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Transcript of Issuer Direct
Second Quarter 2018 Earnings Call
August 2, 2018

Participants

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

Analysts

Mark Lanier – Pegasus Capital
Mike Grondahl – Northland Capital Markets

Presentation

Operator
Ladies and gentlemen, thank you for standing by, and welcome to the Issuer Direct Corporation second quarter 2018 Earnings Conference Call. As a reminder, today's call is being broadcast live via Investor Network, a link of which can be found in today's earnings release. You can also view the full text of the Companies earnings release on their website in the investor relations section.

Today's call will be conducted by the Company's Chief Executive Officer, Brian Balbirnie and its Chief Financial Officer, Steve Knerr, I'll now turn the call over to Mr. Steve Knerr.

Steve Knerr – Chief Financial Officer
Thank you, and good afternoon everyone. Brian and I would like to thank you for taking the time to participate in our second quarter 2018 earnings call today. 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 will 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 Investors relations tab, a description as well as reconciliation of GAAP measures to which we will refer on this call.

With that complete, I'll begin by going over our results for the quarter and then turn it over to Brian who will provide his operational review and outlook, followed by a Q&A session.

The second quarter was another solid quarter for Issuer Direct as we continued to build our Platform and Technology business, increased revenue to a record level and worked toward completing our second acquisition in less than a year.

Total revenue increased 10%, or $356,000, to $3,799,000 for the second quarter of 2018, as compared to $3,443,000 for the same period of the prior year. Revenue for the six months ended June 30, 2018 increased 16%, or $1,031,000, to $7,329,000, as compared to $6,298,000 for the same period of the prior year. Revenue from customers obtained from our acquisition of Interwest Transfer Company, totaled $381,000 and $799,000 for the three and six months ended June 30, 2018, of which $51,000 and $95,000 came from additional subscriptions to our platform or services cross sold to these customers.

Platform and Technology revenue increased $356,000, or 19%, to $2,246,000 for the second quarter of 2018 and increased $767,000, or 22%, to $4,277,000 for the six months ended June 30, 2018. Platform and Technology revenue increased to 59% of our total revenue for the second quarter of 2018 compared to 55% for the second quarter of 2017. As with previous quarters, revenue from our Accesswire module led the growth, increasing 18% and 24% for the three and six months ended June 30, 2018, respectively, compared to the same periods of the prior year. In a few minutes, Brian will talk further about our expectations for continued growth with Accesswire and how we will integrate our recently acquired newswire, Filing Services Canada, or FSCwire, into and with our Accesswire operations. Also contributing to the increase in Platform and Technology revenue was revenue from customers acquired from our Interwest acquisition in the fourth quarter of 2017 as well as increased licenses of Platform ID. During the quarter, we sold subscriptions of Platform id to 27 new or existing customers with an annualized contract value of $242,000.

Services revenue of $1,553,000 for the second quarter of 2018 was flat compared to the second quarter of 2017 and increased $264,000, or 9%, to $3,052,000 during the six months ended June 30, 2018, compared to the same period of the prior year. The increase for the six-month period is primarily the result of an increase in transfer agent services, not only due to the addition of Interwest customers, but also from an increase in corporate directives and actions of our legacy Issuer Direct transfer agent customers, particularly in our community banking sector. The increase in transfer agent revenue was partially offset by the continued decline of our legacy annual report service, due in part to continued attrition as customers leave the service, decrease hardcopy requirements or transition to electronic delivery. Additionally, revenue from our compliance services decreased as we continue to face pricing pressure or customers begin to take advantage of our platform offerings. For the second quarter of 2018, we also experienced a decline in Print and proxy distribution revenue due to the timing of one-time projects that occurred in the prior year.

It is important to note, when comparing results to previously filed reports, $186,000 and $393,000 of revenue during the three and six months ended June 30, 2017, respectively, which was previously reported as Services revenue, was reclassified to Platform and Technology revenue. This was the result of the adoption of a new accounting pronouncement as of January 1, 2018, that required us to separate the revenue in bundled contracts for our ARS, or shareholder outreach offering, which include both electronic and physical hardcopy delivery of our customer's annual reports. The reclassified amounts represent the allocation of contract value of electronic delivery of the annual reports. All results have been appropriately adjusted for comparison purposes.

Moving to gross margin, our overall gross margin percentage was 73% and 72% for the three and six months ended June 30, 2018, respectively, compared to 74% for the same periods of the prior year. The primary reason for the decrease in gross margin percentage was due to an increase in amortization of the capitalized software placed in service in 2017 of $116,000 and $255,000 for the three and six months ended June 30, 2018, respectively. Platform and Technology gross margin percentage was 81% and 80% for the three and six months ended June 30, 2018, respectively, compared to 85% for the same periods of 2017. Again, the decrease in gross margin percentage is due to the increase in amortization I noted earlier. With all of the previously capitalized costs now baked-in, we anticipate gross margin percentage of our Platform and Technology business to expand with increased revenue. Gross margin percentage from our Services revenue stream was 61% and 60% for the three and six months ended June 30, 2018, respectively, compared to 59% for the same periods of the prior year.

As we have continued to invest in our business for top-line growth, we have experienced increases in operating expenses, which increased $373,000, or 21%, and $832,000, or 24%, for the three and six months ended June 30, 2018, respectively, compared to the same periods of the prior year. General and administrative expenses increased approximately 10% as a result of an increase in personnel expenses, stock compensation, and acquisition related expenses. Sales and marketing expenses increased 12% for the quarter and 18% for the six months ended June 30, 2018 due to an increase in our sales and marketing teams by about 20% over the same periods of the prior year, partially offset by a decrease in tradeshow expenses. We also continue to investment in Platform id, as product development expenses increased due to less capitalization and increased maintenance costs associated with our cloud-based products that were placed into production during 2017. Amortization expense increased as well due to additional amortization resulting from intangible assets acquired as part of the Interwest acquisition.

Skipping down to the tax line, we recognized income tax expense of $224,000 in both the second quarter of 2018 and 2017. For the second quarter of 2018, the difference between our effective tax rate of 38% and the federal statutory rate of 21% was due to additional income tax expense associated with a tax shortfall related to stock-based compensation. This is in contrast to the three and six months ended June 30, 2017, in which our effective rate was lower due to a tax benefit associated with stock-based compensation.

For GAAP purposes, we recorded net income of $366,000, or $0.12 per diluted share, for the second quarter of 2018, as compared to net income of $493,000, or $0.16 per diluted share for the same period of 2017. For the six-month period ended June 30, 2018, we recorded net income of $686,000, or $0.22 per diluted share, compared to net income of $817,000, or $0.27 per diluted share for the first six months of 2017.

Looking at some Non-GAAP metrics, total EBITDA increased 4% and 11%, to $935,000 and $1,590,000 for the three and six months ended June 30, 2018, respectively, as compared to the same periods of the prior year. As a % of revenue, EBITDA was 25% and 22% for the three and six months ended June 30, 2018, respectively, compared to 26% and 23% for the same periods of 2017. Non-GAAP net income increased to $663,000, or $0.21 per diluted share for Q2 2018 compared to $590,000 or $0.20 per diluted share for Q2 2017 and $1,121,000, or $0.36 per diluted share for the six months ended June 30, 2018, compared to $995,000 or $0.33 per diluted share during the same period of the prior year.

We continue to generate positive cash flows from operations as we generated an additional $1,052,000 during second quarter of 2018 compared to $810,000 during the same period of the prior year. This brought our total cash balance to $6.8 million as of June 30, 2018. Additionally, on July 12, we announced a cash dividend of $0.05 per share, making it our twelfth consecutive quarter for paying dividends.

Lastly, I would like to touch on our recent acquisition of FSCwire, which was completed on July 3. I would like to welcome the entire FSCwire team to the Issuer Direct family and look forward to working with them. Like our press release business, FSCwire has been experiencing growth which we hope to continue here by combing it with our Accesswire team. Albeit small, we expect this transaction to be immediately accretive to revenue, net income and EBITDA. We are also looking forward to partnering with our new customers and showing them how they can benefit from our single sourced consolidated disclosure and communication solution.

With that, I will turn it over to Brian who will now talk further about the FSCwire integration and our overall strategies and new developments for the remainder of 2018.

Brian Balbirnie – Chief Executive Officer
Thank you, Steve, and thanks to everyone for joining us today to discuss our second quarter 2018 results. As Steve just highlighted, we posted another strong quarter, and a great start to the first half of the year, and as a recap:

- 2018 second quarter revenues were up 10% compared to second quarter last year, to $3,799 from $3,443
- Sequentially, second quarter 2018 was also up 8% from the first quarter 2018.
- Platform and Technology revenues increased 19% from Q2 2017 and on a sequential basis, Platform and Technology revenue increased 11% from Q1 2018
- Our platform business continued to expand, to 59% of our overall revenues for the second quarter

The business is beginning to hit its growth stride, and our team continued their first quarter highs right into q2 this year and delivered. The focus on execution, cross-selling and new customer wins is a recipe we will continue to build upon in the back half of the year and beyond.

As our subscription business continues to expand, so does our deferred revenues numbers and backlog. During the second quarter we generated an additional $242K in Platform id. subscriptions to new and current customers, bringing the total to $564K for the first half of the year, of which $412K remains as backlog, to be recognized over the remaining terms of the contract. This number represents 56 new subscriptions for the period, 27 in the second quarter. Deferred revenue grew from $887K at the end of year to $1,273M at the end of June.

Conversely, the ARPU of these transactions for the first half the year remained just over $10K per customer - something we continue to work hard to continue to normalize our entire arpu toward. Growth in pipeline is vital for us, and areas such as our exchange alliances, and conference partnerships are helping our sales & marketing organizations do just that.

In summary, we saw sequential net new customer growth in both our Platform and services business. We had 1,996 Platform & Technology customers during Q2 2018, compared to 1,854 during Q2 2017 and 1,845 during Q1 this year. The represents 142 net new customers or 8% on a year over year basis and slightly higher on a sequential basis.

We also had 567 Services customers during the Q2 2018, compared to 550 during Q2 2017, that marginal 3% gain came primarily from the addition of Interwest customers.

We are committed to continuing the trend of client growth – and feel we can improve even further our customer profiling, contract terms and transition from our services to our reoccurring higher margin subscriptions business, by doing this we are confident we can further reduce some of the seasonality typically found in parts of our business, print to digital, individual one time services into annual subscriptions.

With our complete platform subscription focus, we believe customers will use our systems more frequently and we will benefit from our annualized bundling, thus giving us a better insight into our customers counts and true subscription ARPU.

Perhaps I can spend a few more minutes highlighting a few areas of our business, ACCESSWIRE & FSCWire transaction, as well as provide everyone a bit of forward looking perspective into our insight business and strategically where were focused the back half of the year.

The second quarter was the 15th consecutive quarter since 2014 we have had year over year double digit percentage revenues growth in our newswire business. ACCESSWIRE has been a catalyst to our business in several ways; not only in how a customer thinks about us as a provider, but also in how we have been able to expand our reach in an ever changing market. Corporate issuers buy newswire differently today than they did when we entered the business. Thankfully we have benefited from being nimble enough to react to the markets and deliver a product we knew could meet their needs. Our customers and revenue growth here speaks to that success, but something were continuing to still mature, understand and look forward to its continued growth. At the end of the quarter we also began integration with several other key distribution points that are seeking to carry our news product on their broker terminals, investor platforms and or news aggregation sites. We anticipate being able to speak in more detail about these on our next call, when agreements are final.

Speaking of growth, the most recent July 3 transaction of FSCWire was the natural next step here for us. FSCWire, a Canadian Newswire that has been in the market for over 12 years, delivered cost effective news distributions services to the Canadian and US Markets. Primarily a Small-Cap customer base provider, that has been growing at a nice pace, fit just perfectly with ACCESSWIREs overall North American goals. When we looked at the Newswire business we knew we needed to continue to expand our distribution, find additional professionals to join our team that has significant experience and a path to growth in markets we otherwise were not the strongest. FSC fit this profile perfectly. Fred Gautreau the President, and his team have been amazing over the last 30 or so days since the transaction. Our first priority was to integrate accounting and HR functions into and with our own systems. Now that that is behind us, we are moving toward systems and client experience platforms. – taking the best from each system and combining that into our ACCESSWIRE distribution platform. This will include moving all 300+ FSC Wire customers into ACCESSWIRE under the brand ACCESSWIRE Canada, a wholly owned subsidiary of Issuer Direct. Some of the 300 customers today also rely on FSC for Edgar and Sedar services, something we will continue to offer and expand upon with our blueprint filing technology. Once we complete the integration we will then turn our focus into cross-selling these customers into and with our Platform id. subscription, this is something we should look for late Q4 and into 2019 as our primary goals right now are set on integration, and client stickiness.

Like Interwest success, we believe we will have similar success here with our FSC customers that are both TSX/CSE and OTC listed. Our communications subscription will be the biggest value driver for these customers in the long term.

The acquisitions of Interwest and FSCwire are the latest demonstrations of a solid track-record of integrating accretive acquisitions. We continue to believe our industry will further consolidate. As such we are seeking additional accretive and strategic opportunities in the market, and as a result, we intend to file a shelf-registration statement today. The shelf will put our company in a great position to have options should we find a potential acquisition target beyond our current capital means. That filing will be accessible on www.sec.gov.

Turning to investor platforms, Investor Network our investor facing front-end platform recently was updated this week to include enhanced issuer profile, industry news, over 3,000 quarterly earnings events, and very soon research and transcripts. Many of the critical components and enhancements are back-end and tie directly into our new data structure we internally call people-hub and company-hub, these hub datasets are the underpinning of our new insight and engagement platform, which we intend to release in Q4 this year.

If we look ahead into next year, we will be in a position to present to our clients the trends and insight they have previously not had the real-time access to before. In aggregate we will be delivering engagement insights from millions of data points, segmented by peers, industries, indexes and exchanges.

Our insight platform will allow issuers and IR professionals, and in some cases third-party licensee’s to query and organize investor attributes in one central dashboard. Utilizing similar technologies to that of common web-cookie, Krux ID, or fingerprint. Customers will be able to sort investors and shareholders - as we believe it’s important to delineate the difference between an investor in the market compared to a shareholder of an actual company.

Insights are generated by investors and shareholders, as they engaging with earnings events, IR website content from our network, investor conferences, alerts and requests from investor registrations and subscriptions. Having this data in one real-time platform will allow our customers to segment their investors in several different ways, so as to maximize and target their messaging more efficiently.

In closing, we are encouraged by our continued client expansion, specifically the customers that are purchasing our platform, and the investments were making in the business, both in our platform advancements and our management team, which will put us in a position to further grow and scale the business. We posted another solid quarter in the second quarter, which put revenues 16% ahead for the first six months of this year, compared to 2017.

Operator, can we please begin the Q&A session?

Operator
Thank you. At this time, we will be conducting a question and answer session. [Operator's instructions]. One moment please while we pull for questions.

Our first question today comes from Mark Lanier of Pegasus Capital. Please go ahead.

Q: Brian and Steve, congratulations on the quarter. I have two questions. I assume that Filing Services Canada is the same as DBA of FSCwire. Is that correct or is that a separate Canadian acquisition?

Brian Balbirnie – Chief Executive Officer
No, it is the same. FCS, Filing Services Canada, is the same. Correct.

Q: Understood. The second question has to do with the metrics around your sales force expansion. I think you mentioned that head count in sales had grown 20% year-over-year or something close to that. I wondered if you would clarify that point and also talk about what your plans for growth is to the sales side going forward. Thank you.

Brian Balbirnie – Chief Executive Officer
Thank you, Mark. Yes, our year-over-year sales expansion, from an expense percentage, was 20% year-over-year. From a head count perspective, we continue to believe that we're going to do the same things in the back half of the year. At 14 head count in sales and marketing, we're looking to increase that another three to four individuals but the end of the year, strategically both geographic in North America and as we look at expanded markets. We just recently expanded our marketing teams at the beginning of Q3 here, and we believe that that team is solid enough to carry us through the end of the year.

Q: Understood. Thank you very much. Good luck.

Brian Balbirnie – Chief Executive Officer
Thank you, Mark.

Operator
[Operator's instructions]. Our next question comes from Mike Grondahl of Northland Capital Markets. Please go ahead.

Q: Hi Brian, its Mike. I think you reached your total client goal of 2,500 this quarter. Any thoughts on the next goal or how we think of that growth going forward?

Brian Balbirnie – Chief Executive Officer
Yes, you're right. It's the blended platform technology service segments of ours, the 2,200 to 2,300 number, and you add in the FSCwire account numbers, gets us to the 2,500. I still believe that we're continuing that nice momentum of client additions and continuing to keep our turn numbers down. In our organic basis, we're still going to see low double-digit growth in our client count numbers. Then, we believe with further opportunities and M&A [ph], we'll see even an expanded way to get to the next step.

Q: In the platform in technology area, are there any modules you would call out that are kind of really leading the way there? I think you mentioned 27 platform ID customers, but what are the modules that have really kind of floated up?

Brian Balbirnie – Chief Executive Officer
It's three core segments. It's the entire platform which gives both of our corporate issuers the ability to have compliance communications, and then each individual module of compliance communications can be subscribed to separately. The bigger driver for us, as a result of ACCESSWIRE has been the communications module. Of the 27, the majority of those folks are buying communications platforms, and the majority of those 27 came directly from our sales force, not our counter [ph] partners or resellers or anything else. That's just pure, organic new wins. But, communication still tends to be the bigger driver for us. As I alluded to in the back half of the call, I think part of it is a result of the implied analytics. What are we going to be able to get from engaging and using your platform, and what insights come of it? So, I think there's an appetite for that from our customer base.

Q: Related to that implied analytics, and engagement, are you still rolling out that module late 2018? What's the timeline there?

Brian Balbirnie – Chief Executive Officer
Yes, we still are. At the end of October, beginning of November, we're planning to release. We have components of it, I think I mentioned in the call here, that we internally call people hub [ph] and company hub, and a little bit of our fingerprint technologies that are being spent throughout our networks now. All of our historical data have been added and analysts have been hard at work. We're in to final testing [ph] and front-end development to be ready. I think we're confident in our data attributes that we're getting. It's most interesting to see how companies are engaged, what kind of materials are requested and consumed by the investment community. I think we're going to have significant amounts of data flow for our customers going forward. So, yes, we're confident in that end of October, November timeframe.

Q: That'll be interesting to see. In a follow-up to the previous person's question, 14 sales people at the end of 2Q '18, what was the number at the end of 2Q '17?

Brian Balbirnie – Chief Executive Officer
I'm sorry. I didn't catch it. At the end of '17?

Q: At the end of 2Q 2017, what was the number of sales people? I'm trying to just get the growth. It's 14 at the end of 2Q '18. What was it a year ago?

Brian Balbirnie – Chief Executive Officer
Yes, pure sales was eight.

Q: Eight, okay, so that's pretty nice growth.

Brian Balbirnie – Chief Executive Officer

We've got work to do there, in fairness, and I think it's a great question. I think we need to continue to commit to invest in platform, and by doing that we've got to have the right blend of sales and marketing folks out in the field to continue the expansion.

Q: Good. Lastly, with FSCwire, I think it was mentioned there were 300 customers. I know you want to integrate first and make sure everything's sticky first, but how many of those 300 do you think are really good cross-sale potentials?

Brian Balbirnie – Chief Executive Officer
That's a great question. I think 25%. I think that's a rule of thumb in the modeling that we use. We examine client quantity, quality, and spend, and then you really just have to look at the type of client they are, market cap, exchanges they're listed on. 25% of those clients fit the ideal profiles for us. That would indicate that, based on our past success, that they would be prime for a subscription of platform ID. And I think that we're zeroing in on those numbers and been focused on that with our Interwest transaction and in historical past transactions we've tried to achieve those numbers.

I think we have a good recipe for added cross-sale, and how to make sure that we love these customers, and teach them our platforms, and make sure they understand the benefits. I think that without the platform we wouldn't be successful doing that, but it is really good to have an ecosystem that shows a clear efficiency, both in spend and time. Clients are beginning to embrace and understand that now, which is fantastic.

Q: Okay, great. Thank you.

Brian Balbirnie – Chief Executive Officer
Thank you, Mike.

Operator
There are no additional questions at this time. I would like to turn the call back to Brian Balbirnie for closing remarks.

Brian Balbirnie – Chief Executive Officer
Thank you, Brock [ph]. I'd like to thank everyone for taking the time to listen to Steve and I talk about our second quarter results. In the meantime, if anybody has any additional follow-up, we'd welcome an opportunity to speak with you again between now and the Q3 call. I wish you all a good day. Thank you.