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CSG Systems International, Inc. (CSGS)

Q2 2019 Earnings Call

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Gregory Burns

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MANAGEMENT DISCUSSION SECTION

Operator: Good day, everyone, and welcome to the CSG Systems International Second Quarter 2019 Earnings Announcement. All participants are in a listen-only mode. A question-and-answer session will follow today's presentation and the instructions will be provided at that time. Today's conference is being recorded.

At this time, I'd like to turn the conference over to Ms. Liz Bauer, Senior Vice President, Chief Communications & Investor Relations Officer. Please go ahead, ma'am.

Liz Bauer

Senior Vice President, Chief Communications & Investor Relations Officer, CSG Systems International, Inc.

Thank you, Kelly Ann, and thanks to everyone for joining us. Today's discussion will contain a number of forward-looking statements. These will include, but are not limited to, statements regarding our projected financial results, our ability to meet our clients' needs through our products, services and performance, and our ability to successfully integrate and manage acquired businesses in order to achieve their expected strategic, operating and financial goals. While these statements reflect our best current judgment, they are subject to risks and uncertainties that could cause our actual results to materially differ. Please note that these forward-looking statements reflect our opinions only as of the date of this call and we undertake no obligation to revise or publicly release any revision to these forward-looking statements in light of new or future events.

In addition to factors noted during this call, a more comprehensive discussion of our risk factors can be found in today's press release, as well as our most recently filed 10-K and 10-Q, which are all available on the Investor Relations section of our website. Also, we will discuss certain financial information that is not prepared in accordance with GAAP. We believe that these non-GAAP financial measures, when reviewed in conjunction with our GAAP financial measures, provide investors with greater transparency to the information used by our management team in our financial and operational decision-making. For more information regarding our use of

non-GAAP financial measures, we refer you to today's earnings release and non-GAAP reconciliation tables on our website, which will also be furnished to the SEC on Form 8-K.

With me today on the phone are Bret Griess, our Chief Executive Officer; and Rollie Johns, our Chief Financial Officer.

With that, I'd like to now turn the call over to Bret.

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

Thank you, Liz, and thank you all for joining us today. We started the year strong as is evidenced by our results for the second quarter and quite frankly the first six months of 2019. For the second quarter, adjusted revenues grew 7% year-over-year to \$228 million, and non-GAAP earnings per share grew 16% to \$0.85. Organic growth was once again about 2.5%. Our operating margin came in at 17.6% at the higher end of our long-term target range of 16% to 18%. We're delivering these strong and stable results at a time that our customers are reinventing the way that they do business. This quarter is a classic example of how we are helping our clients to do this. Whether it be through consolidating their customers onto fewer revenue management platforms, looking to introduce new revenue generating services, or utilizing cloud-based solutions to drive more flexible, agile and lower cost capabilities. Let me share some examples of what I mean by this.

This quarter we completed the conversion of approximately 0.5 million of Charter's customers off of a third-party revenue management solution and onto our platform. This allows Charter to deliver a more consistent and higher quality customer experience. In addition, this reduces the number of technology vendors that Charter needs to manage and train its personnel on. We service approximately 60% of Charter's residential customers. Our goal is to earn the right to serve the remaining 40% one day by helping them standardize and improve their customer experience while improving their overall costs to serve those customers.

Next, a Tier 1 Scandinavian telco signed a multi-year contract with us to help them launch new digital services to their customers later this year. This operator will be deploying many of our next generation solutions to deliver a truly compelling end-to-end digital monetization experience for their customers. We will be providing our solutions in a managed services agreement, meaning we will be implementing, configuring and running our solutions on behalf of this operator. This is a great example of how we are driving longer term engagements with our international customers, in essence lengthening and strengthening our relationships. Solutions that will be deployed include our Ascendon cloud-based digital monetization solution and our recently introduced Journey Orchestration solution.

Our Journey Orchestration solution is part of our customer communications management portfolio. It provides companies with a centralized, personalized, real time decision-making engine that allows them to engage with their customers in a relevant and meaningful way, across any channel and most important, the customers' preferred channel, whether that'd be text, email, voice or others. And finally, this quarter we introduced several new solutions as a result of our continued steady investment in research and development. The first is our Journey Orchestration solution which I just discussed. Next, we have applied our cloud-first approach to our Mediation platform and announced the availability of our industry-leading solution in the cloud.

With the current and upcoming deployments of 5G around the world, we anticipate that there will be massive increase in the number of sensors and connected devices. However, it will be difficult for service providers to predict the number of applications that will leverage this new connectivity. With our cloud-based Mediation platform, service providers will be able to scale on demand to support this growth as it happens. In fact, our

platform can scale up to 150 billion events per day, that provides a cost effective way for operators to tie their cost to current demand versus the traditional method of investing upfront to account for unpredictable peaks. We have several customers that are using our cloud-based mediation platforms.

Next, we just recently introduced our field service management suite. This is a next evolution of our award winning Workforce Express solution in which we've again taken our cloud-first approach to provide our clients with global availability, scalability and data security in real-time. Our product suite enables field technicians, who many times are the first person that a new customer engages with, to provide a more integrated and proactive customer experience that optimizes operations. This is one of those solutions that is very easy to demonstrate a quick return on investment due to the increase in worker productivity. We believe this will become even more important and substantial as the service providers' ecosystem grows.

These are just a few of the examples of how we are helping our clients acquire, monetize, engage and retain their customers. Being a trusted partner to some of the world's leading consumer brands means that you must continually invest, innovate and deliver solutions that help companies optimize each touch point in the customer lifecycle, we've been doing that for over 35 years. As I look forward to the remainder of the year, I like where we are. We're focused on continuing to lengthen and strengthen our relationships with our existing customers and earning more of their business. We are well-positioned to help our customers' biggest business challenges as a result of our investments in our people and our solutions.

Our acquisitions continue to perform to plan, and we believe we have the right formula for delivering the results anticipated from current and future acquisitions. This allows us to diversify our revenue mix in a logical and intentional approach. We continue to evolve our cost structure to ensure that we are true to our competitive differentiator, which is delivering on our promises while at the same time ensuring that we have the right people, technology and platforms to deliver at the right price point. And last but not least, we are consistently delivering organic revenue growth that is above the industry growth rates.

In summary, we're executing on a strategy that is working, and we are seeing the benefits of that strategy, and we are in the fortunate position as we look to the future thanks to several key characteristics of our business. First, we have an enviable business model with strong fundamentals that position us well to drive shareholder value. Second, we have unrivaled domain expertise in the customer experience, revenue management and digital monetization and payment industries. Third, we work with some of the largest and most innovative services providers in the world, and we are establishing ourselves as a trusted digital transformation partner for companies undertaking this journey. Fourth, we have proven technology and a solid reputation for operating our solutions really well. The strength of these solutions allow us to pursue new verticals creating a more diversified and sustainable growth engine. Fifth, we generate strong cash flows and have a solid balance sheet, which gives us tremendous flexibility to grow and diversify the business and still return capital to our shareholders. And most important, we have talented and dedicated employees across the globe who are committed to helping our clients and our company achieve greatness.

With that, I'll turn it over to Rollie to review our financial performance for our second quarter.

Rolland B. Johns

Executive Vice President & Chief Financial Officer, CSG Systems International, Inc.

Thanks, Bret, and welcome everyone to the call today to discuss our financial results for the second quarter, as well as our outlook for the remainder of 2019. We are pleased with our solid start to the first half of the year as we deliver on our strategic initiatives. So let's walk through our financial results. We reported revenues of \$246 million for the second quarter. Non-GAAP adjusted revenues, which exclude transaction fees were \$228 million, up 7%

compared to the second quarter of 2018. This increase is reflective of two key items; first, we delivered organic growth of about 2.5%, driven mostly by continued growth in our cloud solutions and managed service arrangements. Second, the contribution from Forte, which we acquired in early October of last year.

Moving on, our second quarter non-GAAP operating income was \$40 million or 17.6% of non-GAAP adjusted revenues. Our operating results this quarter reflect the consistency in our revenue quarter-over-quarter, and the alignment of costs to continue to deliver those revenues and invest in our people, products and clients. Next, our non-GAAP adjusted EBITDA was \$55 million for the second quarter or 24% of non-GAAP adjusted revenues. Our non-GAAP EPS for the quarter was \$0.85, up 16% over last year, mainly due to our strong current quarter operating performance. As expected, our non-GAAP tax rate was 26%.

So moving on to the balance sheet. We ended the quarter with \$131 million of cash and short-term investments. We generated \$16 million of cash flow from operations and \$6 million of free cash flow for the quarter. Cash flow for this quarter was impacted by the timing of a significant client payment that was delayed and received shortly after quarter end. We've seen this before, for example, in the first half of 2018 we were impacted in very much the same way. Then in the second half of the year, we generated significant cash flow that leveled out our working capital over the full year. This is why we remain confident in our cash flow guidance for the full year 2019.

In addition, we paid approximately \$7 million of dividends for the quarter, which reflects an increase of 6% in our per share dividend rate over last year. And finally share buybacks totaled approximately \$7 million for the quarter. So moving on to our guidance. After two strong sequential quarters, we are reaffirming our 2019 revenue guidance at a range of \$965 million to \$995 million, and we continue to expect non-GAAP adjusted revenues to be between \$903 million and \$920 million. That said, considering our year-to-date performance and the outlook for the second half of the year, we anticipate ending the year at at least above the midpoint of those ranges.

As a reminder, the 5% to 7% increase in adjusted revenue over 2018 reflects growth in our traditional business, as well as the expected incremental revenue contributions from our 2018 acquisitions. The consistency of our performance in the first two quarters strengthens our confidence in our outlook for the remainder of the year. Therefore, we are reaffirming our previously provided guidance as follows. We expect non-GAAP adjusted operating margin of 17% to 17.5% and see a clear path to the higher end of that range. We also expect adjusted EBITDA of \$206 million to \$213 million, a 3% to 7% increase over 2018.

In addition, we expect our 2019 non-GAAP EPS to land in the range of \$3.15 to \$3.31, a 3% to 8% increase over 2018. This expectation is based on a 2019 non-GAAP tax rate of 26% and continued share repurchases under our buyback program, with anticipated outstanding shares for the year of approximately \$32 million. And finally, despite our short-term working capital headwinds in the first half of the year, we continue to expect a range of operating cash flow of \$125 million to \$150 million with an annual capital spend range of \$30 to \$40 million. In summary, we continue to execute well with solid organic and inorganic revenue performance driving bottom line growth. We are pleased with this quarter's operating results, allowing us to continue executing on our long-term business objectives and returning cash to our shareholders to deliver additional long-term value.

With that, I'll turn it over to the operator for questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] We'll hear first today from Tom Roderick with Stifel.

Matt VanVliet

Analyst, Stifel, Nicolaus & Co., Inc.

Hi, guys, Matt VanVliet on for Tom. Thanks for taking my question.

Liz Bauer

Senior Vice President, Chief Communications & Investor Relations Officer, CSG Systems International, Inc.

Hi, Matt.

Matt VanVliet

Analyst, Stifel, Nicolaus & Co., Inc.

Hi, how are you? So obviously another very solid quarter. Just wondering if you could touch on some of the Charter announcement that you talked about 500,000 subs moving over and just how that continues to play out, what the ongoing conversation there is in light of some recent announcements from your competitors around maybe some of the new mobile offerings from those traditional pay TV providers?

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

Yeah, sure, Matt. I appreciate the question. You being on today. Thanks. It was really an opportunistic one where they had a market that they were looking to consolidate. And speaking of the fact that we're the only company in the industry that has a dedicated conversion team for over 30 years. I'm once again incredibly proud of our team that pulled off the conversions moving those 0.5 million subs over onto the consolidated platform without missing a day, without losing anything along the way. So it was an outstanding effort by the team. And as we said in the formal notes is the fact that we believe it positions us really well for that longer term dialogue as we go, including some of the other wins that we've had at Charter around kiosks and some of the items that happened on that front.

As far as some of the other ones and some of the competitiveness have referenced the mobile activities that are going on, we continue to say, these are large clients with a lot of different activities going on. We're doing many different things within their environment. We just viewed this as a very good displacing win that positions us well to create that positive momentum. We'll continue to work day in and day out to serve Charter and all of our customers in a consistent high quality great price point position, and we believe that when these opportunistic things come up potential consolidations in the future we will be very well-positioned for them and we'll continue to deliver that way.

Matt VanVliet

Analyst, Stifel, Nicolaus & Co., Inc.

And then with the Scandinavian telco that you said you were selected by to rollout services, just curious in terms of what that overall contract looks like in terms of length and maybe total contract value, or where you think that that could go over time if you guys continue to deliver like we've seen you do at other areas like MTM and Telstra?

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

Yeah. We're not disclosing the TCV, the total contract value on at this point, but what I can share is it is a multi-year agreement, and it's a really broad one where we're helping to solve challenges as I mentioned with our Ascendon platform, but always or also through the

whole managed services, we're doing a lot more on behalf with them to help to plan and then execute on that. And as you've seen in the past, those are the areas where we get in and we get started and we continue to add value over time. So in essence, if you go back to 1995 and 1996, when we were asked by a small startup called DISH to help them to solve problems, it's been a multi-year relationship. The same way it is with Comcast. We just view when we get in like this and can do a multi-tenant, multi-function area as far as planning, developing, executing and having it on our next generation platform, we believe it positions us very well there in Scandinavia and beyond because we're taking that model that we've had for years and years and expanding more in the international marketplace to drive value with our solutions.

Matt VanVliet

Analyst, Stifel, Nicolaus & Co., Inc.

Q

And then just lastly, curious if you had any update or sort of comment on what the progress is in terms of some of the cross-sell opportunities with Forte, and if you had any key wins with that business in the quarter?

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

Yeah. As we mentioned in the notes, we continue to execute the plan. There have been some really good wins in the last two quarters on that front. No specific names that we're bringing to the call this quarter, Matt. But we're continuing to see really positive things there from the pipeline. And the sales team – actually just this week I've been reading some of the things that are going on and working with that team and there's a lot of positive momentum going and they're still executing the plan. So we're still very positive on what's going on with Forte in our payment space.

Matt VanVliet

Analyst, Stifel, Nicolaus & Co., Inc.

Q

All right. Well, thank you for taking my question.

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

Thank you, Matt.

Operator: We'll hear next from Greg Burns with Sidoti & Company.

Gregory Burns

Analyst, Sidoti & Co. LLC

Q

Good afternoon. I was just wondering if you could just maybe give us a little bit of color on the types of conversations you're having with your customers around Ascendon. If you're seeing any change in terms of pipeline or demand or interest in your legacy cable operators kind of deploying that platform or maybe even over the top, just what's the demand outlook look like for that platform?

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

Yeah, it's a good question, Greg. We continue to have very relevant conversations with our current customers and additional customers that are in the marketplace. Having a next generation platform is so important and so strategic, it has to be one that's solid and one that works. We have it deployed today in our top three customers in different lines of business there, but then we have things going on like the discussions we've had around the Scandinavian one that we just rolled out, we had a couple of new Ascendon wins this year which is a very exciting time for us. So it's not a direct replacement for some of the things that have happened historically, meaning our ACP platform, our workforce management platform, it just provides revenue management and digital monetization and some of the net new models. So the reality is, each of our products is incredibly important. Ascendon keeps us at the table and in very important discussions with the current customer base and a broader customer base because of how impressive it is and has been recognized by Deloitte, by IDC and others as a leading edge, high functioning platform on those lines. So we're getting a lot of positive traction with it, continuing with those sales. We've got it deployed. Customers like Comcast, university around the world and we'll continue to look to optimize all of the products within our portfolio.

Gregory Burns

Analyst, Sidoti & Co. LLC

Q

Okay. Thanks.

Rolland B. Johns

Executive Vice President & Chief Financial Officer, CSG Systems International, Inc.

A

And we've been doing double-digit growth.

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

And the double-digit growth on it has been outstanding. So yeah.

Gregory Burns

Analyst, Sidoti & Co. LLC

Q

Can you share kind of maybe a ballpark of what the revenue base is on that double-digit growth?

Rolland B. Johns

Executive Vice President & Chief Financial Officer, CSG Systems International, Inc.

A

We don't speak publicly of, or break out Ascendon. When Ascendon someday becomes material to our financial results we'll probably disclose that information, but right now I'd say those revenues are less than 10% of our overall revenue base.

Gregory Burns

Analyst, Sidoti & Co. LLC

Q

Okay. And when we think about maybe more basic subscription management or billing solutions, can Ascendon scale down and maybe go down market to expand your addressable market, or is that something you'd have to either build organically or acquire to do so?

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

We know that it has the capabilities to scale down because of the incredible feature functionality in the micro services it come to bear in the AWS solution. When you go down market into some of the subscription billing, there's a lot of opportunity there. We've been contemplating that. We look at that from a build versus buy. It's not just the technology and the product. It's the go-to-market. A lot of those are the more entrepreneurial startup business models. So you see some of the different competitors that are in that, bloody ocean right now working to try to make money in that cycle. We'll continue to look at that and prioritize all of the verticals where we go into Greg, because we just want to make sure that we're going into places where we have the solutions to win and can actually make money and drive value for our shareholders. But the question you're asking is one that we contemplate daily and are continuing to look at the best places to apply our resources to drive the business.

Gregory Burns

Analyst, Sidoti & Co. LLC

Q

Great. Thanks.

Operator: [Operator Instructions] We'll hear next from Zach Silver with B. Riley.

Zack Silver

Analyst, B. Riley FBR, Inc.

Q

Okay. Great. Thank you for taking the question. Apology if this has been asked. I'm jumping over from another call. But with DISH potentially getting into the wireless business on a bigger scale, and you have a relationship with them already, how do you see the opportunity with DISH evolving over time?

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

We see it as a great opportunity, Zack. And thanks for being on the call and asking. From the residential, we've done a lot of work with DISH over the last 25 years, 30 years. We've got great relationships with DISH. We think that the activities that are going on with T-Mobile, Sprint and DISH brings a lot of excitement to the market places. We're now going to have a net new player in that space or at least accelerating the growth, and when you consider all of the assets and resources that DISH has to bring to bear on that. So the discussions are happening. We'll be continuing in that discussion. We believe that the solutions we bring to market are prepared to help them to roll that out and continue to progress down that path, and we're just excited about the change that it's bringing to the marketplace and the opportunity that that will provide. And as we've seen over the years, it's Charlie Ergan and the entire team at DISH, they compete to win, and they will want to. So we will continue those discussions in this multi-decade relationship that we've got and helping them to solve business problems.

Zack Silver

Analyst, B. Riley FBR, Inc.

Q

All right. Great. Thank you very much.

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

A

Thank you.

Operator: [Operator Instructions] And there are no other questions at this time. I'd like to turn things back to you all for closing remarks.

Bret C. Griess

President, Chief Executive Officer & Director, CSG Systems International, Inc.

Well, thank you for being here for everyone who is on the call today. It's always important for us to be able to share with Wall Street and everyone out there about the progress that's being made and the drumbeat we're working to build to continue to have the momentum to solve with the investments that we've done in our next generation platforms and in our current platforms, and most importantly to our customers and our employees that are working so hard to solve in this hyper competitive industry to drive good business and good solutions. So thank you to everyone who is helping to make CSG the great company it is, and thanks for being here. Have a great day.

Operator: Again, that does conclude today's conference. Thank you all for joining us.

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