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Call Participants

EXECUTIVES

Alan Louis Urban

CFO & Secretary

Peter Victor Derycz

Founder, CEO, President & Director

ANALYSTS

Peter Rabover

Presentation

Operator

Good afternoon, everyone, and thank you for participating in today's conference call to discuss Research Solutions' financial and operating results for its fiscal 2019 second quarter ended December 31, 2018.

Earlier today, the company issued a press release discussing these results, and a copy of this release is available for viewing and can be downloaded from the Investor Relations section of the company's website.

Joining us today are Research Solutions' President and CEO, Peter Derycz; and the company's CFO, Alan Urban. Following their remarks, we will open the call for your questions.

Then before we conclude today's call, I will provide the necessary cautions regarding any forward-looking statements made by management. I will also provide information regarding the company's use of non-GAAP financial information.

Finally, I would like to remind everyone that this call will be recorded and made available for replay via a link in the Investors section of the company's website.

I'll now turn the call over to Peter Derycz, Research Solutions' President and CEO.

Peter Victor Derycz

Founder, CEO, President & Director

Thank you, operator, and good afternoon, everyone. I'll open the call with several comments about our second quarter, then pass the call to Alan to speak about our results in greater detail. To conclude, I will return to speak about some of our exciting initiatives and our outlook for the remainder of fiscal 2019.

The momentum from the start of the year continued into the second quarter with the Platform business reporting strong growth in revenue and gross margin. This is primarily a result of our continued execution of new Platform deployments and Platform upsells, which confirms that many of our users find significant value from our Platform and seek greater access to all of its functionality.

During the quarter, we also launched a Platform version update with self-registration capabilities, allowing for more efficient lead generation and frictionless sign-ups, which we believe will drive more deployments. The new release also included the introduction of our Reference Manager gadget. This is a powerful tool that provides key stand-alone capabilities in the arena of literature, data accumulation and management, along with full interplay with our gadget ecosystem and integration with standard writing tools, such as Microsoft Word.

At the end of the second quarter, we successfully launched Version 2.4 of the Platform, which contained major improvements to the Reference Manager function, an expanded Gadget Factory and enhanced self-registration features, including the ability to sign up using a LinkedIn account. Additionally, we expanded our sales team and launched new test marketing campaigns, all of which contributed to the continued Platform acceleration.

I will have more to say about the various operational highlights in the second quarter and expand upon other initiatives after Alan walks us through our second quarter's financial results in more detail. Alan?

Alan Louis Urban

CFO & Secretary

Thank you, Peter, and good afternoon, everyone. Jumping right into our fiscal second quarter results. Our Platform subscription revenue increased 62% to \$668,000 in Q2, which was driven by a 45% year-over-year increase in total Platform deployments to 267 and by continued Platform upselling. This translates into 28 net incremental deployments in Q2. That's up 12% from Q1.

The quarter ended with \$2.7 million in annual recurring revenue, up 10% sequentially and 58% year-over-year. Please see today's press release for how we define and use annual recurring revenue and other non-GAAP terms.

Our Transaction revenue was \$6.3 million compared to \$6.4 million in the same year ago quarter. This 1% decrease was due to our Transaction count declining slightly from 205,000 to 203,000. We continued to see a general trend of decreasing transactions from our larger customers, mostly offset by transactions from new customers, including new Platform customers, and increasing transactions from our smaller corporate and academic customers. Despite this, we still experienced 4% growth in total customer count to 1,083. In addition, the number of corporate customers was up 3% to 838, and academic customers were up 8% to 245.

Together, these businesses delivered consolidated revenue growth of 2% to \$7 million versus \$6.8 million in the same year ago quarter.

Moving on to gross margins. Our Platform business saw a gross margins increase by 360 basis points to 81.7% compared to the same year ago quarter. This increase was driven by continued proportional decreases in third-party data costs. Our target gross margin in the Platform segment remains in the high 70% to low 80% range.

Gross margin in our Transactions business was up 70 basis points to 22.8%, as we continued to optimize cost efficiencies and implement incremental price increases. As a result, consolidated gross margin increased 300 basis points to 28.4% compared to the same year ago quarter.

Our total operating expenses were \$2.7 million compared to \$2.4 million in the same year ago quarter. The increase was primarily due to increased stock-based compensation and technology and product development spend as we continued to invest in our Platform business to drive best-in-class functionality and user experience. Slightly offsetting the increase were lower sales and marketing spend, mostly due to open positions.

Looking ahead, we expect this to revert back to a more normalized level of spend as we finalize the restructure of our sales and marketing departments.

Net loss from continuing operations totaled \$648,000 or negative \$0.03 per share compared to a net loss of \$704,000 or negative \$0.03 per share in the year ago quarter.

Adjusted EBITDA totaled negative \$200,000 compared to negative \$300,000 in the year ago quarter. As we have stated in past earnings calls, although year-over-year adjusted EBITDA continues to improve, we will remain opportunistic to future growth opportunities if we believe it could further accelerate Platform customer adoption and revenue growth.

Moving on to the balance sheet. Cash and equivalents at December 31, 2018, were \$4.8 million versus \$4.5 million at September 30, 2018. There were no outstanding borrowings under our revolving line of credit, and our balance sheet continues to remain clean with cash and receivables comprising nearly all of our assets and accounts payable and accrued expenses and deferred revenue representing nearly all of our liabilities.

This completes our financial summary. I'll now turn the call back to Peter. Peter?

Peter Victor Derycz

Founder, CEO, President & Director

Thanks, Alan. I'd like to spend more time highlighting our Platform business and the initiatives we launched in the quarter and have planned for the future, as we remain focused on growing this high-margin business to generate a meaningful recurring revenue stream.

As I mentioned earlier, we launched version 2.4 of the Platform in the December, which included an enhanced self-registration features that allows users to sign up using their LinkedIn credentials. This option provides an even more of simplified process for those wanting to sign up using the self-registration

option while providing our company useful information on the user to better serve each customer's needs over the long term.

We also further expanded our Gadget Factory to include enhanced descriptions and additional information on each gadget. We believe this will provide users with a better understanding of each gadget's usefulness and assist them in finding valuable tools that they were not previously utilizing.

Within the Gadget Factory, we also made substantial improvements to our Reference Manager gadget, a powerful research tool that we introduced on our last call.

These improvements will help workgroup work more efficiently, help their organization save money as well as give both organizations and end users enhanced data importation capabilities. We also created a specific micro site that provides detailed information on all the capabilities the Reference Manager gadget offers to provide users a better understanding of this powerful new tool.

In addition, we are excited to announce the Reference Manager's Word plug-in will be enhanced to include full compatibility with Word for Apple macOS. We anticipate launching this feature in fiscal Q4, and look forward to welcoming the Mac community.

We also expanded our Article Galaxy resource center where current and prospective customers can find information about our entire Platform and understand the full spectrum of capabilities that the Platform offers. We have included several case studies on the website to provide better information on how the Platform brings value to R&D-based companies through examples of tangible benefits that large and small customers experienced since joining our Platform.

As we have discussed, we are committed to continually providing innovative updates to the Platform. With this constant innovation, we also put an emphasis on providing users and potential customers with the necessary resources and information to assist them in fully understanding the capabilities of the Platform and the many benefits it can offer R&D-focused businesses. We believe this will be essential to bringing on new customers for the Platform and upselling current customers.

With that being said, now I'd like to address our sales and marketing efforts. During the quarter, our marketing team was focused on testing various marketing campaigns with the intention of gathering the necessary data to adopt a more efficient ROI-driven marketing strategy going forward. With our initial tests in fiscal Q2, we were able to identify which platforms provided us better returns as well as conduct AB testing on messaging and target audiences. As a result of our new marketing strategy, we will begin to ramp up marketing spend in the coming quarters as we launch our new marketing campaign. Additionally, our ability to run small experiments and tests will allow us to further improve our marketing ROI as we expand our marketing spend.

We also recently hired 3 additional sales reps as part of our strategy to further expand our reach. The implementation of our new marketing initiatives and growth in our sales team have laid a strong foundation as we aggressively pursue adding new users to the Platform, specifically within the underserved small- and medium-sized business segment.

Along with ramping up efforts to bring on new users, we continue to work diligently on providing our current customers with exceptional support services through our customer happiness group, which provides both customer support and advanced account management. Customer support and account management were merged into a single customer happiness group over the summer. As a result, we've put into place improved customer support processes for our customers' day-to-day needs as well as better and more regular account reviews to help our customers take the best advantage of what our Platform has to offer.

The combination of consistently improving the Platform, excellent customer support and improvements in the average sales price per Platform has resulted in a customer churn rate far better than industry benchmarks.

As we move into the second half of fiscal 2019, we look forward to releasing version 2.5 and 2.6 of our Platform, which we are currently working on. These releases will bring improved user experiences and

update to our look and feel and more interactivity between gadgets and more connectors between our gadgets and the internet at large, including e-mail.

Behind the scenes, there will also be improvements to our overall infrastructure, implementation of more agile development practices as well as a focus on larger and more powerful gadgets that help our customers accelerate their research while saving time and money.

Overall, we are very pleased with the progress we have made in our Platform business, and we believe the consistent innovation and exceptional support are bringing customers significant value. We have laid the necessary foundation with our sales and marketing teams to significantly expand our customer base and provide R&D-focused businesses the Platform and tools necessary to succeed.

With that, I'd now like to turn the call back over to the operator for Q&A. Operator?

Question and Answer

Operator

[Operator Instructions] Our first question comes from Peter Rabover with Artko Capital.

Peter Rabover

So I have a bunch of questions. So Peter, maybe -- I know in the past -- in the last quarter, you talked about maybe having a little slower growth as you got to know your marketing team, and it seems like you've had, like, some really good results, especially in January with the new rollout. Could you maybe bridge the two? Is it just that it's working? Did you guys get more aggressive? Maybe it is the new self-sign-up option? Like, what's working the best?

Peter Victor Derycz

Founder, CEO, President & Director

Yes, I think at this point, what's happening is that we reorged our sales and marketing, and that process really started in earnest sometime around beginning of our fiscal year. And so over the summer and the fall, these new processes, procedures, data management, reporting tools, staff and so on were being put in place, and that started to yield some results, I think, in that fall quarter. So it's just -- I think at this point in time, it's really a matter of the sales and marketing teams really starting to come online and generate some more activity. The single sign-on side of it, the self-registration part, has started, and we are getting daily sign-ups. But I think we don't enough data on that side of the equation yet to say anything meaningful about it. So just to summarize, again, the main benefits have really come from sales and marketing teams being reorged and coming online here.

Peter Rabover

Where do you think was the strength in January numbers? Do you think it was economic certainty? Or just people getting to know the product a little bit more?

Peter Victor Derycz

Founder, CEO, President & Director

I think just people just getting to know our product a little bit more. We've got -- in our sales process, we've got the whole new prospecting capability built up. We've got new -- we had new sales reps coming onboard on the sales side. So I think the sales component was a part of that. And then our customer happiness group with renewals and upselling contracts that come up for renewal, a good crop of them come up in January, and so that had an effect as well.

Peter Rabover

Great. Can you maybe talk about the price increases? Is that a function of -- what is that a function of? Just more gadgets? Or you are increasing prices on the subscription?

Peter Victor Derycz

Founder, CEO, President & Director

Yes, so on average, the -- yes, the prices do go up every year when renewals come up, and we do that on the basis of usage and data based on what customer is actually using the Platform for. And then as we always note, the rest of the product is constantly being improved and innovated upon. So every month you come back to this the Platform, it's got more and more capabilities in it. So based on that, we feel that the usage and the capability that we bring to bear for our customers are really helping them save time and money and accelerating their research, and on that basis, we get a little bit more for it.

Peter Rabover

Sure. And then, I guess, maybe more on the expense side. I think I just wanted to get a clear picture of how much of your, I guess, expense base, which is about \$10 million, would you say is exclusively dedicated to the Platforms business versus just running the distribution business stand-alone?

Alan Louis Urban
CFO & Secretary

This is Alan here. So that's an interesting question, but we actually have taken a look at that. And I think when you look at sales marketing -- sales and marketing and the bulk of technology, that really is for the most part Platform-oriented expenses. And then if you look at G&A, that's, obviously, a little different. I think there's no easy way to do that, maybe a revenue allocation or something like that. But I think that would be one good way to look at it. The sales and marketing and technology, greatly Platform-oriented, and G&A is really hard to determine. It's focused, so you can just get a revenue allocation on that.

Peter Rabover

And how much of your G&A would you say a public company costs?

Alan Louis Urban
CFO & Secretary

I guesstimate about \$400,000 or so, give or take. I don't think that's unusual for a company our size and sort of our profile.

Peter Rabover

Okay, great. And then I noticed on the accounts payable, there was a big royalty -- or maybe -- sorry, maybe accounts receivable royalty -- prepaid royalty expense. Or sorry, and then the net charges, net of [indiscernible]. And so is that -- can you talk -- that was -- it increased by \$300,000. Can you maybe talk about that?

Alan Louis Urban
CFO & Secretary

Are you talking about our prepaid royalty? We have an asset titled prepaid royalty?

Peter Rabover

Yes.

Alan Louis Urban
CFO & Secretary

Yes, we prepaid some of our publishers. And depending on the timing of payments, we may capture a lot of that payment towards the end of the quarter, or we may not, but that's nothing unusual. If we go back through our financials, you'll see that in past quarters and years, our prepaid assets have actually been a little larger than that. So it's nothing significant.

Operator

[Operator Instructions] There are no more questions at this time. This concludes our question-and-answer session.

Before we conclude today's call, I would like to provide Research Solutions' safe harbor statements that include important cautions regarding forward-looking statements made during today's call as well as statements regarding the company's use of non-GAAP financial information.

Statements made by management during today's call contain forward-looking statements that include information relating to future events and future financial and operating performance. Examples of such forward-looking statements in this presentation include, but are not limited to, statements regarding the expected continued improvement and market acceptance of the company's products and services and the expected continued growth in Transaction and Platform deployments and revenue, that the company will

be successful in executing its sales and marketing strategy, that the company will maintain and continue to develop its proprietary software and that the company faces few barriers in terms of achieving greater global expansion and revenue growth. Such forward-looking statements should not be interpreted as guarantee of future performance or results and will not necessarily be accurate indications of the times at or by which the performance or these results will be achieved.

Forward-looking statements were based on information available at this time. They are made in our management's good faith belief as at the time with respect to future events and are subject to risks and uncertainties that could cause actual performance or results to differ materially from those expressed and/or suggested by the forward-looking statements.

Important factors that could cause differences include, but are not limited to, changes in economic conditions, general competitive factors, acceptance of company's products in the market, the company's success in obtaining new customers and new Platform deployments, the company's success in technology and product development, the company's ability to execute its business model and strategic plans and all the risks and related information described from time to time in the company's filings with the SEC, that is the Securities and Exchange Commission, including the financial statements and related information contained in the company's annual report on Form 10-K and interim quarterly reports on Form 10-Q. The company undertakes no obligation to publicly update or revise any forward-looking statements whether because of new information, future events or otherwise. The company also assumes no obligation to update the cautionary information provided in the presentation.

Today's presentation also included financial measures defined as non-GAAP financial measures by the SEC. The presentation of this financial information is not intended to be considered in isolation or as substitute for the financial information prepared or presented in accordance with the generally accepted accounting principles accepted in the U.S., otherwise referred to as GAAP. Please refer to a more detailed discussion about the company's use of non-GAAP measures and their reconciliation to the nearest GAAP measures in today's earnings press release.

Finally, I would like to remind everyone that the recording of today's call will be available for replay after 8 p.m. Eastern today and through February 28, 2019. Please refer to today's press release for dial-in instructions.

Thank you for joining us for the presentation. You may now disconnect your lines

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