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ELMO Software Limited

(ASX:ELO)

ELMO FY22 results transcript

Danny Lessem, CEO and Co-Founder

Good morning and welcome to ELMO Software's full year 2022 results presentation. I will be referring to the presentation released to the ASX this morning. ELMO has been able to deliver a very strong set of FY22 results.

The key themes for today are:

1. The continued strong organic growth through both business segments and geographies.

2. Operating cash burn has improved significantly compared to FY21, as we continue to experience operating leverage as we scale.

3. We remain well capitalised and are sufficiently funded to reach cashflow breakeven which we expect to deliver in FY23.

Turning to page number three, we recorded a record result in FY22 as we are continuing to experience strong demand as more organisations adopt cloud-based technology to manage their hybrid and remote based workforces.

Annualised recurring revenue (ARR) grew to $108.2 million, representing organic growth of 29% when compared to 30 June 2021. Revenue also rose to $91.4 million, up 32% pcp. Underlying EBITDA came in at positive $7.1 million, up $6.5 million pcp. This growth highlights the benefits of our scale and that we are beginning to leverage the significant investments in both our products and people over the last few years.
Cash receipts came in at a very strong $116.9 million, up 46% pcp and ELMO remains well capitalised with $47.9 million cash on hand, which leaves us well positioned to achieve operating cash flow breakeven in FY23.

Turning to page four, Group Overview. ELMO offers a convergent solution, providing medium and small businesses an all-in-one platform to manage people, process and pay.

ELMO's competitive advantage is the breadth of the solution, addressing a wide variety of customer needs all in a single integrated platform. The business operates on a robust SaaS model based on recurrent subscription revenue.

ELMO's offering has multiple modules or revenue streams, and we utilise a land and expand strategy to grow revenue from both new and existing customers. At 30 June, we had grown to over 570 employees with offices across Australia, New Zealand and the United Kingdom.

On to page five. Our expansion strategy is underpinned by three key pillars, which will continue to drive our growth into FY23 and beyond. Firstly, segment expansion, secondly, module expansion, and finally, geographic expansion. Let me go into each pillar in more detail.

On to page six, segment expansion. ELMO has two distinct market segments that we address with two fit-for-purpose platforms. The growth opportunities across each of these two segments are large. On the left side of the page we have the ELMO mid-market business, focusing on organisations with 50 to 2,000 employees. ELMO currently has over 3,400 mid-market customers with substantial upside as we further penetrate this market segment.

On the right side of the page, there's the Breathe small business solution. Breathe's self-service platform caters for businesses who typically have fewer than 50 employees. Currently Breathe has over 11,000 customers and is growing rapidly. There is still substantial room to grow the small business segment as these organisations are still early in their adoption of people management software.

Moving on to page seven. The second pillar of our growth strategy is module expansion. ELMO operates on a land and expand model. The breadth of our integrated solution gives us a competitive advantage in attracting new customers. It also enables us to cross-sell our additional modules to our existing customer base. Recently, we have brought two new modules to market including Hybrid Work and Wellbeing. These two new modules respond to the changing nature of the workplace environment and assists our customers to navigate the new way of working.

Turning to page eight, the last pillar of our growth strategy is geographic expansion. After successfully expanding into the United Kingdom in late 2020, we now have significant revenue opportunities there in both the mid-market and small business segments. The addressable market in the UK is 2.8x the size of that in Australia and New Zealand.

Since expanding to the UK, we've added a number of HR modules to the mid-market platform and have been able to successfully win new customers there. We have also added a number of new modules to the small business platform with good take up from new and existing customers.

Turning to page nine. As a result of our expansion into new market segments, module adjacencies and geographies, our total addressable market has expanded considerably to $12.8 billion. With less than 5% penetration in the mid-market, and less than 1% in the small business segment, there is still tremendous headroom for us to continue our growth into the future.

In addition, we continue to benefit from the tailwinds in the adoption of Human Capital Management (HCM) software due to an increasingly remote or hybrid workforce.

Now I'll hand over to James to take you through our financial results in more detail.

James Haslam, Chief Financial Officer

Thank you Danny and good morning everybody.

Turning to page 11, which shows the trajectory of our ARR. Since 30 June 2018 ELMO has delivered high ARR growth of 37% per annum, on an organic basis ARR growth has been 38% per annum across this period. Revenue has also increased at 36% per annum since FY18.

On page 12 we highlight the breakdown of the ARR growth across the year.

Firstly, Group ARR growth was 29%. In the mid-market ARR grew at 29% which included $27.9m of new business written and a 280 basis points reduction in the churn rate from 11.6% in FY21 to 8.8% in FY22.

We had a similar dynamic in the small business segment which generated 34% ARR growth. We also saw a contraction in the churn rate to 9.5% per annum or 0.8% per month. It is worth noting through the last quarter the strengthening of the AUD had the impact of reducing both the reported ARR and revenue when translating our UK and NZ businesses from their base currency. These operations account for c30% of group ARR.

On to page 13, the ELMO mid-market dashboard. In addition to the strong top line growth, we continue to see operating leverage continue to emerge across key cost categories resulting in the generation of $8.1 million of underlying EBITDA. We also saw the gross profit margin improve to 89.4%, up 60 basis points from FY21.

Through the year we saw net dollar retention return to 100%. This was a reflection of the upsell of additional modules to existing customers, inflationary price increases passed to a number of customers and a significant reduction in the rate of churn to 8.8%.

The upsell combined with the new business sales has also contributed to drive the increase in the average module per customer account from 2.3 to 2.9 over the last 12 months.

Moving across to the small business dashboard on page 14. We have seen continued high growth in the small business segment with organic ARR growth of 34%. Key highlights include the addition of over 3,000 new customers to a total of 11,198. A net dollar retention of 106.1% which reflects the increasing cross sell to existing customers, price increases across the majority of customers and a reduction in the churn rate to less than 0.8% per month.

In addition, we have seen expansion in the gross profit margin which grew to 94.3% in FY22, up 480 basis points from FY21. This expansion indicates how profitable this segment can be at scale.

Page 15 shows a more detailed P&L. At a consolidated Group level you can see how the high levels of ARR growth are translating to revenue growth of over 32% and improved cost ratios across each category. This improvement is driving the generation of positive underlying EBITDA of $7.1 million. It is also worth noting the rate of capitalisation relating to research and development costs has also reduced therefore a larger portion is being expensed.

On page 16 we illustrate the improvements in the cost ratios over the last three years.

Turning to page 17, we saw a significant improvement in the lifetime value (or LTV) of our customer base across both the mid-market and small business segments. The Group LTV of the customer base is now over $1.1 billion. The growth in this metric has been driven by a combination of increasing customer numbers and the reduction in the rate of churn in both segments.

Similarly, the LTV/CAC ratio improved in both segments. The mid-market ratio increased to 9.3 times, up from 6.8 times in FY21. Whilst the small business LTV/CAC ratio improved to 10.3 times, up from 6.9 times in FY21. These improvements demonstrate the increasing efficiency of our sales and marketing efforts.

Moving to page 18, we'll look at the cash flows of the business. Through the last 12 months ELMO has collected a record $116.9 million, a 46% increase on the same period last year. On a quarterly basis you can see the strong profile across the year, which includes a quarterly record of $32.6 million collected in Q4, this is setting us up well heading into FY23.

Page 19 highlights ELMO is well capitalised with just under $48 million of cash reserves which we expect will fund the Group through to cash flow break even.

Notably, the cash burn has decreased significantly by 34% from a negative $26.4 million in FY21 to a negative $17.4 million in FY22. This reduction reflects the move to generating operating leverage as a result of scale and from restructuring initiatives which we have launched during the year.

On to page 20, we further illustrate the trajectory towards operating cash flow break even, starting with the acceleration of EBITDA, followed by the reduction in operating cash burn. Once operating cash flow break even has been achieved, I expect the Group to move towards generating positive cash flows.

Turning across to page 21, I will run through some initiatives which are expected to support the move to the breakeven point in FY23.

Firstly, the strong top line growth is expected to continue and I will come to guidance shortly.

To complement the strong growth there has also been a number of initiatives kicked off during FY22 to support the acceleration of achieving operating cash flow breakeven.

Firstly, we have adopted regional leadership teams to expedite and streamline decision making and this includes the promotion of two UK senior leaders to the ELMO Group executive team. Moving through the P&L items, in the client services team the delivery model has been evolved to now incorporate outsource and offshore support to help lower the cost of and expedite customer onboarding.

In sales and marketing, we have revisited the go to market approach and this has been simplified to focus on the more mature and complementary modules.

Through R&D the investment across the last few years has been materially completed with the focus now moving to more maintenance, coupled with the utilisation of lower cost offshore support through our Hero Teams joint venture with a focus on Southeast Asia where we see great cost arbitrage opportunity.

Within G&A, the group has reduced office space requirements as we have also adopted hybrid working practices within our teams and we expect some savings from this to come through FY23 as we look to rationalise our footprint.

Finally, from a capital management standpoint, we are currently reviewing the current level of debt held on the balance sheet. Given cash flow breakeven is not far away, it is unlikely we require this level of drawn debt for the foreseeable future and a reduction in this benefit will future and ongoing funding costs.

Finally, I am pleased to reiterate our guidance for FY23 that was released to the market on July 28 2022.

At a group level ARR is expected to grow organically by between 24% to 29% across the next 12 months to between $134 and $140 million. The pipeline in both the ANZ and the UK markets is very strong and supports this growth. This would be done through a combination of winning new customers, upselling to our existing customer base and price increases.

We expect this ARR growth will translate to revenue growth of between 25-31% up to $114m to $120m.

As a result of this growth and a stabilising of the cost base, we expect EBITDA to continue to accelerate as we leverage this cost base and expect this to fall in the range of between $20 to $25m.

We expect to breakeven across the year have provided the guidance range of negative $2m to positive $2m operating cash flow. S To be clear operating cash flow includes all capitalised costs. The only costs that are not included in here relate to our financing costs.

Thank you for your time, I will now hand back to the operator for Q&A.

-ENDS-

Authorised by:

Danny Lessem, Chief Executive Officer

About ELMO

Established in 2002, ELMO Software offers cloud-based solutions for small businesses and mid-market organisations to manage people, process, pay and expenses. Spanning across Australia, New Zealand and the United Kingdom, ELMO operates on a software-as-a-service ("SaaS") business model, based on recurrent subscription revenues.

For more information, please visit www.elmosoftware.com.au.