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Kinaxis Inc.

Fiscal 2015 First Quarter Conference Call

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CORPORATE PARTICIPANTS

Doug Colbeth
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Richard Monkman
Kinaxis Inc. — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Doug Taylor
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Andrew McGee
Cormark Securities — Analyst

Thanos Moschopoulos
BMO Capital Markets — Analyst

Kevin Wright
Canaccord Genuity — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen. Welcome to the Kinaxis Inc. Fiscal 2015 First Quarter Conference Call. At this time, all participants are in a listen-only mode.

Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for questions.

Before beginning its formal remarks, Kinaxis would like to remind listeners that today's discussion may contain forward-looking statements that reflect current views with respect to future events. Any such statements are subject to risks and uncertainties that could cause actual results to differ materially from those projected in these forward-looking statements.

Kinaxis does not undertake to update any forward-looking statements except as required.

I'd like to remind everyone that this call is being recorded today, Thursday, May 7, 2015.

I'll now turn the call over to Doug Colbeth, President and Chief Executive Officer of Kinaxis Inc. Please go ahead, Mr. Colbeth.

Doug Colbeth — President and Chief Executive Officer, Kinaxis Inc.

Good morning, and thank you for joining us today. Yesterday afternoon, we issued our fiscal 2015 first quarter financial results, a copy of which is available on our website, kinaxis.com.

With me today is our CFO, Richard Monkman. I'll address the key events from the quarter, and then Richard will review our financial results. I'll then close with a few comments on our growth strategies, and then we'll open up the line to Q&A.

We continue to see very strong demand for our innovative Supply Chain Management solutions in the first quarter. This is highlighted by our accelerating subscription revenues that grew by 36 percent year over year.

In addition, our adjusted EBITDA grew by 47 percent, which demonstrates the strength of our product uniqueness, coupled with our SaaS business model.

What's driving our strong growth is our ability to enable the largest companies in the world to rapidly respond to changes within their supply chain. Large enterprises must be able to quickly analyze the impact of constant changes in their supply chains and then rapidly course correct.

Kinaxis RapidResponse enables our customers to plan, monitor, and respond to change all within a single platform. RapidResponse solutions share a single database, simulation capabilities, and user interface.

This eliminates the need for disparate supply chain offerings and improves the speed of decision making.

The outcome for our customers is the ability to achieve higher customer satisfaction levels and/or generate significant cost savings for their businesses. This is the primary reason we continue to drive strong subscription growth from our business.

With that, I'll pass the line to Richard to discuss our financial results in greater detail.

Richard Monkman — Chief Financial Officer, Kinaxis Inc.

Thank you, Doug, and good morning. I would like to take a moment to remind our listeners that all figures reported on today's call are in US dollars under IFRS.

Revenue in the first quarter increased 26 percent to 19.7 million over Q1 2014. This was driven by subscription revenues that have expanded by over 36 percent to 15.4 million.

This growth in revenue was due to the addition of new customer contracts secured in the third and fourth quarters of 2014, in addition to expansion within our existing customer base.

Professional services revenue was level with the corresponding quarter in 2014 at 4 million. This was in line with our expectations given the timing of new customer project engagements, coupled with the completion of other customer deployment projects.

In addition, our partners continue to play an increasing role in supporting new customer deployments.

Adjusted EBITDA was 5.6 million or 28 percent of revenue in Q1 2015 compared to 3.8 million or 24 percent of revenue in the same period last year. The change in adjusted EBITDA during the period is due to an increase in operating profits that was driven primarily by the increase in subscription revenue and higher gross margin.

Net profit for the quarter was 2.4 million or $0.10 per basic and $0.10 per diluted share compared to a net profit of 2 million or $0.15 per basic and $0.10 per diluted share for the same period in 2014.

The increase in profit over the prior year was primarily driven by higher operating profits.

Gross profit was 13.9 million in the first quarter compared to 10.8 million for the same period in 2014. As a percentage of revenue, gross profit was 71 percent versus 69 percent in the prior period.

This increase was primarily due to relative growth rates between the two quarters. That is, the corresponding growth rate of subscription revenue was higher than the rate of increase in cost of goods sold.

Sales and marketing was 3.8 million compared to 3.1 million for the first quarter of 2014. The increase was due to higher commission expenses incurred in the first quarter of 2015, as well as increased sales and marketing headcount compared to the same period in 2014.

Gross R&D expenses increased to 4 million from 3.5 million in the prior-year quarter. This change was driven by an increase in headcount we made to support ongoing programs designed to further develop our RapidResponse offering for new and existing customers.

G&A expenses increased to 2.2 million from 1.6 million for the first quarter of 2015. This was a result of an increase in share-based expense, as well as external consulting fees.

Total deferred revenue increased by 55 percent to 58.1 million at March 31, 2015, versus year- end 2014 of 37.5 million. The increase was mainly the result of the prepayment of a multiyear subscription of approximately 20 million in the first quarter of 25 (sic) [2015], as well as other new subscription arrangements.

Deferred revenue, related to subscription terms beyond one year, totalled 15.7 million at March 31, 2015.

Cash generated by our operating activities for the first three months of 2015 was 23.6 million as compared to 0.3 million in the same period of 2014. The change was primarily the result of the receipt of a prepayment of subscription arrangements, and the increase in net income, share-based compensation, and income tax expense.

Cash and cash equivalents totalled 78.8 million as at March 31, 2015, as compared to 56.7 million as at December 31, 2014. The increase is primarily due to the already-mentioned prepayment of a multiyear subscription of approximately 20 million, as well as other subscription arrangements.

With that, I will turn it back over to Doug.

Doug Colbeth

Thanks, Richard. As we touched upon on the last call, we have strategically begun to invest in our partners as we see significant long-term potential to scale our business through these relationships.

There are two main partner relationships that we've been working on: implementation partners and channel partners.

With respect to our implementation partners, over the longer term, our expectation is that we will rely on them to take the lead on specific customer deployments.

In order to facilitate this, we have been working with them to ensure they are trained on RapidResponse so they can better serve our customers. To that end, we have established Kinaxis University to provide them with access to the high-level training.

Once our partners are fully trained on our software and deployment process, they will be able to take a much larger role in the deployment process, allowing our team to assume the role of delivery assurance and maintaining customer relationship.

We have also continued to work very closely with our channel partners, leveraging their established relationships to gain access to customers that have been engaged by—to assist in outsourcing certain aspects of their business.

In order to be successful with our channel partners, we've developed RapidResponse so that it could act as a platform upon which our partners can layer their own proprietary software and applications.

This unique feature of our software allows the large system integrators, such as Accenture, the option of providing their customers with a complete solution so they can outsource supply chain functions.

By doing so, we have the ability to take our technology into markets and application areas that we haven't yet explored ourselves, thereby speeding up the adoption rate of our software, and providing us with the leverage to grow the business.

Over time, we expect that as our partnerships with these large system integrators grow, we will see a greater percentage of our new customer bookings result directly from the system integrators, which in turn become an important driver of our long-term revenue growth.

To summarize, we continue to see strong demand for our innovative Supply Chain Management solutions, we've established solid partner relationships that will allow us to aggressively grow the business, and we continue to invest in our technology in order to grow revenue and continue on our paths of innovation.

I want to thank you all for taking the time to join us on this call.

With that, I'll turn the line over to the Operator for Q&A.

Q&A

Richard Monkman

If you could stand by for a minute, please, we're just pulling the Operator in.

Operator

Again, that is *, 1 on your telephone keypad if you'd like to ask a question.

Your first question comes from the line of Doug Taylor from TD Securities. Please go ahead.

Doug Taylor — TD Securities

Thanks. Good morning, gentlemen. I thought I'd start by talking about your margin profile. You've kept your margin guidance unchanged and you performed significantly above that in Q1 which would imply you're expecting a ramp in investment. Can you talk a bit about how you expect the OpEx to develop over the course of the year?

Richard Monkman

Sure, Doug. But first I wanted to frame the—our focus, as you know, is really first and foremost providing forward-viewing strong subscription revenue growth. And that is our key business driver. We will continue to make investments. We are very strong on the bottom line. We have provided guidance of plus 20 percent. The revenue—professional services revenue does tend to vary quarter by quarter, as well as in certain expenses such as sales and marketing will vary by quarter. So we just provided that base level of 20 percent or more of subscription—sorry, gross profit.

Doug Taylor

Okay.

Richard Monkman

As EBITDA performance. So it's—we're comfortable holding the guidance that it will be well in excess of the 20 percent.

Doug Taylor

Okay. Fair enough. I will shift back to the top line. You'd spoken last quarter about targeting about 12 to 15 new customers per year. Are you willing to talk about how many new customers you signed on in the first quarter and/or whether you're tracking towards that goal?

Richard Monkman

Customer acquisitions do vary quarter to quarter. And as such, we're not disclosing the number of customers by quarter. However, we are comfortable that on a full year basis that we will achieve the customer accounts that you indicated. More importantly, is the forward-revenue visibility in that, that 26 to 28 percent that we're now guiding to. Subscription revenue arrangements can vary by customer. And as such, in our model it really is more focused on the aggregate bookings from both new customers, as well as the expansion from existing customers that we used to provide that guidance.

Doug Taylor

Okay. Maybe the last question for me. You spoke about your Kinaxis University. I mean when do you expect the first class, so to speak, coming out of those programs to really start contributing to your revenue growth? Can you provide an update on kind of the timing of when you expect that to start ramping?

Doug Colbeth

Yeah. We already have people in the Kinaxis University. And we've already begun training folks within the large system integrators, so it's begun. We're also in the process of securing executive leadership for that—for Kinaxis University. And I anticipate that will closed will within Q3 time line.

Doug Taylor

Thanks. I'll pass the line.

Richard Monkman

Thanks, Doug.

Operator

Again, if you'd like to ask a question please press *, 1 on your telephone keypad. And again, please limit yourself to three questions.

Your next question comes from the line of Richard Tse from Cormark Securities. Please go ahead.

Andrew McGee — Cormark Securities

Hi. Good morning. Thanks, for taking my questions. It’s actually, Andrew in place of Richard. My first question is just on the existing base of customers, has there been any price increases of note? And then secondly, I was wondering if you could give us a sense of the momentum that you're seeing in any expansion orders, any order of magnitude on that pace would be very helpful? Thank you.

Richard Monkman

Sure. With regards to expansions, we had guided—we had indicated that with our LAN expand model, the weighting of incremental subscription revenue between new-name customers to expansions from the base for the last few years has been about 60 percent new-name customers and 40 percent from the base. That will vary a little by quarter. On an annual basis, were comfortable holding to that level.

With regards to price increases, it's customary to have a price increase upon the renewal of a multiyear subscription agreement. Within the term of a subscription agreement, there is generally price protection for the expansion. So this would be additional applications, additional user sites. So those are already predetermined and are essentially arranged just through a new purchase order.

Andrew McGee

Great. And my last question here is just kind of looking out, how do you see the pace of the cost scaling? It appears that you had a lot of leverage in a few line items, particularly the gross margin and the marketing. Just kind of how do you think we should be thinking about that going forward?

Richard Monkman

Well, the margin—the gross profit on subscription clearly is higher than the professional services. We will—we continue to—I believe that we'll be in the 70 percent gross profit range. Professional services revenue will tend to vary. And I think you can appreciate that with time and material contracts, revenue will vary depending upon that stage and timing of the engagement. One way to look at things would be maybe to see a base of 5 million per quarter of professional services revenue which could vary plus or minus 20 percent. That type of swing, given the relatively stable nature of our COGS, would have an expansion of the gross profit. We've also indicated that our—as partners continue to play a role in both the selling of RapidResponse and the delivery of RapidResponse that we will see an expansion of gross profit over time. But at this point in time, I think we'd be comfortable guiding to the 70 percent gross profit line.

Andrew McGee

Thanks, for taking my questions. I'll pass the line.

Operator

Your next question comes from the line of Thanos Moschopoulos from BMO Capital Markets. Please, go ahead.

Thanos Moschopoulos — BMO Capital Markets

Hi. Good morning. Maybe to ask the OpEx question a different way, are you currently on track with your hiring plans? Or are you running a little bit behind schedule?

Richard Monkman

Sorry. Thanos, you said hardware plans?

Thanos Moschopoulos

No. No. Hiring. Hiring.

Richard Monkman

Hiring. Sorry. Hiring plans. We are on track with hiring. I think the key element, sorry, the key variability on operating expenses is really dealing with sales and marketing. And sales and marketing tends—it's sort of typically higher in Q2 and Q4, primarily given some of the marketing activities that are underway. In addition, in Q4, it's not uncommon to see acceleration with regards to sales compensation. So we would expect to see some changes in the sales and marketing. Professional services, sorry, on the R&D side of things, we are continuing to recruit. And we would expect that we would still hold that in the 19, 20 percent range of our total revenue.

Thanos Moschopoulos

Great. And a question for Doug. As you look at the current pipeline from a vertical perspective, is it still heavily weighted towards pharma and technology firms as you've talked about in the past? Or has there been any change of note in terms of what you're seeing there?

Doug Colbeth

Yeah. I think, Thanos that I would—the most active vertical in the pipeline remains life sciences. Number two is high-tech electronics. We are starting to see an uptick now in CPG. So this is following along with our strategy where we usually enter a vertical collaborating with a marquee name. And then, we obviously perform their deployment, validate its success, and then we go to other players in that market. So we're starting to see some activity with CPG which is encouraging. And then A&D and automotive I would rank in the fourth place from a pipeline standpoint. And as I mentioned before, we continue to look at studying new verticals.

Thanos Moschopoulos

Great. And then, geographically, the bulk of your revenue base is still coming from North America. Can you talk about how your pipeline is progressing internationally? Are you seeing good opportunity across the ocean?

Doug Colbeth

Yeah. Thanos, it's—because of the relatively few but very large transactions we work on, it can get skewed from quarter to quarter as you would imagine. But we do see Europe, quite a bit of activity in Europe. I would label Japan as just consistent with what we've seen in the past. Europe ticking up a little bit, but North America continues to be strong and to be the bulk of the business.

Richard Monkman

Yeah. While our financial statements do disclose geography, all our customers are—basically all our customers are global. And how we write the contracts, so in another words which signed entity is where we determine it. So it's not uncommon to have say, a customer sign a deal in a North American entity and deploy it predominately in Asia or in Europe.

Thanos Moschopoulos

Okay. Thanks, guys. I'll pass the line.

Operator

Your next question comes from the line of Robert Young from Canaccord Genuity. Please go ahead.

Kevin Wright — Canaccord Genuity

Hey, guys. It's Kevin filling in for Rob here. How are you doing?

Richard Monkman

Great, Kevin. Thanks.

Kevin Wright

So you guys had really strong demand this quarter. Can you remind us of the seasonality of your business, please?

Richard Monkman

So the—with regards to seasonality, again, with subscription revenue these are long-term agreements that we enter into. So it is a consistent growth curve. So there really is not a seasonality, other than the ongoing expansion through new-name customer acquisitions and expansions from the base.

With regards to operating expenses, there is some seasonality, if you will, in that—sorry, and then on the same with professional services revenue, it's not uncommon to see a little softening of the time and material work in the summer or at the commencement of a year as these large companies are putting in place their operating plans. So for those quarters, it's quite often Q2 and Q4 are stronger. Similarly, as I noted early, from a sales and marketing perspective those expenses generally are heavier in Q2 and Q4.

Kevin Wright

Yeah. And I guess I'm not talking specifically on the subscription revenue. I'm talking on the new customers. I mean, you guys did well this quarter. Is this a seasonally strong quarter for new adds, rather than the overall revenue itself or should we…

Richard Monkman

Well…

Kevin Wright

Be thinking about this kind of growth through the year?

Richard Monkman

Our sales cycle is typically 9 to 18 months and so it is relatively consistent. We did have a very strong Q4, but we were very pleased also with the results of Q1. So it's—even with the timing of subscription agreements, because of the—how that revenue is then prorated over the next two, three, four years, it doesn't really impact. The signing of a deal in a quarter doesn't impact that quarter. In fact, that's why one of our key metrics is that we always, when we're driving towards revenue, we always go on the basis of that we need to have in backlog in excessive of 80 percent of our subscription revenue for that view. So that's why we—long answer, but I would not say there's seasonality with regards to closing our subscription deals.

Kevin Wright

Okay. That's great. Thank you. Given the number of currencies that you guys sell into and maybe you can help us understand if it is predominately in US dollars or if Japanese companies are always spending in yen. But what sort of currency impact are you guys seeing in the 2015 guidance? How should we be thinking about that?

Richard Monkman

Well, there's two elements to that, Kevin. So from a revenue perspective, predominant currency is USD. In fact, all contracts, other than the contracts written in Japan which have always been in yen, or now with our European entity deals that would close in Europe are in euro. But as I noted early, some of our companies in Europe will be in fact paying USD. The majority is USD. From an OpEx perspective, about 40 percent of our costs are in CAD. And then, there's sort of an equal amount in USD, and then the rest in mixed currency so but our functional currency, as you know, is USD.

Kevin Wright

Right. And then the last question I'll as ask of you guys, you've got a very strong cash balance, $79 million. Is M&A in the near-term objective or do you guys have any view of use of that cash in the near to medium term?

Doug Colbeth

Yeah. Kevin, we have no short-term items on the radar in the area of M&A. As we mentioned on the IPO, if we saw some smaller tuck-ins or any type of technology M&A activity that would enhance our strategy, we obviously have the strength of the balance sheet to take advantage of that. But at this point, I would advise everyone that there's nothing in the short term.

Kevin Wright

Okay. That's great. Thanks very much, guys.

Operator

We have no further questions in the queue.

Mr. Colbeth, I'll turn the call back over to you.

Doug Colbeth

Well, thank you for participating on today's call. We appreciate your questions, as well as your ongoing interest and support of Kinaxis. We look forward to speaking with you again in August when we report our Q2 '15 results.

Goodbye, and thank you.

Operator

This concludes today's conference call. You may now disconnect.

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