VitalHub Q3 2023 Conference Call

SPEAKERS
Dan Matlow, Gavin Fairweather, Babak Pedram, Gabriel Leung, Brian Goffenberg, Christian Sgro, Richard Baldry, Daniel Rosenberg

Babak Pedram:
Good morning, everyone, and thank you for joining Vitalhub's 2023 third quarter conference call. Before we begin, I will read our cautionary note regarding forward-looking information. Certain information to be discussed during this call contains forward-looking statements within the meaning of applicable security laws, including among others, statements concerning the company's 2023 objectives, the company's strategy to achieve those objectives, as well as statements with respect to management's beliefs, plans, estimates, and intentions, and similar statements concerning anticipated future events, results, circumstances, performance, or expectations that are not historical facts. Such forward-looking statements reflect management's current beliefs and are based on information currently available to management and are subject to a number of significant risks and uncertainties that could cause actual results to defer materially from those anticipated.

Also, our commentary today will include adjusted financial measures, which are non-GAAP measures. These should be considered as a supplement to and not as a substitute for GAAP financial measures. Reconciliations between the two can be found in our MD&A, which is available on SEDAR and our website. With that, I will hand over the call to our CFO, Mr. Brian Goffenberg, to go over our financial highlights for the quarter. Please go ahead, Brian.

Brian Goffenberg
Thank you. Good morning, everybody, and thank you for taking the time to join us this morning. Our well-established Business Foundation remains a strong driver of robust financial performance.
In Q3, VitalHub have delivered another impressive quarter, demonstrating consistent growth in revenues, gross profits, net income, and cash generation. This success can be attributed to our unwavering commitment to expanding our healthcare product portfolio, further integrating into healthcare networks and growing our geographical reach. As a result, we achieved a significant increase in our annual recurring revenue, marking 38% growth compared to the same period last year.

We are very pleased with our strong presence in the market as our products consistently provide significant value to our customers. The future of our company holds tremendous promise, and we are very excited about the opportunities we see in our space.

With that in mind, I will now proceed to present the financial highlights for this quarter. Total revenue for Q3.23 was $13.2 million compared to $9.8 million in Q3.22, an increase of 35% year over year. Total revenue for the nine months ended September 30th, 23 was $38.9 million compared to $28.7 million for the same period in 2022, an increase of 36%. Revenue from Term Licenses Maintenance & Support in Q3.23 was $10.8 million compared to $7.7 million in Q3.22, an increase of 41%.

Revenue from Term License Maintenance Support for the nine months of 2023 was $31 million compared to $20.6 million for the first nine months of 2022, an increase of 50%. This increase reflects the impact of continued organic revenue growth in the company's suite of products coupled with the revenue derived from acquisitions completed during the first quarter of 23 and previous years.

Revenue from Perpetual Licenses in Q3.23 was $57,858 compared to $204,233 in Q3.22, a decrease of 72%. Revenue from Perpetual Licenses for the first nine months of 2023 was $623,314 compared to $3.1 million in the same period of 2022, a decrease of 80%. Decrease was primarily attributable to the timing of deliveries of the company's Intouch products. In addition to the unusual volume of high market Perpetual License sales of over $2.7 million in the first quarter of 2022.

Brian Goffenberg
As a reminder, perpetual software licenses are dependent on the type of product sold. Revenue from professional services and hardware in Q3.23 total $2.3 million compared to $1.9 million in Q3.22, an increase of 22%. Revenue from professional services and hardware for the first nine months of 2023 for $7.3 million compared to $4.9 million for the same period in 2022, an increase of 47%. The increase is primarily attributable to the deployment of the ongoing customer projects and additional services revenues from use of surgeries. Annual recurring revenue or ARR of which we formally refer to as annual contract value total $42.6 million as of September 30th, 2023 compared to $31 million at September 30th, 2022, an increase of 38%. The continued increase in ARR growth is reflective of our strategy to grow the business both organically and through our position.

Gross margin on total revenue in Q3, 23 was 82% compared to 80 % for the same period last year. The increase in gross margin in Q3, 23 was primarily due to an increase in high maintenance and support revenues in the quarter coupled with an ongoing effort to reduce costs and gain operating synergies.

Gross margin on total revenue for the first nine months of 2023 was 81% compared to 82% in the same period of 2022. Decreasing the year-to-day gross margins were due to the unusual volume of high margin perpetual license revenue in Q1, 2022 compared to this year primarily.

Operating expenses in Q3, 23 totaled $7.9 million compared to $6.1 million in Q3, 22, an increase of 29%. Operating expenses for the first nine months of 2023 totaled $23 .7 million compared to $17.8 million in the same period last year, an increase of 33%. The increase is due to high sales and marketing expenses for conferences and exhibitions and R&D expenses for acquisitions completed in 2023 and previous years. However, it is important to note that we continue to experience significant reductions in operating expenses as a percentage of revenue as a result of increasing operating cost synergies. 59.5% in Q3 2022 compared to 62.4 % in Q3 2022.

Net income before taxes in Q3 2023 was $1.8 million compared to net income of $498,000 in the prior period, an increase of 78 % year over year. Net income before income taxes for the first nine months of 2023 was $3.3 million compared to $2 million in the same period last year, an increase of 41% year over year. Net income after taxes in Q3 2023 was $2.8 million compared to $41 ,000 in Q3 2022, an increase of 6,833%.

Excluding a one-time tax reversal, Q3 2023 net income was $1.8 million representing $0.04 fully diluted per share.

Net income for the first nine months was $3.6 million compared to $1.6 million in the same period in 2022, an increase of 133%. EBITDA in Q3 2023 was $2.9 million compared to $1.4 million in Q3 2022, an increase of 111%. For the first nine months of 2023, the EBITDA was $6.9 million compared to $4.8 million for the same period in 2022, an increase of 44%.

Adjustred EBITDA in Q3 2023 was $3.4 million or 26% of revenues compared to $2.1 million or 22% of revenues in Q3.22, an increase of 59%. The increase was primarily attributable to the higher recurring revenues of $10.8 million in Q3.23 as compared to $7.6 million in Q3.22, coupled with an ongoing effort to reduce costs and gain operating cost synergies.

For the first nine months of 2023, Gaster EBITDA was $9.3 million or 24 % of revenues compared to $7.1 million or 25% of revenues for the same period in 2022, an increase of 32%. The increase was primarily attributable to the higher recurring revenues of $31 million for the nine months ended September 30, 2023, as compared to $20.6 million in the equivalent period in prior year, coupled with ongoing efforts to reduce costs and gain operating synergies. Cash flow from operations before changes in working capital for the first nine months of 2023 was $8.6 million compared to $5.3 million for the same period last year.

Cash flow provided by operating activities for the first nine months of 2023 was $15.7 million compared to $8 million for the same period last year. Cash on hand at September 30, 2023 was $29.8 million compared to $17.4 million at the end of 2022. In comparison to Q2.23, cash on hand increased by $6.9 million.

With that, I'd like to hand the call over to Dan for an update on the business.

Dan Matlow
Thank you, Brian. I don't have a ton to say. We'll just highlight a few points and get some questions answered, but I think the financials and Brian's explanation are pretty self-explanatory and speak for themselves. We're proud of the quarter and we're proud of what we've done to date. We're starting to see the fruits of a well thought out business plan that we've been articulating to our investor base over the last five years, and it continues to come to fruition and we just keep thinking the foundation keeps getting stronger and stronger on a quarter or a quarter basis. So we're proud of that and it's all led by our high recurring revenue stream of, you know, gets $42 million and we continue to add ARR between $800 and $1.5 million per quarter.

We were on the higher end in this quarter, which is typically not what we do in a seasonally quarter in the summer, but it did happen and we still see velocity in our in our pipeline, primarily driven by the Transform, TREAT solution, and the Hicom Oriel solution as being the, but all the divisions continue to contribute and we are still seeing, you know, impact from all of them. So we are still seeing growth. We got visibility into growth still and we continue to do that. You know, summer time is typically a little bit of a lower spend on sales and marketing, but for the most part, our cost reductions still continues to come in place and we continue to work on using our Colombo software, our Colombo base as effectively as we can. The nice part about the Colombo base, it's really evolved to much more than just a, you know, an offshore development growth. The innovation and the experience of that team continues to grow.
I think we're up to 130 people in that group yet and a lot of these people have been with us for a while now and we're really starting to get some really good IP over there and we're starting to see that in the products themselves from an innovative perspective.

So we're starting to look on new initiatives such as AI, other initiatives, add on products that we can sell to our customer base and we're really excited by some of the things that we're doing in there.
M&A activity, nothing over the finish line, although we are working on some things and we are finally starting to see some movement from some companies that we've been speaking to for a very long time that are finally getting to that point of going there.

So we continue to build our war tests. Our cash is up to $30 million. We continue to add cash on a regular basis. We still have the debt facility available to use and we do want to do M&A and we expect to be doing M&A in the next little while. So we continue to work there in that belief. We're in the budget process right now. We believe we're well positioned for 2024.
The product, the platform is stable in terms of what we do, in terms of our business plan and it just keeps growing with our recurring revenue stream in our base and we're really excited as we move into 2024. And with that, I'll take some questions.

Babak Pedram
Thanks, Dan. Should you have a question, please use the Zoom raise hand function on the bottom of your screen and we will make sure to open your line. The first question comes from Doug Taylor of Canaccord. Please go ahead, Doug.

Doug Taylor
Yeah, thank you. Good morning. This was another quarter-punching at the very high end of the ARR growth targets, the $800,000, $1 .5 million. Can you talk through more specifically where the traction is coming from? And I know you said it's really in your budget process, but is there any reason to think that you wouldn't, on an organic basis, be able to add a like amount of ARR in 2024?

Dan Matlow
I think based on our pipeline, I think we can add that in 2024 at the same levels. There seems to be inertia and we got many different ways and many different products that we can do that.
We're seeing momentum Transforming is definitely seeing momentum in the UK marketplace. And we're starting to see momentum outside of the UK marketplace. The TREAT product continues to win RFPs and we're seeing a lot more RFPs coming from the Children's Mental Health space in Ontario, which is going through a total revamp of how they articulate the importance of digital health records.
And we become the, the de facto standard that I think in many ways for that particular world. And Hicom has that platform Oriel, which is continuously adds users to that platform and continue to continue to grow that particular platform. So those three, but we've had impact from our Australian group. We've had impact from our new coyote group in terms of new deals. We started seeing work in the MCAP product in particular spaces and we continue to see, things happen in many different directions with those products. So we're seeing it all over, but, you know, those are the primary ones Doug.

Doug Taylor
So pretty broad base. That's great to see. You also, the next question you said last quarter, I think you had more to do on the expense side, I think was the quote, you know, this quarter, you actually hit your 25%, you know, medium term EBITDA margin target. So I guess the question is, is there still more to do

um do you think that the 25% margin or 26% you delivered this quarter is sustainable? Should we be expecting something in that range going forward?

Dan Matlow
I think you can do it you can sustain it like we would like to we would like to add a little bit more and some of the sales and marketing costs and as we go into 2024 but still sustain those levels as we get into some new geographies we're seeing some increased activity in the mid-east and we think there's some opportunities there to add and in some other areas so we're balancing investment into some of those areas versus you know getting those margins but we're always committed to at least being that rule of 40 company and we'll keep sustaining that well congratulations on another good quarter I'll pass the line.

Babak Pedram
Thanks Doug next question comes from Christian Sgro of Eight Capital. Please go ahead Christian

Christian Sgro
Hi good morning thanks for taking my questions. I'll start on seasonality which I think used to be a bit of a more pronounced impact not with the UK government year ends in Q1 as you called out then the summer was you know I think stronger than we all expected and it can be slower with the government there. Would you say with how the business is becoming more broad that seasonality is less of a trend quarter to quarter should we think of you know the Q1 of '24 coming up as being the bigger one than normal as in other years or is this becoming a smoothing pattern with the growth

Dan Matlow
You know we're still like we're still only a $50 million dollar company and $44 million and you know we're we're although we're adding $800 or $1.5 million per quarter of ARR I wouldn't be surprised if in the summer quarter we added two million and I wouldn't be surprised in a Q1 quarter if we added $500,000. It's not. Purely that is predictable. Typically, it's hard to get procurement to move in the summertime. You know, as much as possible, a bunch of this revenue that we got in Q3 was fill over revenue from Q2, you know, that was there and we just had to go through procurement and stuff like that, but it's typically summers are not the easiest to do, so I would expect seasonalities to continue in the summer. We definitely had a good quarter of the summer, but if you ask me if we can do it again next summer, I would still say seasonalities still become an issue with it, but you just never know.

Christian Sgro
Okay, that's helpful. And I'll ask one more follow-on related to what Doug was getting at with respect to profitability and reinvestment. The margin and cash flow profile is very strong through the 25%. How do you balance growing that profitability versus investing in headcounts and sales? Like, are there geographies where you could, you think, add a couple of people and really increase the growth or are you comfortable with the capacity currently? How are you thinking?

Dan Matlow
We're putting a little bit more growth into the mid-ease? We did invest in Australia with a team in the middle part of this year, which hasn't started to produce significantly yet on the flow scope. But we are starting to see a pipeline from that group into 2024, which we're optimistic about. Mid-east, we do have implementations in the mid-east through our Hicom acquisition, and we do have a couple of personnel

over there already. We've been spending time flying in and out of there, and we have started to build some partnerships and more relationships, so we will put a little bit more investment into that. that, but we don't want to, we won't enter a market unless it's with a distributor, or we enter it through an acquisition. Every healthcare market is very different, so the markets we're dealing in right now are the mid-East, Australia, Canada, the UK. We're looking at acquisitions in Europe still. We'd like to get something done that open up new markets, but we'll continue to work in these markets. There's enough time here for us to do what we need to do, and we're hoping to get acquisitions that will help us get into new markets, and we continue to do that. Great. Thanks for the call, Dan. Thanks for taking my questions.

Christian Sgro
Thanks, Christian. Next question is from Gavin Fairweather of Cormark Securities. Go ahead, Gavin.

Gavin Fairweather
Hey, good morning. Congrats on the strong numbers. I wanted to start out on some of the acquisitions that you done, which were historically a bit more mature, like Jayex, Roxy, Clarity, Coyote. Are you seeing any interest from those customer bases to upgrading to some of your more flagship offerings, like Intouch or TREAT? Any thoughts on encouraging movement over time, just thinking about whether we could start to see those bases move to your flagship platforms?

Dan Matlow
They're already our movement to our flagship platforms. The Jayex bases, I think we've done last year, and one of the deals this year already was movement upwards into the Intouch base, so we are seeing that. That's the plans of that Jayex Bases, at least for the larger clients. We're moving them forward. We've moved a bunch of the bigger ones, and we continue to move bigger ones into the TREAT platform on a go basis. Actually, some of those are moving to the Coyote platform now, because Coyote has an affinity to that as well. So there's some of that that's happening. Coyote has been a welcome surprise in terms of this tech stack and some things that it offers different for the smaller type of organizations where TREAT would be for the bigger ones. So we are starting to move those guys through a lot of the Alamac and Beautiful Information they're sold with Transforming. It's really one offering that's coming through and into those offerings that we've integrated those offerings into a little bit more of a comprehensive base with Transforming which is always the plan there.

Gavin Fairweather
Okay that's helpful color and then on M&A I mean you referenced it has been a little bit of a slower year so far sounds like you've got some kind of irons in the fire but maybe we can dig in a little bit just on kind of the deal flow that you're seeing and the deal environment.

Dan Matlow
Yeah we've had some deals that we thought we were doing and then pulled out at the last minute just in terms of quality and so forth we're just being careful but there you know we have our targets we speak to them regularly but we're starting to see some movement on some companies that we've been speaking to for you know two-three-four years that have finally decided that this might be the route that we want to go and so we do got some talks for another year.

Gavin Fairweather

Is that moving just timing related to kind of the principle behind the…

Dan Matlow
Yeah usually what it is yeah

Gavin Fairweather
Okay good stuff maybe for Brian the working capital is being a nice tailwind to your cash balance over the past of the while like if I look over the past four quarters you've been kind of adding on average like a million dollars coming out of working capital. If the sales kind of keep up at this five to six million per year rate on ARR, can we start to bake in that tailwind into your results, or is that too aggressive, and maybe some of this was more timing related?

Brian Goffenberg
Some is timing, but I think we can. As we're going forward, we think we're generating, I mean, we probably did a book about cash balance has gone up significantly from last quarter, some of it's due to timing, but part of it is due to the business itself. We're generating about three, just under three million cash a quarter, so I think we can.

Gavin Fairweather
Okay, that's helpful, and then just given that cash balance, obviously you want to keep a good chunk of it for M&A, but given how much cash you're now generating, would it make sense to start to allocate a little bit to the buyback to get out there and buy your own stock, give an evaluation?

Brian Goffenberg
We're hoping the market takes care of that for us, that we don't feel a need to buyback, and I think we can do better with the money. I think we can probably make our creative acquisitions. I'd rather use it for that, which I think we can do.

Gavin Fairweather
Okay, that's it for me, I'll pass it on.

Babak Pedram
Thank you. Thanks, Gavin. Next question is from Gabriel Leung of Beacon Securities. Please go ahead, Gabe.

Gabriel Leung
Morning. Thanks for taking my questions, and congrats on the quarter. I don't have a ton more to ask, but I was going to say, Dan and Brian, you both look very rested, but is there anything that's keeping you up at night, either one of you, in terms of the business, what you're seeing macro-wise, et cetera, et cetera?

Dan Matlow
Right now, we're in a pretty good spot. We see the pipeline looks pretty positive, it's there, yet we're working our way through this. So nothing that's really staring me, like it's nice having a base of $42 million of recurring, right? Like, you know, one of these quarters we're just not gonna hit that organic number. I just, I keep saying it, but we keep hitting it. But, you know, it's still, you know, you just don't

know what government funded healthcare, like just procurements and stuff. Compliance is getting a little bit crazy. You know, I think you guys saw a couple in the news, you know, there's some ransomware going on in some of the Ontario hospitals and we're seeing that in UK concerns. So we have to be in a position to articulate our security and our platform. The good news that we have is we really compete, in most cases, with a lot of smaller competitors, and we've made a ton of investment into our security infrastructures and to our certifications, both on the ISO and in the SOC2-based world. And that's becoming a lot more of an important criteria for buying software. So a lot of these smaller companies, which are targets or competitors, are really gonna struggle on a go-for basis to be able to articulate and really meet what the stringent compliance-based guidelines that are starting to come into our sector a lot more, especially in, you know, hosted-based worlds. On the flip side of that, it costs us money to keep those compliance structures. We're trying to pass that on to customers and so forth, but we are forced to invest heavily into our IT resources and into our certifications and into our compliance, which we think are good investments on a go-for-a-basis, but it is cost. Most of those costs are already baked in. in. We do have a significant group that does it already, so that's the good news that comes with it, but I can't anticipate that's going to get any easier on a go-for basis. It's going to get tougher, and it could also lengthen sales cycles as you prove the ability to have those in place prior to being able to implement at these customer sites.

Gabriel Leung
Gotcha. Maybe just one last thing. I know you guys are in the budgeting process, I guess, for next year or now, but I'm just curious if, I think somebody asked the question previously, but do you actually have a preference for scaling back margins a little bit to drive a bit more growth, or do you aspire to move on to the next even a margin milestone of maybe up to 30% now?

Dan Matlow
We believe in these markets and into the future, a company like ours, but how we operate is, for the most part, going to be evaluated on our margins and our EBITDA. I think they want growth as well, but I do think the EBITDA has to come first, and we're not going to sacrifice that for sales and marketing. We do selectively add into other markets, and we do, but I think at the end of the day, my belief and our board and the Shens and others, we'd like to see that cash balance grow on a quarter-over-quarter basis. That's sort of what we're about.

Gabriel Leung
Gotcha. That's helpful. Thanks for the rest of the quarter. Thank you.

Babak Pedram
Thanks, Gabe. Next question is from Richard Baldry of Roth Capital Partners. Partners. Please go ahead, Richard. Richard, your line is muted.

Richard Baldry
Sorry about that. You've been hitting the upper end of your ARR target pretty frequently lately. So I'm sort of curious how you feel about sales capacity and productivity, whether, you know, with the existing group you've got, you can take that up to the next level, or, you know, without stressing your EBITDA margins, do you think near-term, intermediate term, there's a sort of a step function increase to the sales to kind of bring that up?

Dan Matlow
Yeah, you know, I'm a conservative by nature, Richard. I do think the pipeline would support that. We could have quarters above that $1.5 million in the near horizon, based on some activity that we got going on. But I'm always hesitant to do it, because we could have some lower quarters as well, but I do think there's air. We really need, you know, in order to grow, you know, when we start seeing a little bit more evidence from our other geographies of products taken off, I think we already have a fair amount of investment in sales people in Canada that are trying to bring in in Australia, and the Mid-East that are trying to bring newer products from other markets into those markets that have somewhat hit our growth, but I don't think it's hit as significantly as it can in the next little while. So we are making investments in those markets right now as we speak, and our expectation is that that will contribute to some of the growth. That sort of, you know, we'll selectively add more, but I think just based on the TAM of the markets and stuff, I think we're well suited with our investment in sales and marketing, and we tend to upsell into our base. We'd rather make more acquisitions and get more products and get more growth. That's really where I think our focus is right now is we want to get some of these acquisitions over the finish line.

Richard Baldry
An extension of that, if you look at the defensibility or space, it probably should be better in a macro sort of uncertain world. Inside your sales that you've closed or even the pipelines you look ahead, have you seen any changes to things like how much is coming from green field versus cross sell, upsell, retention rates, maybe a different geographies?

Dan Matlow
It's hard to really define what the definition of cross sell versus green field. Some of them are obvious, but the NHS, for example, is NHS a sort of an entity, and healthcare tends to buy in a herd mentality type of mode, so the children's mental health, if we get one government agency or two, when that RFP comes out next, there's probably a pretty good chance that we've done a good work and the other ones that we're going to get that business again and again and again and again, and if you're the one that's there and every time you implement, you put something in a little bit more that's specific to that particular geography and you become the standard for that, and a lot of our products are that standard, so it's green field, but it is somewhat cross sell as well, and then once we're in there, new products, get added to it, and we spend a fair amount of our money on what we call customer success account management, retention A) to protect our recurring and B) to add on new modules. There's a lot of work still to mine our customer base with add-ons of products and existing stuff. It's still a big part of what our is, but we do, we get greenfield as well.

Richard Baldry
Great. Thanks. Congrats on a great quarter.

Babak Pedram
Thanks, Richard. Next question is from Daniel Rosenberg of Paradan. Please go ahead, Daniel.

Daniel Rosenberg
Good morning, Dan and Brian. Just a quick question on the macro. I was curious about the budget landscape. Coming out of COVID, there was a lot of support from health organizations to support budgets and grow them. I'm curious how you think about this trend in the next several years and how

you square this away with your business. Just any thoughts around what you're seeing on budgetary discussions with clients?

Dan Matlow
We still see budgets for digitization of systems. There's still a lot of work going on in healthcare to get it to the next level. It's somewhat insulated from this macro world. It depends on the market, but NHS seems to continue to put out envelopes for strategic initiatives, which we've fit into in numerous times. We're still seeing money that's being circulated. We're not seeing the amount of credit. In Canada, we don't think we ever saw it in all of our COVID. At least for our products in the UK, there's a little bit of craziness going on in spending. Maybe not to the extent that it was before, but as you can see through this quarter, we're still seeing demand and capital for them to expand and grow their digitization there's still a lot of work to go to get move those places forward.

Daniel Rosenberg
And then as a follow-on so in the UK could you categorize kind of what inning we're in as far as you know digitization you're getting it to like a global you know updated standard versus Australia or the Middle East or some of the other European markets.

Dan Matlow
I think the United States would be the gold standard I think that you would have and UK would probably be a four compared to where the US would be. Canada is probably a little further ahead because we're closer to the US but they still got a ways to go.

Daniel Rosenberg
Great. Congrats on another strong quarter. Appreciate the call.

Babak Pedram
Thanks, Daniel. There are no further questions with that I will hand over the call back to Dan for his closing remarks. Thanks again everyone.

Dan Matlow
Thanks everyone for your support and again particularly where we are we think we've built a really strong foundation with our business model and as I said before we we we focus on three things every day one is to make a creative acquisition but I think a lot of M&A companies do we're really focused on that right now to try to get some things over the finish line. Secondly organic growth high margin recurring based revenue and as that grows it comes to the bottom line and we're seeing that come to the bottom line you know quarter over quarter and we have the ability to move resources into our Sri Lankan based resource for both innovation in a cost-effective fashion and that allows us to service this market in an effective way in a cost-effective way and you know all three of them seem to be working really well we've spent a lot of time at it and we just keep building block by block and that's what we're all about and we continue to do it.

Babak Pedram
Thanks Dan thanks everyone this concludes our conference call you may disconnect now. Thank you everyone. Thank you very much.