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Transcript of Lionbridge Technologies, Inc. Q3 2015 Earnings Conference Call

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Participants:

Lionbridge Executives

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Rory Cowan Chairman and CEO

Marc Litz Vice President, Finance and Corporate Controller

Don Muir Chief Financial Officer

Analysts

George Sutton from Craig Hallum

Kevin Liu from B. Riley

Vincent Colicchio from Barrington Research

Harvey Poppel from Poptech

Juan Bejarano from Noble Financial Capital Markets

Transcript:

Operator

Welcome and thank you all for standing by. At this time, all participants are in a listen only mode. (Instructions from operator) This call is being recorded. If you have any objections, you may disconnect at this point.

Your host today is Ms. Sara Buda, Vice President, Investor Relations. Ma'am, you may begin.

Sara Buda

Great. Thank you. And welcome everybody to the Lionbridge Investor Call to Discuss Financial Results for the Third Quarter of 2015. During this call, we may make certain statements that may be considered forward-looking statements under federal securities laws and which involve risks and uncertainties.

Our actual future results may differ significantly from the matters discussed in any forward-looking statements.

We've disclosed in greater detail in our Form 10K filed with the Securities and Exchange Commission, and in subsequent filings the factors that may cause such differences.

And now, I'll turn the call over to Lionbridge Chairman and CEO, Rory Cowan.

Rory Cowan

Thank you, Sara, and good morning, everyone. Today's call will focus on Q3 results. I will discuss some other exciting developments in our vertical market expansion and our new buyers, in particular we will talk about our acquisition of Geotext and we will provide some details about our share repurchase about our expanded share repurchase programs, as well as expectations for 2016. So I have a lot to cover in this call.

But, first, let me start off with the summary of Q3. Revenue, we delivered revenue of about $139 million, marking growth of about 15% year-on-year. Excluding revenue from our largest client, we grew revenue about 21% year-on-year, a positive result, that's of course a combination of organic and CLS.

While Microsoft was softer than we expected in the quarter due to some project delays. The pace of new business bookings at Microsoft remained strong, which indicates some stability for 2016.

Margins, we delivered a total company gross margins of about 33%, roughly even with last year and margins in our

GLC Language and Content segment were about 35.7%, that's about a 30 basis point increase year-on-year. So we are making some progress in the margin trends in core GLC as well.

Solid margins, ongoing expense control, we delivered a $0.04 per share GAAP and $0.14 per share non-GAAP earnings. The synergies and benefits of our CLS acquisition are starting to show through and our investments in technology and process efficiency are paying off.

In fact, year-to-date, we've increased adjusted EBITDA about 30% year-on-year on 13% revenue growth. Our integration and cost actions are driving these results. So we are well-positioned to drive growth in 2016 and beyond.

Looking at the balance sheet, we drove about $8 million in cash flow from operations and we ended the quarter with about $31 million in cash, so the balance sheet also remains strong.

In short, Q3 was a solid quarter, despite some short-term headwinds with our largest client. We drove year-on-year growth, gross margins are trending well and we generated solid cash flows.

Now let's turn to the revenue trends in the business and our expectations for growth in 2016. First, we continue to grow many of our longstanding recurring revenue clients in our top 10.

Let start with Microsoft. We did expect a bit more from Microsoft in the quarter, based on the pipeline of new programs we won in Q2. Particularly, in the new and exciting areas such as games and social, but the client teams are just slow to release files and to spend against that approved budget.

As we move into some of the new areas of growth in that account, we are learning about the timing between bookings and revenue. So, overall, we are pleased with the stability within Microsoft, but disappointed with the growth within the quarter.

Looking ahead, I think, we will be little more prudent with our forecast to short term, but we do expect these programs to contribute nicely to revenue in '16 and the pace of business remains strong overall, so it looks like this is just a matter of timing.

Outside of Microsoft, many of our accounts are growing very nicely. We grew our second largest client Google year-on-year, Rolls Royce and HP were solid in Q3, and in our top 10 we saw strong growth in Q3 from a prominent West Coast personal device company and ongoing strength in several life sciences accounts. In total, our top 10 accounts now are 47% of revenue and the major accounts remained strong and our strategy for diversifying our client base is working.

Let's talk about new business. Two years ago we implemented a strategy to drive growth in two ways, one, upstream to new buyers, meaning leaving the product group or augmenting our product business with marketing buyers in the same companies, and then pursuing new vertical end markets that generally have higher margins than the core tech business.

So the new business momentum shows that the strategy is working, our marketing services offering continues to scale, you get some numbers specific numbers little later on the call and this quarter we secured some new wins in marketing services with clients such as HTC and Gap.

The investments that we made in marketing services are really beginning to payoff. Last year we added our Costa Rica operation for cutting-edge innovative digital production capabilities in the U.S. time zones. And we added Clay Tablet to use as a rich technology connector solution for seamless integration with our clients' digital marketing platforms. So we have technology integrations with these platforms and in-time zone execution of marketing capabilities.

We've also expanded our sales force to we have hired some people from the large agencies that really know how to talk to these buyers. As a result, we are increasing our credibility and our brand visibility with these marketing buyers, and winning new business against many prominent digital agencies.

And finally, our ongoing growth of the onDemand platform supports both marketing and general translation activity, gives us a proven channel to reach new marketing buyers who want to procure and managed translation, and other marketing services through a highly automated, efficient delivery model.

In short, the marketing services group initiative continues to be the right strategy as content moves out of technology products and into the hands of the marketing buyers of large organizations. We now have the right operational models and the right sales models to drive this ongoing growth in marketing services in '16 and beyond. That's the first leg of the strategy moving to new buyers within enterprises.

The second leg of the strategy, of course, is new vertical markets. In the third quarter, we saw growth from several accounts in the life sciences, automotive and industrial sectors. In fact, our life sciences practice continues to be our fastest growing vertical, as we expand revenue streams from major accounts such as PRA and GSK.

And our industrial and manufacturing practices is also growing notably, as we expand clients like Rolls Royce and drive new business from accounts such as Siemens, Ford and Bentley. So the organic initiatives to penetrate new vertical is working.

And the acquisition of Geotext, which we also announced today, will be a very strong tuck-in acquisition that will allow us to accelerate our vertical market strategy even further. Geotext as you probably already read is focused on the legal and financial markets, primarily legal around the world.

Let's put a final point on the Geotext acquisition. It's a growing, profitable translation firm, specializing in legal translation services. This includes everything from patent translation(translations 8:20), to e-Discovery and crossborder litigation, to translation of commercial contracts, as well as depositions.

The addition of Geotext enables Lionbridge to address growing demand in these areas with proven resources, skills and capabilities that are unique to the legal translation market.

In fact, even before we closed we're making some joint bids between our global organization and their deep customer knowledge. So it should be a very, very exciting combination.

I should note that the Geotext integration is not about cost synergies or expense reduction. Clearly, we are going to control expenses and do what we can, but this is about capabilities expansion in new verticals.

We expect minimal integration cost as a result of this strategy. In fact, Geotext operations in London and New York will become our legal practice centers of excellence for us to expand and build upon. Geotext is-- should be a very strong tuck-in acquisition for us. It aligns with our strategy of expanding into higher margin markets and some of the more highly regulated global industries.

In essence we are applying the skills, scale and capabilities we've developed for the tech end market into these new vertical end markets, and we are doing this both organically and through acquisitions. So we are very we are delighted with the addition of Geotext. We would like to extend a warm welcome to them as they join our team of Lions in 28 countries.

So looking forward to 2016, we see solid growth in three areas, ongoing growth in marketing services. We should continue to grow by 15% to 20% next year, ongoing expansion in non tech verticals both organic and through Geotext and new revenue streams from on demand, which continues to ramp very nicely.

So now, I will turn it over to Don and Mark for the numbers and our outlook for Q4 in 2016.

Don Muir

Thanks, Rory and hello everyone. As many of you saw, I will be retiring from Lionbridge at the end of this year, which will be a year of record revenue and earnings. I have greatly enjoyed my eight years here and I will miss working with the Lionbridge teams around the world.

Marc Litz, our current VP Finance will be promoted to the position of CFO. Mark understands this company very well and has been working closely with me, as well as Rory and Rich Tobin over the past three years in the integration of acquisitions, the management of cash flows and implementation of our new global costing systems.

You will remember that he was at Sapient before joining us. As a result, the transition will be seamless. I think it is appropriate to have Mark walk you through the quarter and outlook before I wrap up the call.

Marc Litz

Great. Thank you, Don and hello everyone. I have met a few of you at conferences and over the phone over the years and I look forward to meeting all of our analysts and shareholders in the coming weeks and months. Today, I'm going to walk you through the Q3 results and talk about our new share buyback program. I will also provide an outlook for Q4 and our expectations for 2016.

Let me begin with an overview of Q3. In the third quarter, we delivered revenue of $138.6 million. This marks 15% year-on-year growth, or $18 million from last year and $23 million, or 19% in constant currency. Excluding revenue from the CLS acquisition, total company revenue grew 4%, or about $5 million year-on-year in constant currency. While our year-on-year underlying trends remain strong, Q3 was below expectations largely for two reasons, as Rory noted Microsoft delays and a bit of softness on the CLS side. Despite these factors, our GLT language and marketing segment grew 6% organically, ex-CLS in constant currency and also 9% ex-Microsoft in constant currency. And we drove yet another strong quarter of gross margin. So the fundamentals of the underlying business remained strong and Q4 is firming up, which positions us well for 2016 and beyond.

Total company gross margins were 32.9%. On a segment basis, our GLC language business margins were 35.7%, an improvement of 30 basis points year-on-year. GES test margins were 28.8% and interps were 10.5%.

Q3 operating expenses increased by $4 million year-on-year excluding restructuring. This is driven by higher SG&A associated with the CLS year-on-year. However, SG&A is also down about $3 million, or 12% on a run rate basis in Q3, as compared to where we started the year in the first quarter of 2015. So the benefits of our cost actions are starting to take hold. We are executing well against the synergy plan we outlined a year ago and we are well on track to see the full benefits of CLS integration in 2016.

Restructuring related expenses were about $3 million in Q2. Looking ahead, we expect another $3 million to $4 million in restructuring in Q4 and maybe another $1 million or $2 million in Q1, as we complete the integration of CLS.

Once that's behind us, we don't expect any notable restructuring expense, as the integration will be largely complete by Q1 of '16. So the operations team continues to execute well on our integration plan and we remain very positive about the expected benefits going forward.

On the P&L, the other expense line is about $400k in the quarter, was largely related to the current effect on monthly balance sheet item revaluations. Our tax provision was $755,000 for the quarter, marking an effective tax rate of about 22%, a bit below our expected 25% tax rate. So the team continues to do a terrific job on the tax side. And as Don pointed out for your models going forward, we would expect a quarterly tax provision of about 25% going forward.

On a GAAP basis, our net income was $2.7 million, or $0.04 per diluted share. Non-GAAP adjusted earnings were $8.7 million or $0.14 per share in the quarter. Now onto the balance sheet, we generated $7.9 million of cash flow from operations during the quarter and we expect strong cash flows in Q4 as well.

Our DSOs in Q3 were about 57 days, driven by a strong September revenue month and associated increase in September AR. I think it's reasonable to expect going forward that we normalize back to the 54 to 55 day range in DSO in Q4. We had an ending cash balance of $31 million and bank debt was $94 million. CapEx was $2.4 million for the quarter.

We didn't repurchase any stock in Q3, as we knew we had Geotext on that. However, as we look ahead to Q4 and continue our planning process for 2016, it is clear that we'll be driving even stronger cash flows. With confidence in our profit and cash flow, we together with the board have decided to implement a new accelerated repurchase plan of $50 million through 2018. This is a sizable increase in the $18 million three-year plan we have in place previously. As you saw from the release, we expect to have ample flexibility to fund additional tuck-in acquisitions as

appropriate or pay down debt while supporting this accelerated buyback plan. The increased buyback underscores the confidence in our business. And we'll continue to manage our capital to both fund growth and pay down debt as appropriate.

Let me wrap up by talking about our outlook. For Q4, we're estimating revenue of about one $140 million to $143 million which will lead to a record year in 2015 for both revenue growth and EBITDA. For 2016, we expect revenue to grow 5% to 8% including Geotext. As many of you know this business tends to drive very strong conversion of incremental revenue to profit given the company's unique crowd model.

And for those analysts, who track adjusted EBITDA, we should see adjusted EBITDA growth of 20% to 30% year-on-year in 2016 with the ongoing benefits of revenue volume, efficiencies and automation. In fact, year-to-date we've grown adjusted EBITDA about 20% year-on-year. The next year, it looks like we'll be on plan to achieve our target of double digit adjusted EBITDA margins. As a reminder, we calculate adjusted EBITDA as operating income plus amortization, depreciation, stock based compensation and restructuring and other related charges.

Don, back to you?

Don Muir

Thanks Marc. And a final note, I'd like to thank Lionbridge and in particular our worldwide finance organization the management team and of course, who're in the board. It's a great team. I'm confident that Lionbridge's best days lie ahead. And I'm excited about the path they are on. The business is doing well. The foundation is solid. I have complete confidence in the finance team. And 2016 looks like another year of strong earnings growth. I've enjoyed working with the Lionbridge team and with the shareholders and analysts, who have supported the company over the past eight years, I wish you all the best.

Now, Rory, back to you.

Rory Cowan

Thanks, Don. And it's been a solid eight years together. You've been part of the tremendous transformation of Lionbridge. We and the rest of the management team thank you for contributions and wish you the best. And we also welcome Marc Litz and congratulate him on his new role here at Lionbridge. We're looking forward to introducing Marc to analysts and to shareholders during the coming months.

So to summarize a very busy earnings announcement. Q3 was a solid quarter with about 15% revenue growth, solid gross margins, earnings and cash flow. We're executing on our strategy of moving upstream to new buyers and over to new additional vertical markets. We're diversifying outside of our core text sector with both organic growth and acquisitions in the new verticals.

We’re delighted to add Geotext as an example of that expansion. 2016 is looking strong. And we’re deploying our capital wisely to both accelerate our stock repurchase program and to fund growth.

So with that, I’ll open the call up for questions.

Question and Answer Session

Operator

Our first question comes from Mr. George Sutton of Craig Hallum. Sir, your line is now open.

George Sutton

Thank you and congratulations to both Marc and Don.

Don Muir

Thank you.

George Sutton

So as we try to peel back the onion on Q3 results, you talk about the Microsoft. I think you just sort of expected things to pick up quicker there. If we were to look at what we would define as about an $8 million shortfall, how much of that would be related to other items. We’ve talked about technology development patterns been a little bit different. I'm curious if you could break it down a little bit more finally?

Rory Cowan

Yeah, George. Think about the technology group is what really the center of gravity is Microsoft. It was probably about $3 million of it. A large of player in Asia handheld device manufacturer was about $2 million of it. And then bits and pieces around some other activities but CLS was about probably a million behind where we hope it would be.

And that I think really was our misquarterization of the business as well as one or two of their accounts slipping in August. I think these new end markets don't have the rhythms of the tech market that we knew, so that was maybe about a million. And then GSK and others was may be about 1 million. So you're absolutely right, it comes more than sort of 7 million, 8 million range, center of gravity around the big techs, one in Asia and Microsoft.

George Sutton

Rory, I haven’t looked it up yet, but quarterization maybe a new word. So, congratulations for that. So as we you talked about Q4 firming up, and I wondered if in the context of Q4 firming up, a stock that might be weak today and your interest is becoming much more aggressive in your stock repurchase plan. I wondered if you could just give us the thought process behind all that.

Rory Cowan

Yeah, I think a couple of things. First one is on quarterization, just want to respond, when we bought CLS, we had -- we are taking our numbers down year on year. We just did a straightline across all quarters. And we are finding, of course, that Q1 is a little bit stronger, Q2 is in the middle, Q3 is weaker and Q4 is stronger for them. So that's, I mean, when I say quarterization. I think that's the first thing.

Second thing regarding the stock buyback, many of our investors have been asking us to accelerate our stock buyback. And so this last Board meeting, we wanted to make certain that we had a well balanced future between acquisitions, working capital, growth capabilities, as well as the ability to buy back some increased stock. We've done a lot of sensitivity and we feel pretty comfortable with that. So I think that you'll find that we will be in the market as soon as possible.

In terms of next year, just in terms of the of growth activities here, wins that are ramping into 2016, maybe we didn't put a finite point on this, but our Siemens and Tech Pubs could be additional sort of $2 million a year. Rolls Royce is a drafting contract of $4 million, $5 million a year . Google Ads, HTC, Gap, Ford renewal, we just had a terrific timing of bookings here and we're really beginning to feel it as we understand these new end markets that there is a up firmness in '16 from the nontech end markets.

George Sutton

That's great. One other thing, does your 2016 guidance assume the runoff for the government translations business?

Rory Cowan

Yes, it does. And that's something we should mention again for those who are new to the call. We will not be working

with the Department of Justice, which is about a it was about $14 million, $12 million contract that really had a single-digit gross margin. And as you know, we did that at a price that we thought would hit our industry standards. If we didn't make it, we wanted to move it along and mostly I think someone else has the joy of that contract now. So that's about $13 million year on year decline and we will be replacing that in these numbers that we're talking about.

George Sutton

Right. Thank you.

Operator

Thank you. Our next question comes from Mr. Kevin Liu, B. Riley. Sir, your line is now open.

Kevin Liu

Hi, good morning. Just with respect to the fiscal '16 guidance, I think you guys said you expect to grow 20% to 30% on the adjusted EBITDA line, I don't recall seeing guidance or updated guidance for the full year. So just curious what sort of base we should be working off of.

Rory Cowan

Full year base, I mean, no, full year base for 2016 EBITDA versus 2015 EBITDA, so I think we're going to be in that adjusted model. We've never really given it, but it's sort of in that 50ish, maybe a little bit higher than that for '15. And so if you think about a 20% lift on top of that and that feels pretty comfortable and conservative at this time.

Marc, don't me to take, that's in your call, your response I am sorry.

Marc Litz

That's fair, Rory. Yes, that's correct.

Kevin Liu

Got it. And just with respect to the Geotext acquisition, could you talk little bit about the types of growth rates we've seen historically and what sort of margin profile we should expect?

Rory Cowan

Yeah, Geotext is about, I mean just to give you a sense of it, it's about 65 employees, about 22 in London, a few in San Francisco, they had about $18 million of revenue in 2015, that's what we're estimating and they have $2.5 to $3 million EBITDA range for this year. We expect management to stay, and in fact as you've seen from the announcement that they have a strong incentive to stay and execute the growth numbers there. And so it has a stronger margin profile and it also has some very peppy growth rates. So as I said, we're very positive, not only for their own organic growth that they see year on year, but we've also put together a two or three winning bids using our global infrastructure and their end market knowledge, which is just how you want to see these things happen.

Kevin Liu

And just lastly, for your largest customer, you talked about the bid of bookings having been strongest for this year and just not converting the revenues yet. As we look into '16, what are you guys seeing in the pipeline today from a booking standpoint? And what are your expectations on kind of the profitability of the programs you're winning versus as you move into some of these newer areas like social and gaming?

Rory Cowan

That's great. All good questions. First, we've done a we're expecting Microsoft to show some year on year growth marginal, but year on year growth for '15 to '16. We're learning how to close - how to better forecast. These are far more complicated programs and that they have a much more consistent -- once they launch, they have a much more consistent revenue profile, not that pig in the python stuff we fight with the product releases, so that feels good.

Margin profile is about the same, maybe a little bit stronger. As you remember, we are optimized for these large global companies and so incremental revenue from them converts at a very nice model.

Kevin Liu

Got it. Thanks a lot.

Operator

Thank you. Our next question comes from Mr. Vincent Colicchio of Barrington. Sir, your line is now open.

Vincent Colicchio

Rory, what the business that was delayed in the current quarter? Will there be a catch up in the coming quarters? How does that look?

Rory Cowan

You know as I said, I'm a little .. I'm hesitant to say that it's going to be a rubber band that springs back or the just everything shifting a little bit, but my sense is still the latter, Vince. I know these are new markets that we're discovering here and they are new buyers and they're new processes, we've got to get a lot of technology handshakes in place, so it just take a little bit longer than we thought. I don't think you have to be I don't want to heroic here and say, gee, it's going to bounce back. I think it's more of a shift than a recovery.

Vincent Colicchio

On the marketing services side, was the growth consistent with what we've seen in prior quarters you know and is the outlook look as good as it did, say, a quarter ago?

Rory Cowan

Yeah. It was, in fact, it's interesting. We're findings that as we learn how to talk to these customers, these marketing customers, these are large multi-year of contracts. So they are not the project based stuff that we had in the product business that's first. And second, we're finding that our onDemand offering has terrific appeal to marketers because a lot of their activity is really recurring campaigns in this country and that country.

They are doing micro-sites for a marketing initiative. And so there's both the technology piece that we've developed as well as the end market knowledge are really coming together for this marketing services space. So to remind you, we won HTC. We won the Gap. We've hired a couple of sales people from the agencies themselves that are also I think that's real indication when sales people in the industry are making a change to someone that's out of the industry because they see our capabilities.

Our onDemand team, we also won Iron Mountain and Avid that was onDemand and that is both marketing and product. So a lot of the things we initiated over the past 18 to 24 months really seem to be crystallizing.

Vincent Colicchio

Hey and then Marc, just some housekeeping, Your first questions here certainly an easy one, what was the I've got the GLC gross margin at 35.7%. What were the gross margins for the other two segments?

Marc Litz

So GES was 28.8% and Interps was 10.5%.

Vincent Colicchio

Thank you.

Marc Litz

And you should mention that in Interps is not just the DOJ contract. The DOJ contract was single digits. There are some other things in that Interps business that lift that up. And we've (we're) of course retaining those businesses and so as you go through to '16, you should see that segments GM's come up as well.

Rory Cowan

That's correct. They are the much more efficient model for us for delivery and delivers higher margins.

Vincent Colicchio

Actually one more if I can, what was Microsoft's contribution to the quarter and how does that compare to the year ago period?

Rory Cowan

All right. Want to get that, one second.

Vincent Colicchio
Okay.

Marc Litz

So for the quarter. Microsoft came in about $19.3 million and that's across remember that's across both of our larger business units. So it has a component that's in GES, as well as the local business as well. Versus last year, that's 21.5%. I'm sorry, $21.5 million last year versus the $19.3 million this year.

Vincent Colicchio

Okay.

Marc Litz

And down $2.3 million.

Vincent Colicchio

Thanks for answering my questions.

Rory Cowan

Thanks.

Marc Litz

Thank you.

Operator

Thank you. Our next question comes from Mr. Harvey Poppel of Poptech. Sir, your line is now open.

Harvey Poppel

Thank you very much. Want to congratulate you in particular on the acquisition of Geotext. Sounds like a great fit.

On that score, you talked about trailing revenues of $17 million. Early in the call you mentioned it's a growing profitable company. And if you look at 2016 and your revenue growth forecast of 5% to 8%, one would impute that Geotext alone would account for one point half or even a little more than half of the 5% to 8%. Is that a reasonable calculation?

Rory Cowan

Yes, it would. And remember, Harvey that the DOJ account will be down $13 million year on year. So, we are replacing that $13 million and growing that 5% to 8%.

Harvey Poppel

Okay. So the cliff on the DOJ is at the end of this year basically.

Rory Cowan

Yeah. I think November will be our last month. Government had two one month extensions and they took both of them.

Harvey Poppel

Okay. Thank you very much.

Rory Cowan

Great. Thanks, Harvey.

Operator

Thank you. Our next question comes from Mr. Juan Bejarano of Noble Financial. Sir, your line is now open.

Juan Bejarano

Hi. Good morning. Thank you for taking my questions. You mentioned about a $2 million in shortfall with an Asia client. Sorry if I missed this. But can you provide us with a little bit more color there, was it a timing issue like

Microsoft or was it something else?

Rory Cowan

I think that one is probably a product cancellation. It is a Korean, a well known Korean electronics manufacturer that is sort of configuring some of their software for their devices.

Juan Bejarano

Got it. So, we shouldn't consider it coming back in the future.

Rory Cowan

Our teams suggest so, but I think we'll just keep it again I think prudent suggest just to keep it at this level and if we have an upside surprise I think we will also be pleased.

Juan Bejarano

Great. Thank you. And just a housekeeping question, what was top 10 accounts as a percent of revenue last year?

Marc Litz

This is Marc. It was 52% last year versus the 47% Rory mentioned for this year.

Juan Bejarano

Got it. Okay. Thank you. That’s it for me. Appreciate it.

That’s great. Well, thanks everybody. So, as always looks if there are no more questions here on the board, thanks for participation and as always, please give us a call. So, we are going to find a point on any questions you may have. Thanks a lot.