OneSpan Inc (Q1 2024 Earnings)

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Corporate Speakers:

- Joe Maxa; OneSpan Inc.; Vice President, Investor Relations
- Victor Limongelli; OneSpan Inc.; Interim Chief Executive Officer
- Jorge Martell; OneSpan Inc.; Chief Financial Officer

Participants:

- Trevor Rambo; BTIG; Analyst
- Chad Bennett; Craig-Hallum; Analyst
- Anja Soderstrom; Sidoti; Analyst
- Rudy Kessinger; D.A. Davidson; Analyst

PRESENTATION

Operator^ Good day. Thank you for standing by. Welcome to OneSpan's First Quarter 2024 Earnings Conference Call. (Operator Instructions) Please note that today's conference is being recorded. I will now hand the conference over to your speaker host, Joe Maxa, Vice President, Investor Relations. Please go ahead.

Joe Maxa^ Thank you, Operator. Hello, everyone. And thank you for joining the OneSpan first quarter 2024 earnings conference call. This call is being webcast and can be accessed on the Investor Relations section of OneSpan's website at investors.onespan.com. Joining me on the call today is Victor Limongelli, our Interim Chief Executive Officer; and Jorge Martell our Chief Financial Officer.

This afternoon after market close OneSpan issued a press release announcing results for our first quarter 2024. To access a copy of the press release and other investor information, please visit our website. Following our prepared comments today, we will open the call for questions.

Please note that statements made during this conference call that relate to future plans, events or performance including the outlook for full year 2024 and other long-term financial targets, are forward-looking statements. These statements involve risks and uncertainties and are based on current assumptions.

Consequently, actual results could differ materially from the expectations expressed in these forward-looking statements.

I direct your attention to today's press release and the company's filings with the U.S. Securities and Exchange Commission for a discussion of such risks and uncertainties. Also note that certain financial measures that may be discussed on this call are expressed on a non-GAAP basis and have been adjusted from a related GAAP financial measure.

We have provided an explanation for and reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures in the earnings press release and in the investor presentation available on our website.

In addition, please note that the date of this conference call is May 2, 2024. Any forward-looking statements and related assumptions are made as of this date.

Except as required by law, we undertake no obligation to update these statements as a result of new information or future events or for any other reason. I will now turn the call over to Victor.

Victor Limongelli^ Thank you, Joe. And good afternoon, everyone. Thank you for joining us today. I want to start out by congratulating the entire OneSpan team for delivering another solid quarter, which exceeded our internal revenue and adjusted EBITDA expectations. Revenue grew 13% year-over-year to $65 million, and adjusted EBITDA was $20 million, or 31% of revenue. ARR growth also exceeded our internal expectations.

It grew 9% year-over-year to $155 million and offset the headwinds we discussed on our last earnings call related to expired contracts of sunsetted products. Q1 was my first full quarter leading OneSpan, and I continue to be impressed with the team's work ethic and dedication to operational rigor.

For example, one of the major factors in the Q1 outperformance was that our renewals team did a great job closing several delayed renewals earlier than expected, which increased Q1 revenue by a few million dollars. And our APAC team did excellent work delivering its strongest quarter in terms of year-over-year growth in more than three years.

In addition to the impact from delayed renewals closing in Q1, our first quarter top line outperformance was largely driven by expansion contracts from existing security customers, who continue to place high value on our industry-leading anti-fraud solutions designed to mitigate potential hacking attacks.

Profitability outperformance was driven by strong revenue, favorable product mix and increased operating leverage resulting from the right-sizing of our cost structure over the last several quarters.

We also generated $27 million in cash from operations and ended the quarter with $64 million in cash.

Our two business units, Security Solutions and Digital Agreements, both had strong quarters with solid year-over-year revenue growth and significantly improved profitability. Revenue growth in Security was primarily driven by strong increases in software licenses including approximately $3 million from the past-due renewals just discussed that we had originally expected to close in Q2.

We also saw several annual contracts renew with multi-year [term lines], resulting in about $2 million of additional revenue as compared to our forecast.

And we had solid double-digit ACV growth in Security, driven in part by increased demand for our cloud-based authentication solution, OCA including a new seven-figure ACV contract and the expansion of a two-year contract to the mid-seven figures with new ACV of nearly $1 million.

DIGIPASS hardware revenue declined as expected. Last quarter, we discussed a few orders that had shipped in Q4 to the tune of approximately $2 million that were originally scheduled to ship in the first quarter of 2024.

Revenue growth in Digital Agreements was primarily driven by expansion of cloud subscriptions from existing customers.

Our profitability and cash flow generation improved significantly in the first quarter as compared to the prior-year period. For the balance of the year, seasonal software and hardware revenue patterns suggest more modest revenue growth and profit margins in Q2 and in the second half.

We will continue to focus on operational excellence and on driving efficient revenue growth to help ensure we achieve our profitability and cash flow commitments. With that, I will turn the call over to Jorge. Jorge?

Jorge Martell^ Thank you, Victor. And good afternoon, everyone. I'll start by providing an update on our cost reduction activities. Cumulative annualized cost savings to date from our restructuring efforts reached $64.5 million, in line with the $64 million to $65 million target range we previously announced, although achieved earlier than our end of 2024 forecast.

We now expect total cumulative annualized cost savings to approximate $75 million by the end of 2024. Now turning to our first quarter results, I'll provide a brief overview of our results and then discuss each business unit in more detail before providing an update to our 2024 outlook.

I will then turn the call back to Victor for closing remarks. ARR grew 9% year-over-year to $155 million.

ARR specific to subscription contracts grew 17% to $128 million and accounted for approximately 83% of total ARR. Net retention rate, or NRR, was 107%. It was impacted by a few percentage points as expected due to the timing of contract expirations related to sunset products.

First quarter 2024 revenue grew 13% to $64.8 million as compared to the same period last year, driven by 9% growth in Security Solutions and 25% growth in Digital Agreements.

Subscription revenue grew 34% to $40 million. Security subscriptions grew 34% and digital agreement subscriptions grew 33%.

The strong growth in subscription revenue was partially offset by a decline in maintenance revenue, which is by design as we transition to SaaS and subscription licenses, and a decline in hardware.

First quarter gross margin was 73% compared to 68% in the prior-year quarter, driven primarily by favorable product mix including record subscription revenue and seasonally low hardware, partially offset by an increase in depreciation of capitalized software costs.

First quarter GAAP operating income was $14.1 million compared to an operating loss of $8.1 million in the first quarter of last year.

Increases in revenue and gross profit margin and a decrease in operating expenses, primarily from lower headcount-related costs, were partially offset by an increase in restructuring and other related charges.

GAAP net income per share was $0.35 in the first quarter of 2024 compared to a GAAP net loss per share of $0.21 in the same period last year. Non-GAAP earnings per share, which excludes long-term incentive compensation, amortization, restructuring charges, other non-recurring items and the impact of tax adjustments, was $0.43 in the first quarter of 2024. This compares to a non-GAAP loss per share of $0.09 in the first quarter of 2023.

First quarter adjusted EBITDA and adjusted EBITDA margin was $19.8 million and 30.5% compared to negative $1.6 million and negative 3% in the same period of last year, respectively.

Turning to our Security Solutions business unit, ARR grew 7% year-over-year in the first quarter to $100 million. ARR growth was impacted by approximately 1.5 percentage points due to the transition of identity verification products to our Digital Agreements business unit at the beginning of the quarter.

Subscription ARR grew 16% to $77 million and was partially offset by an expected decline in perpetual maintenance ARR. We are transitioning perpetual-based maintenance contracts to subscription over time. First quarter revenue increased 9% to $50.4 million.

Subscription revenue increased 34% to $26.2 million, driven by strong renewals, primarily expansion of licenses from existing customers for on-premise, mobile security and authentication solutions. The earlier-than-expected closing of past-due renewals and larger-than-expected increase in multi-year term contracts, as discussed by Victor, resulted in approximately $5 million of revenue upside in the quarter.

Maintenance and support revenue declined slightly year-over-year to $10.1 million, with growth from on-premise subscriptions, offset by the expected decline from legacy perpetual contracts. DIGIPASS hardware token revenue decreased by $2.3 million or 15% as compared to the same quarter last year.

This was primarily a result of a few contracts totaling approximately $2 million that closed earlier than expected and shipped in Q4 of last year instead of the first quarter of this year.

Q1 2024 gross profit margin was 74% as compared to 67% in the first quarter of 2023. The increase in margin is primarily attributable to favorable product mix including strong increase in high-margin subscription revenue and a decrease in lower-margin hardware revenue.

As a reminder, Security gross margin is typically highest in the first quarter of the year due to product mix favoring software and can fluctuate on a quarterly basis due to product and customer mix.

Operating income was $25.9 million and operating margin was 51% compared to $15.6 million and 34% in last year's first quarter.

Strong increases in revenue and gross profit margin, combined with reduced operating expenses primarily attributed to restructuring and other cost reduction activities, drove the improved performance.

I'll now discuss the financial results for Digital Agreements. ARR grew 14% year-over-year to $55 million.

ARR growth benefited by approximately 3 percentage points due to the relocation of identity verification products to Digital Agreements at the beginning of the quarter.

Subscription ARR grew 18% year-over-year to $51 million. Maintenance ARR declined as expected due to sunsetting of our on-premise products. First quarter revenue grew 25% to $14.4 million.

Subscription revenue, consisting primarily of cloud solutions, grew 33% in Q1 2024 to $13.8 million and included an unexpected $0.5 million short-term on-premise contract renewal, which we do not expect to repeat in future quarters.

SaaS revenue grew 29% to $13.3 million. Maintenance and support revenue was $0.5 million as compared to $1 million in Q1 of last year. The year-over-year decline is attributed to the sunsetting of our on-premise e-signature solution.

First quarter gross profit margin was 69% as compared to 73% in the prior year quarter. The decline in gross margin is mainly related to the following two items that we discussed last quarter. One, we relocated certain costs, primarily related to customer support and professional services, from sales and marketing expense to cost of revenues.

We did this to better reflect where employees are spending their time. And two, depreciation of capitalized software costs have increased now that certain R&D projects are in production.

Operating loss was $0.3 million as compared to an operating loss of $6 million in Q1 last year. The improved performance was driven by an increase in revenue and a decrease in operating expenses, primarily attributed to the restructuring and other cost reduction activities, and were partially offset by an increase in cost of revenues.

Now turning to our balance sheet, we ended the first quarter of 2024 with $63.9 million in cash and cash equivalents compared to $42.5 million at the end of 2023. Due in part to the seasonality in our collections with the first quarter being typically strong, we generated $27 million in cash from operations during the quarter.

We used $3 million in capital expenditures, primarily capitalized software costs, and $3 million for restructuring payments.

We have no long-term debt. Geographically, our revenue mix by region in the first quarter of 2024 was 49% from EMEA, 33% from the Americas and 18% from Asia Pacific. This compares to 48%, 36% and 18% from the same regions in the first quarter of last year, respectively. I'll now provide our financial outlook.

For the full year 2024, although we are, of course, pleased with the Q1 outperformance, given the time-shifting nature of certain items in Q1 such as the $3 million of delayed renewals closing in Q1 rather than Q2, at this point, we are affirming our previously-issued revenue and ARR guidance.

We are increasing our adjusted EBITDA guidance to reflect an increase in operating leverage for the year. More specifically, we expect revenue to be in the range of $238 million to $246 million, ARR to end the year in the range of $160 million to $168 million, and adjusted EBITDA to be in the range of $51 million to $55 million as compared to our previous guidance range of $47 million to $52 million.

With due consideration of seasonality of collections in our business, we expect to end the year with more than $70 million of cash, absent additional share repurchases. That concludes my remarks. Victor?

Victor Limongelli^ Thanks, Jorge. Just to recap, we had an excellent first quarter, and I'm very proud of the OneSpan team's performance. Beyond the first quarter, however, we know that we have more work to do in order to deliver an excellent year.

We're going to continue to focus our efforts on delivering value to our customers and thereby creating value for our shareholders. Jorge and I will now be happy to take your questions.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) And our first question coming from the line of Trevor Rambo with BTIG.

Trevor Rambo^ This is Trevor on for Gray. Congrats on a great quarter all around. So first one for me, now that we're about four months into the year, how do you guys feel about your visibility on your pipeline for both the next quarter and the second half of the year? And I was wondering if you could touch on any linearity that you saw throughout Q1 as well.

Victor Limongelli^ Well thanks, Trevor.

What was the last part of the question? Can you repeat that?

Trevor Rambo^ Yes. Just wondering if you could touch on any linearity you saw throughout Q1, or if there's any like onetime items you saw besides some of the things you mentioned on the call.

Victor Limongelli^ Well we did mention a few things that were more of onetime nature. The big one in Q1 was the delayed renewals that came in, in Q1. They made up a significant chunk of the onetime performance in Q1.

For the rest of the year, we have a pretty good view into Q2. As you might imagine, we're sitting here on May 2, almost halfway through the quarter, and we've continued to see good performance in many regions. I mentioned the APAC team by name in my remarks about the first quarter, and they're continuing to do well in the second quarter.

Obviously as you get later out in the year, things get a little fuzzier when you're talking about Q4 -- our pipeline for, say, Q4. And that's part of the reason why we wanted to keep the revenue guidance where it was because it just -- a lot of our revenue, as you know comes in later in the year, and it's a little too early to get too certain about Q4 revenue. Jorge, I don't know if you have anything you want to add on that.

Jorge Martell^ Yes. No. I think the only thing I would add is it takes four quarters to make the year, Trevor. And so, we got a solid Q1. We're proud about what the team executed on. But yes, we have a number of key renewals with potential add-ons that we're looking at. But it's still a little bit too early.

We want to see a little more movement. And once that transpired one way or the other, obviously we'll be looking into either changing guidance, et cetera, but that's going to happen later in the year.

Victor Limongelli^ Trevor, let me just comment also, I know you asked specifically about pipeline and revenue, but I will say when it comes to the cost structure of the business, we have a pretty good sense of it for later in the year. And that was partly the reason why we were -- why we increased the adjusted EBITDA guidance for the year.

Trevor Rambo^ Yes. Awesome. That makes a lot of sense. And maybe just one more. I know you mentioned last quarter that you had strong visibility into your large customers and some visibility into the mid-market.

I was wondering if you could touch on that aspect of the business and kind of see how that compares to some of your commentary and what you saw last quarter.

Victor Limongelli^ Sure. I think we definitely saw some good large deals last quarter, and we continue to have some good opportunities in that area in the second quarter.

So I think quite naturally, the larger the opportunity, the more attention and focus it gets, not just from the salesperson, but also all the way up the chain for the sales management up to and including Jorge and myself. Mid-market, we do have decent visibility there.

Once you get to the smaller deals, probably a little bit less. So I don't think that that's -- I don't think Q2 is too different than Q1 in that regard.

Trevor Rambo^ Great. That's it for me. Congrats again on a great quarter, guys.

Operator^ And our next question coming from the line of Chad Bennett with Craig-Hallum.

Chad Bennett^ Great. So obviously a few onetime items that benefited the first quarter here. And I think the rest of the year is pretty straightforward from a guide standpoint.

But I'm just curious, just in terms of Digital Agreements versus Security Solutions, just kind of the relative growth rate for the rest of the year of those two segments, and if you kind of have any different view on the growth rates of the two businesses for the remainder of the year?

Victor Limongelli^ Yes. Thanks, Chad. Part of the Q1 numbers, part of that is due to the shift of the IDV business. We put it into the Digital Agreements segment from -- Jorge, I don't know if you can comment on exactly what percentage of that growth came from that shift.

Jorge Martell^ Yes. –It was minimal from a revenue perspective, it was about \$300,000. From an ARR perspective, it's \$1.5 million, Chad. So not too much from that standpoint. And one thing to add is, so -- if I may, Vic, so on the Digital Agreements side of the house, so that you have to also take into account.

It is a land-and-expand sort of like approach, right? And so, you normally land a customer, one or two use cases, and then from that, it expands. And so, the timing is critical, right? Once you land, particularly enterprises, and the land-and-expand is across the top of the pyramid, also the bottom of the pyramid. And so, the timing of that could be -- is always critical.

What you would expect to see is gradual increases, particularly in SaaS. Now that the on-prem is basically in the rearview mirror, we still have some dynamics there, as we explained.

But taking that aside, you would expect to continue to see growth there, not exponentially, but gradual growth on the SaaS component with that expansion.

Obviously we have new customers. But again, those are not in the millions of dollars. Some are, but obviously not often as we hope, but it's more of the land-and-expand. On the security side, you will see in the security software, most of that growth is going to continue to be from expansions.

We do have new customers, new logos in there. And -- but that doesn't move -- it's not going to be as dramatic because of our scale there, right? We service 60% of the top 100 banks, so it's a more mature market as well. And then, on the hardware side of the business, you have to take into account the secular decline a little bit in some regions like APAC and EMEA to a certain extent, right, where the dynamic is shifting a little bit off of hardware into software.

We try to capitalize from that as best we can. And so, what I would expect is security to be in the low-single-digit growth, whereas the DA side of the house, a little bit more like mid-to-high single-digits. That will be sort of like the expectations.

But again, we want to have more visibility into the second quarter -- not second quarter, second half, rather, to be able to give you more precise. But again, we don't guide on a per quarter basis. So just keep that in mind.

Chad Bennett^ No. That's great color. So maybe a follow-up just on -- I mean you guys are ahead of plan on cost savings and actually exceeding plan, it sounds like, on cost savings by, call it, $10 million from where we started. And I know you upped EBITDA incrementally there.

Is there -- are there any other types of investments we're making? Why kind of that incremental $10 million wouldn't just kind of drop down to that EBITDA guide? And obviously we'll want to be conservative and do better. I appreciate that, but just curious, your thoughts there.

Victor Limongelli^ Well Jorge, I'll let you touch on this, but let me just comment. The $10 million is not -- that's the annualized number.

So some of those cost savings are going to be coming later in the year as we -- they're already identified, but as we move through the year. So it won’t -- all of that won’t hit in 2024.

Chad Bennett^ Got it.

Jorge Martell^ Yes. And I would say, just from a product perspective, Chad, so obviously we've been selective at what investments we deploy from an R&D perspective, things like that.

We mentioned last quarter about FX BIO products, et cetera, more towards the -- or 100% towards the workforce authentication market, right? And so, obviously it's still early. It's still premature, but it's just one example of investments that we're working on.

Chad Bennett^ Got it.

I appreciate it. Nice job on the quarter.

Operator^ And our next question coming from line of Anja Soderstrom with Sidoti.

Anja Soderstrom^ Congrats on the good quarter here. Just to clarify, the gross margin this quarter was helped by the lower volume of hardware, right? So that should be coming down as you see more higher hardware revenue in the coming quarters.

Victor Limongelli^ That's correct.

Anja Soderstrom^ Okay. And then, in terms of sort of the macro environment and your customers' proneness to take on more subscription costs and whatnot, are you seeing that changing at all, the sentiment among your customers?

Victor Limongelli^ Well I think, let me -- to talk about the macro, I don't think -- and I think we talked about this last quarter. It's not the greatest macro-environment ever, but it's not terrible either from our perspective.

So we've had good results in some regions. Probably the European environment has been a little bit less strong than some of the other regions for us so far. But all in all, it's decent, tolerable, I guess, I would say.

Anja Soderstrom^ Okay. And is there any way you're sort of measuring the land-and-expand approach, how that is trending?

Victor Limongelli^ Well we do report NRR. We report that quarterly. And so, that -- in terms of the things that we're sharing with the public, that would probably be the most pertinent data point.

Anja Soderstrom^ Okay. And there's some sunsetting and stuff that's clouding that right now right?

Victor Limongelli^ A little bit, yes. So Jorge, I don't know if you want to comment on that. I think it was 107%, if I'm remembering correctly.

Jorge Martell^ That's right. So -- and if you remember, last quarter, we had 110%. And we mentioned 2 percentage points, 3 percentage points of that was clouded with the conversion from on-prem in our e-signature solution to the cloud. Clients were in migration. They bought both solutions.

Now that they completed those migrations in Q1, we guided towards -- it's going to be about 3% lower, right? Once the on-prem version of those that completed migration dropped, and that's exactly what happened.

So it sort of behaved the way we expected. I think the end of life, we'll have a little bit more with respect to -- I think, Q3, there's more deal flow. I think that's going to materialize in that quarter on the security side.

But I think when you take those one-offs, you would expect that sort of like 107%, 106% sort of like go through. But obviously as I always caution, we don't guide on a quarterly basis. So just keep that in mind.

Anja Soderstrom^ Okay, thank you. That was all for me.

Operator^ And our next question coming from the line of Rudy Kessinger with D.A. Davidson.

Rudy Kessinger^ Jorge, I want to double-click on some things. I'm not sure I caught it all. Just on the outperformance in the quarter, there was a -- I believe you said a couple million of benefits from renewals that pushed from last quarter. And then, what was the benefit from multi-year terms? Were those renewals, or were those new deals (inaudible) multi-years?

Jorge Martell^ Yes Rudy, thanks for the question. So what benefit us -- so just to go back through this, so there were $3 million of delayed renewals that closed earlier than we expected this quarter.

So that's $3 million, in the software terms, subscription revenue. There's also a couple million dollars, about $2 million of increased multi-year deals that closed this quarter that we were not forecasting. And again, that's part of the operational rigor the team is going through.

They're incentivized to close multi-year deals. And so, we benefited from that standpoint this quarter. And we always have, in any given quarter, a number of conversions also really from perpetual to term. And so we -- that also benefited this quarter.

But -- so you're looking at about $5 million, a little more than that in terms of those three items. Again, I caution, the conversion -- we always have a number of conversions in any given quarter. So yes, those are the most notable things, Rudy.

Rudy Kessinger^ Okay. That's helpful. And then, I guess just -- I heard you guys call out the strength in APAC, but APAC is less than 20% of the revenue. So if you look at the U.S., the rest of the world, how was bookings performance in those regions in the quarter relative to expectations?

Victor Limongelli^ Yes. Thanks for the question, Rudy. From a public statement standpoint, we're not giving detailed geographical performance.

I was calling out APAC because the team has performed very well there. And I did mention that the macro-environment in Europe, I think, was a little bit weaker. So you can probably read into that what you will.

But overall, I think performance in North America feels -- the macro-environment in North America feels pretty decent. So we're continuing to work on execution, and we're looking to have, of course, every region and both business units performing well.

Operator^ And I'm showing no further questions in the queue at this time. I will now turn the call back over to Joe Maxa for any closing remarks.

Joe Maxa^ Thank you, everyone. We appreciate your time today and look forward to sharing our progress with you again next quarter. Thanks again. And have a nice day.

Operator^ Ladies and gentlemen, that does conclude our conference for today. Thank you for your participation. And you may now disconnect.