which we are anticipating a stronger performance. Revenue from Infrastructure grew 20% over the prior year, to $26.3 million, and predominantly represents renewal and capacity sales. The product line continues to be a strong source of cash flow, with strong margins.

The company's balance sheet, presented on slide 12, shows cash at bank of $9.3 million, with no debt. The accounts receivable balance of $72.8 million provides a rich source of future cash flow, bearing in mind the high quality customer base, and the relatively low experience of historical doubtful debt write-offs.

Turing to the cash flow on slide 13. Cash flow from operating activities of $21.2 million, was comparable to the prior year, but with much less debtor factoring. The top line of cash flow shows cash receipt from customers, excluding debtor factoring, up 22% to $84.4 million. Debtor factoring is used by the company to manage credit risk and improve working capital. Cash flows from operating activities continues to fund the investment into development, as well as provide a regular dividend to shareholders. I would be happy to take questions on the numbers towards the end of the call but for now, I will pass back to John to talk about the FY20 growth drivers and to close out the formal part of the presentation.

John Ruthven: Thank you, Peter. Let's move to slide 14, titled 2020 Key Drivers. You'll notice a commonality with slide 5, where we use the same model to describe our growth vectors or how we think about growth. Quarter of our growth in FY20 will be maintaining our base, with high confidence that our retention rates will remain greater than 95%. In FY20, the renewals component of our pipeline is up on last year and our underlying market growth in payment transaction volumes of 14% and [end nodes] of 3% provides further confidence that renewals can be supplemented with capacity and additional modules and will be a strong foundation for growth in FY20. New modules like Merchant Portal and Dynamic Thresholds currently have low customer penetration and offer good up-sale.

We also expect a turnaround in UC in FY20, with a refocused field execution. As Peter has already mentioned, the renewals pipeline is stronger than last year and, in both Europe and the US, new leadership's in place, our coverage model has been enhanced to improve our deal qualification and closure. A large percentage of our UC is in fact is conducted through and with large service providers and partners. This is a broad category of companies including names like Cisco, Avaya, BT, Dimension Data and many others. We conduct business in two principal ways through these channels. Firstly, manage services and second, resale. Depending on the service provider or partner, we have tailored programs for their go-to-market model where IR solutions are included in a managed service offering that they provide directly to their customers. In re-sell, IR products are included in the partners' price book and sold in conjunction with a broader sale that they conclude with their customer.

The pipeline and outlook for both managed services and re-sell is up on prior years, including the renewal and extension of some larger contracts or agreements that fall due within FY20. Whilst we acknowledge a competitive environment, our new logo prospects are good in FY20. Coming into the year, over 30% of pipeline relates to new customer opportunities. Increasing complexity in customer environments in both payments and UC amplifies the value proposition for prognosis. To capitalise on this, enhancements to our coverage model in both Europe and the US have been implemented, along with new leadership in place to drive focus. In Europe, as I said earlier, we've actually put in place dedicated new business territories and teams.

In summary, our UC and payments networks across the globe are becoming more pervasive, more mission critical and complex and as such, they require effective performance and user experience management. This generates demand for solutions such as prognosis. We expect to benefit from this, in terms of future growth. IR plays a critical role in creating clarity and insight in a world of connected devices.

This concludes the formal part of today's presentation and we'll now turn it over to the moderator to take questions.

End of Transcript

By authority of the Board,

David Purdue
Company Secretary
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About Integrated Research Limited (ASX:IRI), Integrated Research the leading global provider of proactive performance management software for critical IT infrastructure, payments and communications ecosystems. More than 1200 organizations in over 60 countries—including some of the world's largest banks, airlines and telecommunication companies rely on IR Prognosis to provide business critical insights and ensure continuity-critical systems deliver high availability and performance for millions of their customers across the globe.
For further information on IR, visit www.ir.com.

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