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ASX Market Announcements Office
FY23 Earnings Conference Call Transcript

Integrated Research Limited (ASX:IRI), encloses for release a transcript of the FY23 Earnings Conference Call held on 25 August 2023.

By authority of the Board

Will Witherow
Company Secretary
Integrated Research Limited
ABN: 76 003 588 449

MARKET ANNOUNCEMENT

Investor Conference Call Transcript

Sydney, August 30, 2023 – Integrated Research (“IR”) (**ASX: IRI**) advises the following is a transcript (excluding Q&A) of the Investor Conference Call held on Friday 25 August 2023 at 10:30am. The Conference Call was conducted via the Open Briefing format of Orient Capital. *References to slides are to the slides contained in the Results Presentation released to the ASX on 25 August 2023*.

Start of Transcript

Operator: Hello, and welcome to the Integrated Research Limited Fiscal Year ‘23 Results Investor Conference call. All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question and answer session. If you would like to ask a question during this time, simply press star one on your telephone keypad. If you would like to withdraw your question, again, press star one. I'll now turn the conference over to John Ruthven. Please go ahead.

John Ruthven: Thank you, Operator. Good morning and welcome to the Full Year FY23 Results Briefing for Integrated Research. My name is John Ruthven and I am the CEO of IR. With me today is Matthew Walton, our CFO. I will open the presentation and then hand to Matthew to take us through a detailed financial review. He will then hand back to me to talk through strategy and key priorities for FY24. At the conclusion of the presentation, we'll open the call for questions.

This morning we posted our results presentation to the ASX website, which we will be referring to during this call. You can also find a copy of it in the Investor Relations section of our website at ir.com.

Moving to slide 2. Integrated Research or IR as we’re better known, is a global software company providing performance and experience monitoring solutions for critical business systems. We have three product lines, Collaborate for Unified Communications and UCaaS or Unified Communications as a Service, Transact, which sits in the payment space, and our Infrastructure product for Hewlett Packard Enterprise or HPE NonStop environments. Common to the customer use cases that we support are complexity, mission criticality, and scale.

Slide 3 highlights the underlying strength of IR’s business model, our customer base. These customers are large, well-known global enterprises in key industries including technology, telecommunications, financial services, government, healthcare, higher education, retail, and industrial services. Our customer base is long-tenured, on long-dated non-cancellable contracts with mission-critical requirements.

On slide 4, CEO key messages. Reflecting on the full year, we had an improved TCV performance across all geographies and product lines underpinned by a stronger renewal cycle and improved sales discipline. That said, we have work to do with our new business execution across both sales and product.

We've trimmed our R&D expenditure and increased our focus on getting sales traction with products that have been developed in recent years.
Across the board, we've exercised greater discipline in managing our cost base.

Our three-phase strategy continues whilst we extend the execution phase to focus on getting business fundamentals right, before scale. In this process, we continue to refine our GTM or Go-To-Market model.

Cash at bank was up strongly on the back of good collections discipline, and a reduction in our DSO or Day Sales Outstanding. That said, we expect the cash balance to pull back a little in the first half because of the seasonality in our business and the weighting of renewals to the second half. We have no debt and no debtor factoring was undertaken in the fiscal year.

On slide 5, we summarise our statutory results. The Company achieved normalised profit after tax for the year of $2.6 million, excluding a non-cash impairment charge resulting from impairment assessment forecast reflecting current trends in new business, renewals and expense growth.

Statutory revenue for the period was $69.8 million, up 11% over the prior year. The strong performance was the consequence of improved sales execution, a larger renewal book, and healthier external trading conditions. The FY23 licensed renewal book grew by 10% or $4 million through price increases accounting for $3 million and term extensions accounting for $1 million.

Cash receipts from customers totalled $76.3 million up 1% over the prior period. The Company continues to benefit from term-based non-cancellable license contracts with a high-quality customer base, the increase in cash receipts and increase in cash at bank, which continues due to a strong focus on cash management.

Now on slide 6 and switching to proforma results. The lead performance indicator, Total Contract Value or TCV was $68.5 million for the year, up 21% on the prior corresponding period. We continue to report revenue on a proforma subscription basis, which while the lag measure, we believe is more reflective of the long-term underlying performance of the business.

Subscription revenues for the period was $68.3 million, marginally down as a result of lower new client sales and lost clients from FY22 and FY23.

Revenue from testing solutions and services contributed to the period-on-period decrease in total proforma revenue as the year had a large renewal focus.

Proforma EBITDA dropped 28% as a result of lower revenue and cost increases due to inflationary pressure, and a one-off US loan forgiveness in FY22. Our cash conversion rate for the year improved to 101% as a result of the strong cash collection in the year.

Moving to the FY23 progress report on slide 7. Prior to handing over to Matthew to provide an in-depth look at our financial results, I'd like to provide a progress update of sorts as we've done in prior periods. Critical to our turnaround is getting our largest geographic region, the Americas, growing again. Whilst it’s modest, TCV was up 5% pcp and heading in the right direction.

Europe too continued its return to growth up 18% pcp. APAC continued its strong growth trajectory up 36%.

Critical to our strategy is getting a return on the investment we have made in bringing new products to market and getting them into the hands of our customers. In this area, we are behind plan and are taking steps with both our GTM and sales execution to address. Whilst we've achieved some early wins, momentum is slow.

Our Transact portfolio continues to achieve high customer retention and contract terms close to five years. By contrast, Collaborate retention rates are more challenged and contract terms closer to three years. The challenge of vendor tools in customers' cloud migration continues and has placed pressure on our Collaborate renewals.

Through the second half of FY23, we reset our product and development strategy to align to customer-driven demand and near-term opportunities. The reality of this is smaller pieces of work, and in many cases, more of a co-development approach working closely with customers on specifications. It has also resulted in increased innovation on our on-premises or server platform.

Our balance sheet remains debt free with an improved cash position at the end of the year, part of our drive to improve our overall working capital position. I'll now hand over to Matthew to take us through a detailed review of our financial performance.

Matthew Walton: Thank you, John. We're now on slide 9. Slide 9 shows the linkage between Total Contract Value, statutory revenue, proforma revenue, and annual recurring revenue. It's worth unpicking these for a moment.

Total Contract Value, the black line is the total value of revenue-generating contract written in the year. This includes software license and related maintenance, cloud, testing and consulting services revenue. TCV is a function of the term of the contract and annual value of the contract. For example, TCV can reduce significantly if the term is reduced even though the annual value of the license subscription has increased.

Statutory revenue, the red line is revenue recognised per the accounting standard. This has strong upfront revenue recognition with less revenue recognised over the life of the contract. As a consequence, there is strong alignment with TCV.

Proforma subscription revenue, the middle blue bar is the license and maintenance revenue from the contract spread over the life of the contract. It's a non-statutory and unaudited view that we believe better represents the recurring nature of the contracted revenue streams.

Proforma revenue, the left purple bar is proforma subscription revenue plus other non-recurring revenue streams, typically professional services and one-time through testing services.

Recurring revenue, the grey bar is the annualised end-of-period subscription revenue, and best represents the ongoing recurring value in the revenue stream. This chart highlights that while there is more volatility in TCV and statutory revenue, there is more consistency in the revenue streams over time as represented by proforma and annual recurring revenue.

Two key points to address in this slide are the convergence of TCV and statutory revenue, which is driven by the shift to SaaS with less upfront revenue recognition. Secondly, the recent stability of proforma/ARR compared to the volatility of the lead indicators of TCV/Statutory revenue, which shows that the growth of proforma/ ARR occurs as new clients TCV are added to the renewal base. The renewal base is extended through price increase, and this offsets any lost revenue through client exits and downsell adjusted for any foreign exchange movement.

If we turn now to slide 10. Slide 10 presents our TCV, Statutory revenue, Proforma subscription revenue and Annual Recurring Revenue by geographic region and by product set. This slide should be considered in conjunction with more detailed slides in the appendix.

Points to highlight include the Asia Pacific chart, clearly shows consistently strong Proforma and ARR growth of 9% on a five-year CAGR. The Asia Pacific growth was across all products and new business and renewals, improving Collaborate renewal period, including a significant growth in the contract term. New transact sales will grow future proforma revenue and ARR, and new leadership in the Americas and Europe is driving licensed TCV growth.

If we turn now to slide 11. This slide focuses on the key metric underpinning value, namely the change in the components of recurring revenue. Total ARR or Annual Recurring Revenue declined by 1% to $67.5 million.

New logos in Collaborate and Transact, Upsell in Collaborate from new capacity and price increases and favourable foreign exchange were overshadowed by the loss of clients and downsell (price reductions) in Collaborate.

Collaborate is experiencing headwinds in all geographies, further information is in the appendix.

We turn to slide 12, operating costs excluding the impairment. Turning to slide 12, IR has continued to manage costs tightly. While costs have increased 2% on the prior period, this is down 5% in the increase that we had at the half as a result of inflationary pressures offset by managing our headcount.

National attrition continued through the period as the market for technology staff was competitive, and pleasingly IR was able to replace all critical roles quickly with high calibre candidates.

Our innovation agenda continues as illustrated by the left-hand chart. The jump in product and technology expenditure primarily reflects a lower level of capitalisation as we reset our investment in our cloud platform, balanced with customer-driven solutions focused on near-term opportunities.

As covered in the first half, for sales and marketing, while our headcount is lower than in FY22, this is offset by increased travel costs as customer face-to-face meetings and marketing events have returned and some upward pressure on remuneration.

The Company's general and administration expense increased with costs incurred in retaining and recruiting staff in a competitive market.

Slide 13, we looked at the full year performance review and some further key metrics. The additional metrics in this slide underpinning value are the level of recurring revenue, the contract length and the proportion of new business to renewals in the period.

Recurring revenue has nominally increased as a proportion over the prior period. If we normalised for the same level of testing and services revenue non-recurring, we've actually stayed consistent - our recurring revenue's consistent at 86% of the proforma revenue.

Contract length has improved over the prior period with the average length of the contract written in a year increasing to three years up from 2.6 years in the prior corresponding period. Renewals dominated the year with $41 million in renewed TCV up from $25.5 million in the prior year.

If we turn to slide 14, net cashflow analysis. Cashflow is illustrated in this slide with cash at bank increasing $6.3 million or 51% over the year. Significant focus was paid to collecting long overdue balances, and this is highlighted in note 11 of the accounts with receivables past 60 days due to being less than 20% of the prior period.

Cash paid to employees and invested in development reduced compared to last year. Finally, FY22 cash included the repayment of $5.3 million of borrowings. The Company believes we have appropriate cash reserves to manage the cyclical nature of our business.

Slide 15, EBITDA cashflow bridge. While the Company had statutory EBITDA of $12.1 million, $1.6 million of cash was generated from operations. The primary drivers of this difference are over time revenue and cash conversion compared to statutory upfront revenue recognition combined with improvements in working capital of $0.6 million as a result of improved collections, offsetting historic debtor factoring of $2.7 million, which concludes in December and income tax paid.

We should emphasize, the Company is not factoring any receivables, and the current factoring completes in December 2023.

We turn to slide 16. The balance sheet shown on this slide shows a 31% decline in net assets, a result of the $31.8 million impairment of goodwill and intangible assets.

Cash and trade receivables increased $1 million on the prior year while payables are down $2.2 million. Receivables remain a strong source of cashflow in the current and future years. The Company remains debt free.

I'll now pass back to John for the rest of the presentation.

John Ruthven: Thank you, Matthew. Moving to strategy on slide 18. Our three-phase strategy of innovation, execution and scale remains intact, albeit with an extended execution phase. As discussed throughout today's presentation, there's a strong focus on strengthening our business fundamentals. Our strategy remains focused on our core markets of Collaborate and Transact and Infrastructure, acknowledging the close linkage between our Transact and Infrastructure business.

The core focus of the execution phase is to enhance our ability to win new business, both new customers and new products to existing customers. Key to doing this in our Collaborate business is to focus on large, complex, multi-vendor enterprises where our value proposition and price point resonate more strongly.

Also, enterprises where there will be a longer tail for on-premises, our traditional business, these include organisations like large critical healthcare providers, higher education institutions and law enforcement. To accelerate our innovation for these customers, we often work in a co-development engagement, smaller targeted pieces of work.

Two significant drivers of demand for Transact are compliance and real-time payments. ISO 20022, an electronic messaging global standard for financial information is driving compliance issues for large financial institutions and payment processes.

For some years now, countries have been rolling out real-time payment schemes, creating new challenges for monitoring and managing these rails. We are targeting customers and prospects with existing products and value-added services to address these challenges.

Now on slide 19, core to our Collaborate strategy and roadmap is the customer journey. This is a market segment that has been going through significant disruption for a number of years. Not just the structural market change of work from home, but the rapid innovation in the applications, infrastructure and devices that define the collaboration space.

Three major challenges we are facing, (a) customers moving away from their on-premises infrastructure, our core strength, (b) vendor tools for cloud-based deployments, and (c) data limitations from vendor APIs. To address this, we are leveraging our extensive large enterprise customer base where the average number of seats is greater than 25,000.

Our GTM is focused on large multi-vendor customers and prospects where scale and complexity play to our core strengths and price point. We can grow with customers through renewal yield, upsell of seats, and new products. To deliver on this, we've refocused our product investment to differentiate from vendor tools or simply stated as value beyond the vendor tools and working with vendors on migration assurance.

On slide 20, we take a look at the Transact and Infrastructure strategy and roadmap. The Transact and Infrastructure segment is a curious dichotomy of systems, processes, and infrastructure that have been around for 40 years, and rapid disruption with modern payment methods driven by customer experience. This is capped off with a demanding compliance, standards and services level environment with serious penalties for breach or failures, and a large dominant vendor landscape.

The challenges for IR reflect this dichotomy, (a) customers are slow to adopt new products, (b) it's difficult to project how the segment evolves with cloud, (c) aligning to large vendor priorities that can be difficult, and (d), in a dynamic market, new competition emerges.

To address these challenges, we've rebalanced our GTM to align with our customer's journey more closely. We'll benefit from the long tail of on-premises, our core strength. At the same time, we're broadening our monitoring strategy to an ecosystem play to increase our value proposition, and leveraging targeted co-development opportunities with key customers to better align to near-term opportunities.

Moving to slide 21, Collaborate customer wins. In June, we closed a significant new customer opportunity with Stutter Health based in California. They're a large not-for-profit integrated health provider with over 53,000 employees. They have a large multi-vendor environment, and have previously been using Cisco's Prime Collaboration Assurance or PCA, which is at end-of-life.

They licensed our complete Cisco product set as well as our MS Teams solution. In the critical world of health services delivery, they lacked the end-to-end visibility across a complex environment of video, room and network endpoints, making it difficult to identify and troubleshoot issues.

Cigna Healthcare has been an IR customer for more than 10 years, leveraging our full suite of Cisco products to monitor and troubleshoot their critical voice and video environment. Several years ago, they acquired a large organisation and recently made the strategic decision to consolidate the two collaboration environments and standardise on IR.

Critical to this process is migration assurance, and our new agreement gives them the tools and the capacity to do this. Growing our license from 80,000 seats to 135,000 seats and extending the term for another three years.

In our prior earnings, we disclosed a significant new customer win with LANcom, a large service provider in Taiwan for 120,000 users supporting their Cisco on-premises users. In March, we expanded this agreement to 250,000 users adding additional vendors of Avaya, MS teams and Cisco Webex. They now have a single enterprise-wide solution for their operations teams with monitoring tools that provide proactive alerting, troubleshooting, and resolution.

On slide 22, we now look at a couple of key Transact customer wins. Earlier, I talked about countries rolling out real -time payment schemes and modernising their payment platforms. Qatar Central Bank or QCB is in the process of doing so, including adding new payment types and services. We signed a five-year agreement with the bank for a holistic monitoring solution across Cards, Real-Time and NonStop. This will provide QCB with rapid notification of issues so that their scheme partners are aware prior to customer escalations.

A core strength of our customer base is the longstanding nature of our customer relationships. Evertec, a large payment processor in Puerto Rico has been an IR customer since 2004. Earlier this year we signed a new five-year renewal for our solutions to continue to provide visibility across the full-service transaction processing environment, merchant acquiring, payment processing, and business solutions for over $2.5 billion transactions annually.

On slide 23, we break out the R&D spend across the key product and platform categories. In FY23, 67% of R&D was spent on SaaS, hybrid and platform. Going into FY24, we've adopted a more balanced approach to innovation investment. We’re moving to a focused customer-driven approach with smaller pieces of work to deliver on near-term opportunities. The outworking of this is that we will reduce spend by about 50% to $7.5 million.

Slide 25 captures our priorities going into FY24. There is not too much change from FY23, a clear and consistent set of priorities as we work hard to continue the business growth trajectory. (1), [field] leadership in all three regions continue their focus on improved sales discipline, renewal yield, and new business pipeline. We’re confident in the plans we have in place, the design of the GTM model and leadership's commitment to growth. (2), we've rolled out a commission plan that rewards new. There is a foundation of new pipeline, but we need more, and we’re working with an external Company to embed a funnel plan approach to build new customer pipeline. (3), the renewal book is stronger in FY24 and is expected to benefit from the processes, cadence and discipline implemented in FY23. We’re very focused on some of the challenges impacting Collaborate renewals.

In FY23, we flexed our approach to innovation and R&D spend. We will benefit from this approach in FY24 with customer-driven solutions, co-development with customers and vendors, and a near-term focus. (5), our cash position has strengthened. We have done some balance sheet repair. Through prudent cost management and operational performance, we'll continue the improvement of the Company's working capital position to fund growth.

Coming to the final slide, I would now like to remind you that IR does not provide specific guidance. However, coming into FY24, we make the following observations to inform the market. (1) customer sentiment is steady and we're not encountering budgets being cut or withdrawn. In the same way that we're focused on cost management, many of our customers have adopted that approach as well.

(2), we've entered FY24 with a stronger renewal book over the prior period, which is weighted to the second half and skewed to the Collaborate product line. We do have a number of significant renewals in June of our second half. We expect Collaborate churn to remain with customers migrating to UCaaS-based infrastructure.

(3), we entered FY24 with pipeline that was broadly flat over the same time last year. Our focus on larger enterprises is evident in the pipeline mix. (5), we expect growth in all regions with stronger growth in the Americas and Europe coming off lower bases. (6), delivering into our plan, we will see an improved cash balance at year-end based on higher sales, cost management and ongoing collections focus.

Operator, that concludes the presentation.

End of Transcript

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