ISSUERDIRECT
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Transcript of Issuer Direct
Third Quarter 2017 Earnings Call
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Participants

Steven Knerr – Chief Financial Officer
Brian Balbirnie – Chief Executive Officer

Analysts

Miles Jennings

Presentation

Operator
Good day, ladies and gentlemen, and welcome to the Issuer Direct Third Quarter 2017 Earnings Call. All lines have been placed on a listen-only mode, and the floor will be opened for your questions and comments following the presentation. [Operator instructions].

At this time, it is my pleasure to turn the floor over to your host, Steve Knerr. Sir, the floor is yours.

Steven Knerr – Chief Financial Officer
Thank you, and good afternoon, everyone. Before we begin, I need to read the following Safe Harbor statement. Statements or comments made on this conference call may be forward-looking statements that include financial projections or other statements of the Company's plans, objectives, expectations or intentions. These matters involve certain risks and uncertainties. Our actual results may differ significantly from those projected or suggested in any forward-looking statement due to a variety of factors, which are discussed in detail in our recent SEC filings.

Further, we'll discuss both GAAP and non-GAAP financial information on this call. We believe the presentation of non-GAAP information provides you with useful supplementary data concerning the Company's ongoing operations and is an appropriate way for you to evaluate the Company's performance. Non-GAAP results are, however, provided for informational purposes only. Please refer to the press release and related tables for GAAP information and a reconciliation of GAAP to non-GAAP information. We also posted to our website, in our Investor Relations tab, a description as well as reconciliation of GAAP measures to which we will refer on this call.

With that out of the way, I'll begin by going over our results for the quarter, and then turn it over to Brian, who will provide an operational review and outlook and discuss some of our recent announcements, followed by a Q&A session.

The third quarter was another positive quarter for Issuer Direct, as we continue our transition from a services organization to a platform first engagement. Total revenue increased 2% to $2,931,000 for the third quarter of 2017 as compared to the same period of the prior year. Revenue of $9,229,000 for the nine months ended September 30, 2017 decreased 1% compared to the same period of 2016.

However, it is important to note that revenue for the nine months ended September 30, 2016, included a one-time benefit of $316,000, due to the reversal of an accrual related to unused postage credits for ARS customers acquired as part of the acquisition of PrecisionIR. Excluding this one-time benefit, total revenue for the nine months ended September 30, 2017 would have increased 3% over the same period of the prior year.

Leading the way again was revenue from our Platform and Technology business, which increased $584,000, or 56%, to $1,619,000 during the third quarter of 2017 and increased $1,628,000, or 52%, to $4,736,000 for the nine months ended September 30, 2017. Platform and Technology revenue increased to 55% of our total revenue for the quarter compared to 36% during the third quarter of last year, as we continue to focus on driving revenue on our high margin cloud-based platform.

As with previous quarters, Accesswire is the main driver of the increase, as revenue increased 93% for both the three and nine months ended September 30, 2017, over the same periods of 2016. During the quarter and throughout the remainder of 2017, we had and will continue to make strategic enhancements to this product as well as invest in additional sales staff. We also experienced increased revenue from licensing of other components within our Platform, most notably our transfer agent, whistleblower, Blueprint, Classify and webcasting platforms. In a few minutes, Brian will talk about further development of our cloud-based platform.

Services revenue decreased by $526,000, or 29%, to $1,312,000 during the third quarter of 2017 and $1,683,000, or 27%, to $4,493,000, during the nine months ended September 30, 2017 compared to the same periods of the prior year. The decreases are primarily the result of a decrease in revenue from our legacy Annual Report Service due in part to continued attrition, as customers leave the service, decrease hard copy requirements, or transition to electronic delivery. On a year-to-date basis, the decrease is also attributable to the one-time benefit of $316,000 included in the revenue for the nine months ended September 30, 2016, which I noted earlier.

Our print and proxy distribution services also declined for the three and nine months ended September 30, 2017 as compared to the prior year, due to the timing of certain projects and the impact of one-time projects that occurred in 2016. In addition, we continue to experience a decline in revenue from our compliance services, as the market commoditizes and we continue to face pricing pressure. Overall, gross margin percentage was 72% and 73% for the three and nine months ended September 30, 2017, respectively, compared to 74% and 75% for the same periods of the prior year.

While Platform and Technology gross margins remained strong at 82% and 83% for the three and nine months ended September 30, 2017, respectively, we did experience some decline in our services margin. Gross margin from our services revenue stream was 60% and 63% for both the three and nine month periods ended September 30, 2017, compared to 70% and 71% during the same periods of 2016, respectively. The decrease in gross margin was due to lower revenue associated with the fixed cost of delivering ARS, print, proxy and stock transfer services.

Operating expenses decreased $211,000 and $335,000 during the three and nine months ended September 30, 2017, respectively, as compared to the same periods of the prior year, primarily as a result of a decrease in amortization costs due to certain intangible assets which became fully amortized during 2016.

Partially offsetting this decrease was an increase in product development expenses. As we continue to refine and improve our cloud-based platform, we expect to see this line slightly increase, however, see an offset on the cash expenditures that are capitalized.

During the three and nine month periods ended September 30, 2017 we capitalized an additional $269,000 and $948,000, respectively, primarily related to the development of Blueprint. For GAAP purposes, we recorded net income of $308,000, or $0.10 per diluted share for the third quarter of 2017, as compared to net income of $195,000, or $0.07 per diluted share for the same period of 2016.

For the nine-month period ended September 30, 2017 net income was $1,126,000, or $0.37 per diluted share, compared to $1,045,000, or $0.36 per diluted share, for the same period of 2016.

Looking at some non-GAAP metrics. Non-GAAP net income was $445,000, or $0.15 per diluted share for Q3 2017, compared to $393,000, or $0.13 per diluted share, for the same period of 2016. Non-GAAP net income for the nine months ended September 30, 2017 was $1,441,000, or $0.48 per diluted share, as compared to $1,485,000, or $0.51 per diluted share, for the same period of 2016.

As a percentage of revenue, EBITDA was 23%, or $663,000 for the third quarter of 2017, compared to 19% or $550,000 in the prior year, with an increase being primarily attributable to lower operating costs. For the nine months ended September 30, 2017 EBITDA percentage was 23%, or $2,093,000, compared to 26%, or $2,426,000 for the same period of the prior year. Excluding the one-time benefit noted earlier, EBITDA percentage would have been 24%, or $2,110,000 for the nine months ended September 30, 2016.

Moving to the cash flow statement, we continue to focus on generating positive cash flow from operations, as we generated $638,000 during the third quarter of 2017, increasing our cash balance to over $6.4 million as of September 30, 2017. Additionally, on October 10 our board of directors declared a quarterly cash dividend of $0.05 per share, making it our ninth consecutive quarter for paying dividends.

Lastly, I would like to touch on the acquisition of Interwest Transfer Company, which we are excited to have completed on October 2 and welcome our new family to the team. So far the integration of staff, processes and customer information has gone well. We expect the transition to be immediately accretive to revenue, net income and EBITDA.

Not only does the acquisition more than double the size of our current stock transfer business, it also affords us the opportunity to strengthen our platform customer base in offering our single-source, consolidated disclosure and communication offerings to the Interwest customers.

I will now turn it over to Brian, who will discuss more about the acquisition, operational strategies, and product enhancements, as well as the strategic alliance we announced yesterday.

Brian Balbirnie – Chief Executive Officer
Thank you, Steve. Good afternoon, everyone. The third quarter ended in a fair bit of activity for us, all of which I'd like to talk about today as best we can. On October 2 of this year we announced the acquisition of Interwest Transfer, and just yesterday we announced the strategic alliance with OTC Markets. Plus, we've been hard at work in expanding our Accesswire distribution and enhancing the unique content prospects of our real-time engagement analytics business for next year.

But before I go into the details, perhaps I'll quickly recap part of what Steve just covered. On a year-over-year basis revenue increased 2% for the third quarter this year, and on a standalone basis our Platform business increased 56% year-over-year. Also, something we have been messaging is the explanation of our Platform business growing beyond where it has been this year, and we're happy to report that our Platform business accounted for 55% of our overall third quarter revenues, compared to just 36% last year same period, and on a sequential basis it's up 5.5%, from 49.5% in Q2.

We believe we can continue to make additional gains here in the last quarter of the year and all of next year. Even though our service businesses continue to see declines, we remain confident in our ability to continue to transition and grow our overall Platform business, which will have a positive impact on our overall revenues.

I also think as we mature the business even more, which means some refinement of offerings, we will see less and less seasonality. For the third quarter of this year, we saw marginal client growth similar to our year-over-year revenues, and our Platform growth came in at 3% higher, coming in at 1,582 compared to 1,533 clients the same period last year, and 1,854 in Q2 of this year.
Our Services business still continues to see similar attrition as we've seen in previous periods, 493 customers utilized our service offerings during the period, compared to 554 for the same period last year, and 622 in Q2 of this year. As I just mentioned, seasonality still affects our sequential numbers, as most of the industry completes the majority of their regulatory and communication requirements in the first half of the fiscal year.

Now, I would like to explain upon a few areas I just mentioned a few minutes ago. In September, we announced the upgrade of our regulatory filing software that included in-line packing processes as well as the compatibility to meet IFRS foreign filing requirements for this coming year. This advancement puts Issuer Direct in the same company with only a handful of software or cloud-based platforms that today have complete EDGARIzation XBRL, in-line XBRL and IFRS tools.

That in itself is an accomplishment to our overall development efforts. But what makes this even more interesting, and we're about to see this in the long term of our product, is that our regulatory platform is the only system connected to the SEC EDGAR filing platform through a North American newswire, Accesswire, and to a complete communications and target platform that manages the events of a public company to the exchanges in the marketplaces globally.

As most of you know that follow our company, we're not only building a single-point solution, like Google or SharePoint dependencies or other collaboration engines, our platform is agnostic and completely self-contained. And that's just one of our competitive advantages that we feel strongly and excited about.

During the third quarter, we continued to move forward with our global distribution efforts with Accesswire. Q2 is the beginning of this initiative, and something that we talked about in our last call, and the team continues to be hard at work in these efforts. I'm happy to report these new distribution points, as well as an entirely new Accesswire experience, will be available to our clients during this quarter. This is something that we needed to have. It's not that the business isn't growing, it is, and we're all seeing that obviously, it's more about the foundation that we're building today that will carry us into the future even stronger for tomorrow.

Part of our platform upgrade will address our previously mentioned targeting and cross-selling options, whereby new customers will be able to add newsrooms, webcasts, trade and industry targeting from our Investor Network. We are excited to see the ARPU expand here as we gear up to move into our new business and a complete subscription model in the coming year. By moving forward with the subscription model, we will see less and less of the seasonality of our private company news business that has been evident over the last couple of years.

As you can imagine, it is difficult to predict private company news frequency, therefore, we believe an annual subscription business will help us address this. Last quarter we spoke about our future in real-time analytics and engagement, a single-source, real-time dashboard that gives customers the ability to view, analyze and target the stakeholders as they shape their message to the market. I'm happy to report also that this initial phase of this planned initiative will be released this quarter to our clients. It will unlock the value of our targeting platform, provide easier access to audiences, and put our customers in the driver seat to access our entire systems.

From there we will continue to enhance components each quarter next year that will help our customers analyze the effectiveness of their message, improve disclosure and the engagement, as well as offer unique data sets that many in the market just don't have. We feel very good about the long-term opportunities of this new layer of our Platform business. That does not mean the other components of our Platform business are not performing, or do not have a path to growth. We do. As I mentioned, in fact, anything that touches the shareholder we feel

extremely confident that we can grow from the customer side as well as build analytics and additional subscription revenues that will further unlock the shareholder value for Issuer Direct, and some of our upgrades to our regulatory and communications platform, which we believe will have a positive impact on our business in the future.
We also ended the third quarter with a significant amount of momentum, the acquisition of Interwest Transfer and the strategic alliance with OTC Markets, which I'd like to discuss further. As most of you know, on October 2, 2017 we announced the acquisition of Interwest Transfer, a 50-year-old transfer company with a long, respectful tenure in the corporate stock transfer business. With over 300 plus accounts, we expect this acquisition to tuck in nicely with our current stock transfer and annual meeting management business. The total purchase price was $3,228,000, which consisted of $1,935,000 in cash at closing, approximately 25,000 shares, equal to about $330,000 in cash, and $960,000 over a three-year period.

On a standalone basis, the business is approximately double our current [indiscernible] revenues, and further derails in the transaction will be filed in the pro forma financial statements with the Securities and Exchange Commission in mid-December. A lot of people have asked us why a transfer agent and what are our plans? And I think it's very simple and succinct: when we looked at our client base at our own transfer agent business, we found that these customers bought more services and subscribed to more platforms than our non-transfer agent clients, thus meaning they also spent more average per year in revenues.

We have in the past talked a lot about ARPU and how we can expand these numbers, and stock transfer is a part of the path to get there. We intend to spend a great deal of time getting to know each of the Interwest clients, their needs and to ensure that they understand the value our platform can play in their business, both in the communications and compliance path. This will be given with a deliberate sales and marketing campaign to each and every Interwest client, with upgrade offerings to move their shareholder compliance and communications access in tune with our platform. That should begin in January 2018.

As an example, customers of Interwest will take advantage of a small upgrade, and will begin to see real-time access to shareholder records, a secure place to issue shares, search and build reports, track dividends and create online access to shareholders to download tax statements, dividends and update their contact information from any web browser.

This is a clear demand for most of our clients today, and will be of theirs as well. We expect to see a good portion of the ITC, Interwest customers increase their annual spend by as much as 50% of their current platform spend today.

I think it's worth mentioning that we have previously known ITC for years, and in fact we've had a partnership with them for over one year now, and assisting their clients with annual meeting management. Our platform picked a select group of their clients, which was a great test to see how both companies can work together and how Interwest stock transfer clients would react to our offers. In our minds, an overwhelming success and a contributing reason to move forward in this transaction, and now we have the opportunity to expand this offer to the rest of the customer base.

In closing, I'd like to touch on our recent alliance with OTC Markets. Yesterday's press release highlighted some of the areas that we both intend to work together. Our news brand, Accesswire, and our regulatory and communications platforms have been bundled to and with the OTCIQ platform. Essentially, when an SEC listed issuer connects to the respective IQ platform, they will have the ability to add specifically designed solutions and products that both OTC and our teams have put together, all of which have preferred pricing to the issuer. The focus of our direct sales force will not change. This partnership will just shine the obvious light on our OTC client base and then join the OTC listed professionals in ensuring that their market share clients have access to the best of breed solutions from Issuer Direct.

There are thousands of OTCQX and QB clients that we intend to ensure understand these offerings that are available to them under this partnership, basic compliance and communication needs that these clients need to have, who generally spend, on average, $17,000 a year annually. Our alliance targets two critical components, to reduce the annual spend, and two, to decrease the complexities and maintaining compliance by integrating into and with a single interface. In this case, it will be OTCIQ powered by Issuer Direct.

Even though OTC will be the front-end access point it's important to point out, under the alliance all customers that subscribe or purchase our partnered offerings will enter into with Issuer Direct an SLA and a billable agreement. Furthermore, from an expectations perspective, the pricing will range from $1,195 and go all the way up to $11,000 annually. We expect the average annual spend to be approximately $2,500 per client. Our joint teams are hard at work, as we speak, getting ready to launch these offerings, and in the coming weeks we should see more market awareness and alliances.

The OTC agreement is the second key exchange marketplace partnership that has been forged [ph] in our history. The first was the New York Stock Exchange. We are also working towards a third partner that will complement our exchange partner program. Once completed, all three partnerships, we will have a customer reach of over 17,500 listed companies globally.

In closing, I'd like to highlight again the revenue trends that we're seeing in our overall business. Q3 marked the first quarter in our history that our Platform business was able to achieve greater than 50% of our overall revenues, 55% to be precise, which we're pleased with, and I think delivering on this data transition to a platform first engagement speaks to the value our shareholders are placing in our business today.

With that, I'd like to turn the call back to the operator. Operator?

Operator
Thank you. The floor is now open for questions. [Operator instructions]. We do have a question from Miles Jennings. Please state your question.

Q: You guys make it look easy.

Brian Balbirnie – Chief Executive Officer
Thank you, Miles. We're working on it.

Q: I just had a couple of definitions that I'd appreciate knowing. When you say that the number of platform customers during the quarter was, let's say, 1,000, are you taking a weighted average of the number of days in that quarter multiplied times the number of customers on each of those days?

Brian Balbirnie – Chief Executive Officer
No, we're not. We're looking for clients that are under license agreements during that quarter that are active. If they're active in the quarter then we count them as an active client and report those numbers.

Q: And by "active," do you mean they've turned on their platform during the month?

Brian Balbirnie – Chief Executive Officer
Yes, under a current agreement, turned on the platform, are using the platform. Yes.

Q: Oh, good. I don't know the seasonal changes between the second quarter and third quarter because of all the work that's done in the second quarter, but I see that the number of platform customers declined about 15%

between the second quarter of this year and the third quarter of this year. Is that about the normal sequential decline you would expect from the high second quarter numbers?

Brian Balbirnie – Chief Executive Officer
As we talk a little bit about seasonality, that's a great question. A lot of what we see during the first and second quarters as it pertains to AGM, our annual meeting management, tend to have a component of a platform license to monitor real-time votes and manage the annual meeting process. And as we all know, the majority of public companies have a 12-31 fiscal year-end that cause them to complete that annual meeting within the first 120 days of the year. That's where we see a bigger shift of our platform, is those folks that are licensing it, but it's been fulfilled, used and completed during that period. So, as you get into Q3 and Q4 those clients tend to not be using that portion of the platform.

I think what will solve that for us is addressing a complete subscription platform that takes into account all of our communications and compliance products under one cohesive license rather than components. And that's something that we're focused on for the remaining part of this year and next year.

Q: So, this decline from 1,854 to 1,582, about 15%, you would consider a normal running rate for both of those quarters? There's nothing unusual as to why the change in the third quarter?

Brian Balbirnie – Chief Executive Officer
No, not at all. You get a blend of private company news distribution that's under subscription there during the period as well, which, as we all know, private companies, unlike public, aren't consistent in their news distribution, so that has a small effect on it. But, no, we don't see any irregularities in those numbers at all.

Q: Good. Yes, it doesn't look like it. I was also impressed by the way, even if you do have some sequential decline in the metrics sequentially quarter to quarter, your revenue and earnings stream for the quarter were really impressive. Do you have the number of Classify customers, or do you disclose that number?

Brian Balbirnie – Chief Executive Officer
No, I actually don't have it handy. We typically don't disclose individual product subscriptions.

Q: That's understandable. Thanks very much, and congratulations.

Brian Balbirnie – Chief Executive Officer
Thank you, Miles.

Operator
There appear to be no further questions at this time.

Brian Balbirnie – Chief Executive Officer
Thank you, Mike. I'd like to thank everybody today for taking the time to listen to Steve and I talk about our Q3 numbers. If anybody has any follow up questions after the 10-Q is filed this afternoon, we'd welcome an opportunity to speak with you again. Thank you. Have a good rest of the day.