Synchronoss Technologies Inc (SNCR)

Q3 2016 Synchronoss Technologies Inc Earnings Call

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CORPORATE PARTICIPANTS

- Daniel Ives, Synchronoss Technologies, Inc. - SVP of Finance and Corporate Development
- Steve Waldis, Synchronoss Technologies, Inc. - Founder and CEO
- Karen Rosenberger, Synchronoss Technologies, Inc. - CFO

CONFERENCE CALL PARTICIPANTS

- Samad Samana, Stephens Inc. - Analyst
- Michael Nemeroff, Credit Suisse - Analyst
- Nandan Amladi, Deutsche Bank - Analyst
- Tom Roderick, Stifel Nicolaus - Analyst
- Tavis McCourt, Raymond James & Associates, Inc. - Analyst
- Greg Burns, Sidoti & Company - Analyst
- Gray Powell, Wells Fargo Securities, LLC - Analyst
- Greg Mesniaeff, Drexel Hamilton - Analyst
- Nina Kansu, JPMorgan - Analyst

PRESENTATION

Operator

Good afternoon, ladies and gentlemen, and welcome to the Q3 2016 Synchronoss Technologies, Inc. earnings conference call.

(Operator Instructions)

As a reminder, this conference call is being recorded.

I would now like to turn the conference over to your host, Mr. Dan Ives, SVP, Finance, Corporate development.

Daniel Ives, Synchronoss Technologies, Inc. - SVP of Finance and Corporate Development

Good afternoon and welcome to Synchronoss Technologies' third-quarter 2016 earnings call. We will be discussing results announced in the press release issued after the market closed today. I'm Daniel Ives, SVP of Finance and Corporate Development of Synchronoss. With me on the call is Karen Rosenberger, CFO, and Steve Waldis, Founder and CEO.

During the call we will make statements related to our business that may be considered forward-looking statements under federal securities laws. These statements reflect our views only as of today and should not be reflected upon as representative views as of any subsequent date.

These statements reflect our management's current view and expectations, plans and strategies and anticipated financial results, all of which are subject to known and unknown risks, uncertainties and factors that may cause the actual results to differ materially from those expressed or implied by these forward-looking statements. For a discussion material risks and other important factors that could affect our actual results, please refer to those listed in our SEC filings, included in our most recently filed annual report on form 10-K and quarterly report on form 10-Q.

In addition today's discussion will include a certain non-GAAP financial measures. Our press release for this quarter's results contains reconciliations of these measures to their nearest GAAP equivalent. I also want to lastly let investors know we will be presenting at the Credit Suisse Technology Conference in Phoenix on December 1 and look forward to seeing many of you there.

With that, I will turn the call over to Steve and then Karen will come back a bit later to provide some further details regarding our financials and forward-looking outlook. Steve?

Steve Waldis, Synchronoss Technologies, Inc. - Founder and CEO

Thanks, Dan, and thanks to all of you for joining us this afternoon to review our third-quarter financial results, which exceeded the high end of our expectations on the top line, while coming in towards the high end of our expectations on the bottom line. Our non-

GAAP revenues in the quarter were $181 million, which represented 20% percent year-over-year growth and was above the high end of our guidance.

From a profitability perspective, we generate 26% non-GAAP operating margin and a non-GAAP EPS of $0.68, which was towards the high end of our EPS guidance of between $0.65 and $0.69. Synchronoss' strong revenue growth and profitability in the third quarter was highlighted by a 40% year-over-year growth in our clou***d sol***ution business, which we believe is on course for a very positive trend in the fourth quarter, as well as 2017, as Karen will discuss a little bit later in the call.

We're also progressing well within integration of Openwaves, which has already led to significant cross-selling opportunities in Japan. As discussed, this is a major focus region for Synchronoss' team over the coming years. Messaging has proved to be key linchpin of ***cloud*** adoption, engagement and monetization with many of our existing customers.

We had a number of customer summits, both in Japan as well as here in our headquarters in New Jersey, with new and potential Japanese carrier customers to walk through the value of the proposition of our ***clou***d solution and how it fits into their respective customer growth, engagement and retention plans. To this point, we're excited with our progress in Japan believe we have a clear path towards $100 million or more in bookings for 2017, based on significant clou***d and*** messaging success with a number of Japanese customers, including SoftBank, NTT Plala and Kddi during the quarter. We look forward to discussing more details around these next-generation ***cloud*** and messaging deals as we progress further down the path.

A key contributor to our ***clou***d performance in the quarter was continued success of the Verizon relationship, as we have significantly expanded our partnership during the course of 2016 on the heels of our Personal ***Clou***d success, which also continues to ramp. We continue to expand and make progress on our new strategic initiatives with Verizon that we mentioned on our last conference call.

As part of these strategic initiatives we signed a $25 million license deal with Verizon during the quarter, which is helping us both pave another area of growth at our flagship customer and furthermore, secure the importance of our personal ***clou***d platform for the coming years. We look forward to discussing more details around these new, broader domestic and international initiatives over the coming months as we expand our addressable ***cloud,*** analytics and messaging opportunities at Verizon, as well as customers both in the US and abroad in the coming years.

Now, during the quarter we made great progress furthering advancing our ***clou***d initiatives and migrating the rest of the F-Secure clients to Synchronoss personal ***clou***d platform, a trend that is starting to lead to ample cross-selling opportunities over the next 12 to 18 months. We're seeing the fruits of our labor in clou***d sta***rt to pay dividends as the success will Verizon is now laying the groundwork for further clou***d suc***cess with America Movil, British Telecom, AT&T and others in the quarter. We're also excited about Reliance Jio and its national 4G wireless much of his services in India, which lays the path for further monetization in this growing market.

We feel confident in these ***clou***d opportunities, as customers start to realize the clear value proposition of our ***clou***d platform and thus giving us healthy revenue opportunity and visibility into the next few years. As we further build out these ***cloud*** deployments over the next 6 to 12 month, we believe our ***cloud*** monetization strategy is set to kick in to next gear of growth. Overall, we had a very strong quarter in ***cloud,*** which sets up well in the fourth quarter and gives the Company healthy momentum into 2017 and a testament to our innovative product development, solid customer relationships, and strategic partnerships.

Now in the enterprise front, we are progressing extremely well with the Goldman Sachs strategic partnership, as we have successfully built a strong pipeline of customers and enterprise pilots across various verticals, with a core focus on financials and healthcare. During the quarter, we had a number of successful conversions from our platform -- from our pipeline into signed deals, including a handful of replacements of existing competitive deployments.

We are pleased at how quickly our salesforce and strategic partnerships have translated into some early enterprise success, which is leading our ramping substantial revenues in our enterprise business in the fourth quarter. We believe the market is right for our solution to be a replacement for this major pain point of enterprises across the globe as CIOs continue to grapple with BYOD trend. I believe this foundation will serve Synchronoss well as we expand our enterprise offers and revenues in 2017.

Our Verizon partnership around the Synchronoss Universal ID platform is also ramping and on track as we further build out this product portfolio. This innovative method to credential and authenticate users on a secure mobile platform will provide an uncompromised secure experience that we believe could open the doors to multi-billion total addressable market over the coming years.

To this point, our Verizon partnership helps provide us with access to approximately 1/3 of the US consumer market and roughly 50 large enterprise customers. This platform offers us a great way to secure and scale with high visibility into the online consumer market for multi-factor authentication and clearly jump-starts our goal of expanding our secure mobility suite efforts.

Now I want to discuss our activation business and some strategic initiatives, which we are actively working and are underway at the Company. Now, when I found at Synchronoss back in 2000, we started and activation business and the revolutionary iPhone activation software put Synchronoss on the map in 2007. But we recognized that over time, the number of subscribers and upgrades would slow down and put pressure on our growth, as well as our margins. And while our activation business is stable, as devastated clearly this year and still has pockets of high growth potential, we have decided to evaluate strategic alternatives for our activation business to enhance shareholder value.

We believe the timing is right as our growth initiatives and sales pipeline on our higher-margin ***clou***d business and enterprise business have surpassed our expectations and gives us solid revenue and booking momentum into 2017 and beyond. We will keep investors updated on this ongoing strategic process with our activation business, but please keep in mind it may end up resulting in no changes to the current business.

In summary, we had a very strong quarter and I feel confident about our broadening ***clou***d platform expansion and growth initiatives heading into year end, with our enterprise strategy laying the path for what will be the next chapter of growth and profitability headed into 2017.

With that, let me turn it over to Karen to discuss the quarter in a little bit more detail.

Karen Rosenberger, Synchronoss Technologies, Inc. - CFO

Thanks, Steve, and good afternoon, everyone.

As Steve stated, our business performed well in the third quarter. I will now review our results in more detail and finish by providing our guidance for the fourth quarter an update full-year 2016 guidance. We are very excited to deliver another strong performance in the third quarter, with healthy business momentum heading into the fourth quarter and 2017. All of the numbers I will be going through will be non-GAAP. A reconciliation of non-GAAP to GAAP numbers can be found in our press release and on our investor relations site.

Starting with the top line, non-GAAP revenues were up $181 million, which was above the high end of our guidance and up 20% on a year-over-year basis, driven by strong-than-expected ***clou***d revenues and in-line activation performance. Our ***cloud*** solution revenue in the third quarter was $106.4 million, which represented 59% of our total revenue and grew 40% year over year.

This was above the high end of our guidance range of between $102 million to $105 million. As Steve highlighted, our ***cloud*** business has hit an inflection point as our previously stated strategic initiatives at Verizon on the personal ***cloud*** front enabled us to further expand our addressable market at this key customer with a $25 million license deals signed a recognized in the quarter. We expect this new strategic ***cloud*** initiative will help us realize more recurring revenues in the upcoming quarters and look forward to discussing more details around this deal as we head into 2017.

We also were pleased to see ***clou***d deals from a handful of other customers materialize during the quarter as the value proposition on personal ***clou***d is gaining steam in the field domestically with AT&T and on the international front with British Telecom, America Movil, and in Japan around our efforts at SoftBank and other carriers. Our activation solution revenue was $74.6 million for the third quarter, representing 41% of our total revenue and was down 1% year over year.

Generally, we saw volumes consistent with expectations in the third quarter with only a modest uptick from the iPhone launch. Strength from DirecTV deal neutralized some of the smartphone headwinds in the quarter. As Steve mentioned, we are in the process of evaluating strategic alternatives for our activation business, which, depending on the outcome of this process, may or may not impact the future trajectory of this revenue stream.

Breaking down further, 66% of our third-quarter revenue came from recurring sources versus 70% in the prior quarter, while this other 34% came from nonrecurring sources such as professional services and licenses. The $25 million ***cloud*** license deal with Verizon shifted the recurring mix down in the third quarter. As a reminder to investors, our revenue streams generally consist of 65% to 75% transaction and subscription revenues and the remaining 25% to 35% professional service and license revenues with quarter-to-quarter variability.

With our enterprise solution going GA in June, we saw healthy customer activity during the course of the quarter in our enterprise business, with a growing subscription pipeline heading into the fourth quarter and 2017. We now expect enterprise revenues at or above $10 million for 2016, based on additional wins, competitive displacements and better-than-expected momentum in the field, with a clear path to profitability for this business in 2017.

On the international front, revenues continue to be in the double-digit range at 11%, up from single digits in 2015. We continue to make steady progress towards our longer-term goal of deriving 25% of revenues from outside of the United States, with Japan poised to play a key role as we execute the strategy.

As Steve mentioned earlier, we believe we have a path towards achieving $100 million of bookings run rate in Japan for 2017. We are pleased with our international performance, as this continues to be a major strategic focus of ours as we look to diversify revenue geographically over the coming years.

Turning to costs and expenses, non-GAAP gross profit in the quarter was $109.1 million for a gross margin of 60%, which was in line with our guidance. We will expect to see more leverage take hold as our enterprise product ramps and ***cloud*** revenues continue to contribute a larger percentage of our revenue stream. Non-GAAP income from operations was $46.5 million in the third quarter, representing an operating margin of 26% at the high end of our guidance.

Non-GAAP net income attributable to Synchronoss in the third quarter was $32.5 million, which led to a non-GAAP EPS of $0.68, toward the high end of our guidance of between $0.65 and $0.69 based on a 35% non-GAAP tax rate. On a GAAP basis, our EPS was $0.16. We note that we continued our restructuring, cost cutting and integration efforts during the quarter. This continues to be part of a broader restructuring effort that we highlighted on our last earnings call as we look to shed underperforming assets, cut costs, change the direction of our international strategy and position us for a stronger profitability and cash flow trajectory over the next few years as we move towards higher-growth areas of the mobile and enterprise landscape going forward.

Looking at our cash, total cash, cash equivalents, and marketable securities were $144.3 million, a decrease from $187.3 million at the end of the second quarter. Our cash balance was negatively impacted by some collections after the end of the quarter and a cash outflow related to our strategic build out of Japan. Regarding our $100 million buyback plan, announced in the first quarter, we still have $60 million remaining, which we plan to opportunistically deploy, although we did not repurchase any shares during the quarter.

On the collections front, DSOs came in at 113 days versus 94 days in the prior quarter as we received cash related to our large license deal after the quarter closed due to some customer processing issues and expect DSOs to return to more normalized levels in the fourth quarter, with a target range in the high 80s heading into 2017. Non-GAAP cash flows from operations was negative $17.7 million, in large part due to the discussed collections issues, while free cash flow was a negative $37 million, which was impacted by the build out of our Japanese ***cloud*** initiative signed in the quarter.

This was a one-time capital expenditure that laid the groundwork for this major strategic endeavor to ramp in 2017 and thus helps us build out Japan into a key growth region for the Company. On a related note, CapEx in the quarter was $19.3 million, or 11% of revenues, and we still anticipate CapEx spending for the year in the range of 9% to 10% of revenues. We expect strong cash flow to be resume in the fourth quarter and into 2017 as we benefit from an efficient operating model and lower CapEx structure looking ahead.

Now, let me move to guidance for the fourth quarter. Non-GAAP revenues are expected to be in the range of $194 million to $201 million, representing year-over-year growth of approximately 25% at the midpoint. Breaking our revenue guidance down further, we currently anticipate our ***cloud*** solution revenue will be in the range of $122 million to $125 million, or growth of 36% at the midpoint of our range, as we have a visible, stronger pipeline heading into the fourth quarter in 2017 on the heels of a number of ***cloud*** deployments with new and existing customers.

We also note that on an apples-to-apples basis, if we exclude the one-time component of our Verizon strategic partnership announced in the fourth quarter of 2015, our guidance implies ***clou***d growth of roughly 60% of the midpoint year over year. We currently anticipate our activation solution revenue will come in the range of $72 million to $76 million, or an increase of 11% at the midpoint of our range, given the seasonal strength expected from both AT&T and DirecTV channels heading into the holiday period. This assumes no change during the quarter as a result of our strategic process on the activation front.

Turning to profitability, we currently expect non-GAAP gross margins of between 62% and 63% in the fourth quarter. In terms of operating profitability, we expect non-GAAP operating margins of between 28% and 29%, leading to non-GAAP EPS of $0.80 to $0.85, assuming a non-GAAP tax rate of 30% and 48.7 million diluted shares.

We are expecting another restructuring charge of roughly $3 million in the quarter to reflect cost-cutting initiatives. For 2016, we now expect total revenues of between $682 million and $689 million, representing 18% year-over-year growth at the midpoint versus our prior forecast of between $673 million and $685 million. To this point, our new ***cloud*** solution range for 2016 is for revenues of between $408 million and $411 million, representing 32% year-over-year growth at the midpoint versus our prior forecast of between $394 million and $411 million.

On the activation front, we are lowering our range to between $274 million and $278 million versus our prior forecast of between $279 million and $284 million, representing 2% year-over-year growth at the midpoint. For 2016, we still expect non-GAAP gross margins of between 60% and 61% and operating margin guidance range for the year tightened to 25% to 26% versus our prior guidance of 24% to 26%. Non-GAAP EPS is now expected to be in the range of $2.54 to $2.59 per share versus our prior guidance of $2.42 to $2.61 per share on a diluted share count of approximately 48.5 million and assuming a non-GAAP tax rate of 30%.

While we are not providing formal guidance for 2017, given the underlying pipeline strength we are seeing from our ***clou***d business, we are forecasting initial ***clou***d revenues to be north of $520 million and 2017, not including the contribution from our enterprise business. We plan to give more details around our 2017 outlook on our fourth-quarter earnings call in February. In summary, we feel proud of the Synchronoss team for delivering another strong quarter, with exciting opportunities ahead as we look out into the fourth quarter and 2017.

With that, let me turn it back to the operator to begin the Q&A session.

QUESTIONS AND ANSWERS

Answer – Operator: (Operator Instructions)

Your first question comes from the line of Samad Samana from Stephens Inc. Your line is open.

Analyst: Samad Samana, Stephens Inc. - Analyst

Question – Samad Samana: Hi. Congrats on a great quarter and thanks for taking my questions. My first one is, could you give us some additional detail in how far along you are in the process of the strategic alternatives and what you're potentially exploring and what you're leaning towards? Then I have a couple of follow-ups.

Answer – Steve Waldis: Okay, I think you were just cutting out a little bit. I think the question was around where we are in the strategic process and what are the areas of focus. Is that correct?

Question – Samad Samana: That's correct.

Answer – Steve Waldis: Okay. Yes, we're obviously in the process of evaluating opportunities in the activation world. Clearly, there are good pockets of strength, certainly in analytics, certainly of some of the new emerging areas, Internet of Things. But there's been obviously areas or facets that of slowdown as you guys have seen in the market today and so when you look and compare that to both our clou***d an*** enterprise business that have both high growth trajectories and margin profile significantly better than the activation business, we want to make sure that as we evaluate the process that we're doing everything we can to ensure we are making the investments in the high-growth, high-margin businesses of the future. That's something that will play out over the next quarter or so and as we'd mentioned, we'll certainly keep everybody up to speed.

Question – Samad Samana: Great. Switching gears a little bit, I wanted to ask about in Japan, it seems like your strength is ramping there. Could you give us maybe some more details on what you're doing or where your early strength has been by -- in clou***d ser***vices and how you expect the messaging to attack going forward?

Answer – Steve Waldis: Sure. The biggest part for the Japan market, which has been great for us, is out of our Openwave acquisition, which is messaging has really proven to be a really key linchpin for ***cloud.*** That great an engagement monetization perspective in that market which has similar ARPUs to what we would experience here in North America.

Once you have adoption and engagement in messaging clearly creates a high degrees of engagement. That really opens the door for monetization. You'll see in the coming years as we get more and more open about some of the initiatives we're working on, it really helps us set the stage for that next growth at cloud fo***r us*** very effectively, which is in that area monetization.

Answer – Daniel Ives: Samad, I would just add, remember, Japan is also going to really be key. We talked about that 25% of revenue growth coming from international. This is something over the last few quarters we've sort of weighed the groundwork on Japan and we've really seen some of those seeds now prospering to deal flow and we've talked about that $100 million of potential bookings into 2017.

Question – Samad Samana: Great. Karen, I have one question for you. On the $25 million Verizon deal in 3Q, was that baked into your initial guidance, or was that a deal you were ready working on? I guess I'm just trying to parse out how much of the upside contributed -- came from that? Then as you think about 4Q guidance, are there any lumpy type of deals from Verizon or any other ***cloud*** customers that we should be aware of?

Answer – Karen Rosenberger: Yes, so clearly that deal has been in the works for little while and was clearly contemplated while we were giving guidance on our last earnings call. The other thing that I would say is by way of our overall business model, it's remained unchanged from the 65% to 75% of our revenue streams coming from recurring sources of revenue with the balance coming from nonrecurring sources and that can vary from quarter to quarter.

Question – Samad Samana: For the last question for me. On free cash flow, are you still expecting 15% to 20% year-over-year growth? I'm not sure if I caught that in the guidance section not.

Answer – Karen Rosenberger: Right now, I mean, we are expecting, from a DSO perspective, normalizing in Q4. Obviously, that will impact to the free cash flow that we anticipate for the year.

Question – Samad Samana: Okay. Great. Thanks, guys, for taking my questions.

Answer – Steve Waldis: Thanks.

Answer – Operator: Your next question comes from the line of Michael Nemeroff from Credit Suisse. Your line is open.

Analyst: Michael Nemeroff, Credit Suisse - Analyst

Question – Michael Nemeroff: Hey, guys. Thanks for taking my questions and congratulations on a nice quarter. Steve, during your prepared remarks, you talked about Japan a lot. Karen, I think you mentioned that there was a big CapEx spend on the build out there. I'm a little bit confused because I thought that you were virtualizing the storage, so if you could maybe just detail what that CapEx build out in Japan was related to?

Answer – Steve Waldis: Sure. Well, the first thing, you are right, as we put together, without getting into specifics, it's involving a lot of software purchases that we are pulling in combined with a solution that were bringing to the market that'll be much more robust and will have a lot more features in terms of some of the partners that you'll hear about in 2017. A virtualization component was completed unscheduled and that's why I think you also see that were still within the 8% to 10% kind of yearly guide on CapEx.

Question – Michael Nemeroff: Then if I may, backing on the last question, as you look to potentially sell the Activations business, I'm just kind of curious if you could give us maybe a little more detail? Maybe this is for Karen around what type of profitability or what type of an EBITDA margin that Activations business carries versus the blended company?

Answer – Karen Rosenberger: Yes, what I would say as far as the Activation business is really, we took a look at the Activation business. We have discussed previously that generally speaking, the Activation business, is a lower-than-corporate gross margin as well as down to contribution margin, so we haven't given specifics on exact EBITDA percentages, but I will say that it is lower than the corporate margins that we are achieving now.

Question – Michael Nemeroff: Okay. One last one for Karen. If you back out Activations, what percentage of the business would be transactional and subscription?

Answer – Karen Rosenberger: From an Activations perspective, obviously that is a higher transaction and subscription model, so it's slightly higher than what we've talked about on the call, as well as -- I mean, from an overall perspective.

Question – Michael Nemeroff: Okay. Thanks very much for taking my question.

Answer – Daniel Ives: Mike, the one thing I'd also add is that remember, the enterprise because that is really ramping and Steve talked about that's above expectations. That's a pure subscription piece. That's really as we go into 2017, that's also going to play a role as we'll talk more about in February.

Answer – Steve Waldis: I would say, Mike, the summary if you were thinking about from models that you'll see the transactions, the recurring stay the same but then you'll get more recurring in subscription as the enterprise business starts to scale, because that's 100% recurring. When you look at the net-net of the both growth next year, you would see a business that has not just a much higher margin profile but a business that has a much more recurring stream of revenue.

Answer – Karen Rosenberger: Right.

Question – Michael Nemeroff: Okay. Thanks very much for taking questions. I'll get back in the queue.

Answer – Operator: Your next question comes from the line of Nandan Amladi from Deutsche Bank. Your line is open.

Analyst: Nandan Amladi, Deutsche Bank - Analyst

Question – Nandan Amladi: Thanks for taking the questions. Steve, the activation business, clearly e-commerce is still a growing trend, so why the decision to divest this business given all of the (technical difficulty) very solid growth this year, so can you explain sort of the difference between e-commerce growing on a secular basis?

Answer – Steve Waldis: Yes, I think you see in general that e-commerce, there are pockets of high growth and activation as we look at the business as whole in terms of what -- as we strategically look at it. There are areas certainly online, certain new areas of Internet of Things and online over the year, activation components, but there also is a series of transactions in smartphones in general that have declined. I think almost going through the earnings season there wasn't an OEM out there that didn't discuss that, so that impacts us.

What I like to focus on is as we build the businesses going forward, I want to make sure that the investments that were making are in the high-growth, high-margin areas that can create the next chapter of growth and success for Synchronoss that we've done for year for shareholders. I think it's the prudent thing to do is to evaluate what our options and opportunities be and decide whether we may or may not have a conclusion to it. It may or may not change the business at all. I think it's something that we need to seriously evaluate to make sure that we on the right path going forward.

Question – Nandan Amladi: A quick follow-up on the financial disclosures. Assuming that Activation is divested, do you plan to change your segment disclosure for next year, or perhaps breaking out -- I know you broke out international on this call, but how about the enterprise segment and perhaps a little more granularity in the ***cloud*** segment?

Answer – Steve Waldis: Yes, I think as we do every year, Nandan, we evaluate what the right metric should be going forward. One of the feedback we got from a lot of investors last year was to kind of give the updated quarterly guidance on both ***cloud*** and activation. As enterprise becomes a meaningful part of our businesses, that something that we would think would make sense, but again, we haven't finalized that yet. It's something that we would plan to make sure was part of our 2017 guidance. It's something that we would cover in greater detail at our annual Analyst Day.

Answer – Karen Rosenberger: Right, that's correct.

Question – Nandan Amladi: Thank you.

Answer – Operator: Your next question comes from the line of Tom Roderick with Stifel. Your line is open.

Analyst: Tom Roderick, Stifel Nicolaus - Analyst

Question – Tom Roderick: Hey, guys. Good afternoon. Congratulations on the extension here with Verizon. Steve, I was wondering if you just go into a little bit more detail regarding what that extension represents, what side of the business, how they are utilizing that. Understanding that historically you haven't typically done one-time license deals, what was the nature of this deal that sort of forced your hand into or caused them to want to do this major one-time license deal?

Answer – Steve Waldis: Obviously, Tom, it's tough because we're going discuss more in the coming quarters, which you guys will get more visibility in terms of the offers. Obviously we've got some NDA requirements.

What I can tell you is that a lot of the work that we've done at Verizon on the clo***ud sp***ace led to great opportunities to expand that into new areas and as Verizon makes strategic initiatives on their own, we believe that our product offers play a bigger role into that. This opportunity for us really sets the stage for, as we typically do, recurring revenue streams in new areas.

If you'd looked at the past and the history, when we've done one-time license, it's typically led to that. You see the fruits of the labor coming out and accelerating our enterprise business this year. That was a big part of our initial work with Verizon. This falls into the same category albeit it's a different area.

It does two things for us. One, it really solidifies the importance of our personal ***cloud*** there. Secondly, it creates new opportunities and I will say not just here in the US, but internationally as we partner with them on new initiatives.

Question – Tom Roderick: Great. Karen, following up on just the accounting of that in the quarter, I mean, typically if you see a large license deal late in the quarter, it comes with it some really high profitability, particularly on the gross margin side. Gross margins here look like they're just about the same with last quarter.

Are there other expenses that you're able to layering on the quarter that we may not see again next quarter? Was there anything that you used to offset some of the strength in the license that may go away and create some added leverage in the model? I noticed you're guiding gross margins up by a couple hundred to 300 basis points next quarter, so maybe it's in there.

Answer – Karen Rosenberger: Certainly we had some expenses that we anticipate not repeating in Q4. As we talked about, our guidance and gross margins for Q4 is 62% to 63%, so clearly there were some one-time expenses that hit Q3 this year.

Answer – Daniel Ives: Tom, just to add that, remember there's the recurring that you're get from this over the coming quarters, that's also going to help that profitability stream.

Question – Tom Roderick: Got you.

Answer – Steve Waldis: One other thing, Tom, too, is when you look at modeling, we always, when we look at our recurring/nonrecurring and the ranges that are typical there, in the nonrecurring there is always a portion of license revenue that's pretty consistent. Now there's a little bit higher than normal but it's not a -- there always is some expected as we work specifically into newer markets or opportunities where it makes better sense.

Answer – Karen Rosenberger: I would add to Steve's remark that when you've seen the spike in some of the nonrecurring and prior years or prior quarters, you've seen an uptick in recurring revenue in subsequent quarters.

Question – Tom Roderick: Got you. Last one for me, Karen. I want to make sure I understood your commentary with respect to the cash flow guidance for the year, understanding that AR kind of puts a little pressure on it this quarter. Is the guidance still for 15% growth off of last year's free cash flow number?

To the extent that it is, can we just get some clarity as you guys recapture historical numbers around your ASU 2016 early adoption? What that is that we're using a sort of the historical 2015 number that we should be thinking about as we sort of update our historical numbers there? Thanks.

Answer – Karen Rosenberger: Yes, from a cash flow perspective, we're expecting things to normalize in Q4. I would say as part of the early adoption of the ASU for the nine-month period, there was approximately a $6.5 million impact to cash flow from operations to date.

Question – Tom Roderick: $6.5 million to date.

Answer – Karen Rosenberger: Yes.

Question – Tom Roderick: Okay. Thank you.

Answer – Steve Waldis: Thanks, Tom.

Answer – Operator: Your next question comes from the line of Tavis McCourt from Raymond James. Your line is open.

Analyst: Tavis McCourt, Raymond James & Associates, Inc. - Analyst

Question – Tavis McCourt: Hey, guys, thanks for taking my questions. I've got a couple, but first a housekeeping one for you, Karen. You gave the Q4 guidance. I didn't hear you say a tax rate. Should we still be factoring in about 30%?

Answer – Karen Rosenberger: That's correct. 30%.

Question – Tavis McCourt: Okay. Then a couple of questions. I noticed AT&T Locker kind of got an update in October. It looks like they're giving away 50 MB free, at least initially. What I'm wondering is, as a you switch to this virtualized software model, are you still getting paid on storage or is this much more of a pure recurring business where the revenue to Synchronoss is more on a per-subscriber basis? You don't have to comment specifically on AT&T, but just generically, because it seems like most of those deals going forward are going to be more software-based.

Answer – Steve Waldis: Yes.

Question – Tavis McCourt: Go ahead, Steve.

Answer – Steve Waldis: I was going to say, Tavis, that's a great question. If you think about it, it varies by customer so there are examples where we've, like in the past with Reliance Jio, they manage 100% of the storage, so we get a fee for the use of the active subscriber.

There are other customers today that even though we're virtualized will use a third party whether that's Amazon or some other type of service. Then what ends up happening is we do get the revenue for that but it also shows up in our cost of goods. It's not a CapEx expenditure. It's put in as a cost of the service.

Question – Tavis McCourt: Okay. On the ***cloud*** guidance for 2017, I think you said $520 million. I want to make sure that was before the enterprise segment. Is that correct, Karen?

Answer – Karen Rosenberger: That is correct.

Question – Tavis McCourt: When you look at kind of the major customers outside of Verizon that are ramping, some were in your press release. I don't know if AT&T was in there. As we look at kind of the some of the professional services revenues you get to stand up those clouds and prepare them, is that -- are those types of nonrecurring revenues going be bigger next year or was this the heavy-lifting year on those types of revenues?

Answer – Steve Waldis: Yes, Tavis, good questions. There was a lot of that with the migration work that typically you'd get on our platform. Because we've done it as the product has got more mature and it's more virtualized, it's much more standardized to plug it in and use it and so there are services, but they are not as material in our core product.

That being said, if we're working on new initiatives that would expand the product altogether, which we would point out, then it might go to a typical model where if it makes sense to us to do some service or some license work up front, because there's a big recurring revenue stream on the backend, we'll do that.

But if I look at my current personal ***clou***d deployments that we talked about on the script today, the ones that we went through the migration next year, now the cross-sell upsell is really getting the adoption and the monetization up with the existing active subscriber. We don't see that to be any higher. In fact, it might be slightly lower than you typically see on those that are ramping into production now.

Answer – Karen Rosenberger: I don't think that at this point in time, our business model's pretty much staying consistent with the 65% to 75% recurring revenue streams and the balance coming from the nonrecurring revenue streams. If we would do any updating to that, we would talk about it on the next earnings call.

Answer – Daniel Ives: Tavis, as Karen talked about and Steve, remember ***clou***d and enterprise, especially the needs for some of those ***clou***d deals, you really going to see the benefit into next year and it speaks to the comfort in us giving that guidance in 2017.

Question – Tavis McCourt: Much appreciated. Last question, I promise, for Karen. The differential between the GAAP and non-GAAP revenues, which I suspect is mostly driven by the SoftBank acquisition, will there be more of that in 2015 or will most of that be run through by the end of 2016? Thanks.

Answer – Karen Rosenberger: There will be a tail on that into 2017.

Question – Tavis McCourt: Okay. Thank you.

Answer – Operator: Your next question comes on line of Greg Burns from Sidoti. Your line is open.

Analyst: Greg Burns, Sidoti & Company - Analyst

Question – Greg Burns: Good afternoon. The strength you're seeing in the enterprise segment, is that coming from any particular vertical? In the instances where you had a competitive displacement, what are the factors that are driving that win for you? Thanks.

Answer – Steve Waldis: Sure. A couple things. We've had good success in both financials and healthcare. I would say on the financial side what's driving a lot of the success is just the ease of use of being able to have the Secure Mobility product. It's intuitive, it's easy to install, it's secure and it allows this BYOD phenomena to really be important.

I think the second part that we been able to add a lot of value is analytics portion of our business. As we add more analytics we know who's -- not just the security but were able to provide all this kind of analytical information about what's happening with those users and embedding it back to those telcom managers. That's really been well received.

I think when you think about typical competitors in the market today, they're either locking down the devices. They're making it really painful for the users to have to use them. We have everything from easy-to-use interface to the integration we've done with the Microsoft products. If you use some of the products that are out there today, if you're trying to get email it takes a few minutes to pull it down to actual device. Ours is instantaneously.

There's a bunch of features out there that really make it usable for folks who want to be productive on the road but be secure. There were two common themes. There's finally a solution here that we can put on someone's BYOD device that's secure and simple and easy to use and that can actually be productive.

Question – Greg Burns: Okay. Is there anything you could share with us in terms of maybe the number of businesses or users on the platform right now?

Answer – Steve Waldis: We haven't because -- discussed any of that yet but we are doing is will, as part of our consideration into 2017, so as we think about guidance in metrics, things like enterprise users, number of subscribers, et cetera, things that we're definitely looking at to give folks like yourself a real good flavor for it.

But as we're just getting out of some of the of implementations this past two quarter and we ramp, it gives us an opportunity to make sure that what metrics we do give you guys are the most accurate and the most reliable.

Question – Greg Burns: Okay. Lastly, in regards to the opportunity in Japan, I guess it seems like you've upgraded your outlook for next year and you put in that big capital investment to lay the groundwork for what you're hoping to a accomplish there over the next few years. Has your visibility into the opportunity there increased over the last few months since the Analyst Day?

Answer – Steve Waldis: Yes, we've had quite a number of summits with some of the customers and the perception that we've gotten from a lot of the buyers across carriers has exceeded what we thought out of the gate. When we saw opportunities again, where I think the messaging component really fits well with our ***cloud*** offer really helped solve the adoption questions that typically we have to fight through to get to scale.

All of that has kind of been a very effective planning tools since the Analyst Day. It gives us more momentum as we think of 2017.

Question – Greg Burns: Okay. Thank you.

Answer – Operator: Your next question comes from the line of Gray Powell from Wells Fargo Securities. Your line is open.

Analyst: Gray Powell, Wells Fargo Securities, LLC - Analyst

Question – Gray Powell: Great. Thanks for taking the questions. On the Verizon revenue, so in the past large license revenues have hit the floor, recurring revenue ramps up. Is that the case with the $25 million Verizon license revenue in Q3? If so, what is that curve look like?

Did that revenue in Q3, did that take place of anything that would of happened anyway? I think you had a similar situation last year. Thanks.

Answer – Steve Waldis: Yes, so typically, it does vary but if you look back historically, the recurring revenue, we typically enter these type of arrangements on tier 1 carriers, because again, sometimes we will do some license deals for tier 2 and tier 3 because it has some direct correlation to recurring revenue streams. Depending upon the type of market or service that you're offering, they will vary.

If you take a look at last year's numbers, for example, on some of the guidance that Karen gave for the quarter, if you look at the one-time deal that we have with Verizon, if you back that out you'll see a 6% cloud g***rowth*** on the cloud s***ide,*** 37% with it in. Part of the subscription revenues that are growing out of the enterprise is part of the deal that we struck with them at the time. There's no guarantee on a fixed number, Gray, in terms of where it will end up, but we will absolutely do that when we know that there is visibility to grow in description streams.

Answer – Daniel Ives: Gray, I would just add, too, that this is something we hinted at last quarter in terms of strategic initiative with the Verizon. Karen talked about it. It was something that we expected this quarter and obviously the benefit you will see from a recurring perspective over the coming quarters. But this is something that is right in line with as we sort of highlighted.

Question – Gray Powell: Got it. That's really helpful. One more if I may. On the enterprise JVs, you talked about $0.20 of dilution this year and being breakeven in Q4 2016. I think implied around $4 million or $5 million in revenue in Q4, just make sure I'm thinking about that correctly. If so, how should I think about the pace of growth or the ramp beyond Q4?

Answer – Steve Waldis: I think as we start to scale it out for the year, I think it gives us the comfort that we will get to profitability as scheduled in 2017. That's been a key driver in terms of the investments that we've made this year on those accounts.

Question – Gray Powell: Okay. Thank you very much.

Answer – Steve Waldis: All right, thanks, Greg.

Answer – Operator: Your next question comes from the line of Greg Mesniaeff from Drexel Hamilton. Your line is open.

Analyst: Greg Mesniaeff, Drexel Hamilton - Analyst

Question – Greg Mesniaeff: Yes, thanks and congratulations on a great quarter. Couple of questions I have. Looking at the enterprise business, as it ramps, what kind of CapEx needs do you foresee having for that business?

Answer – Steve Waldis: Very minimal, because most of the software, if not all of it, is always t the customer premises -- or I'm sorry, it's hosted at the customer premises so the CapEx burden, for obvious reasons, a lot of the major enterprises have their own security standards there so it's very minimal.

Question – Greg Mesniaeff: Got you. As you look at the current customer profile, I mean it's mostly Verizon at this point. Can you give us some color as to what kind of discussions, if any, you're having with some of the other major carriers for offering a similar type enterprise mobility platform for their customers.

Answer – Steve Waldis: Sure. We've looked -- historically, we've been working with other folks to see how we can partner with those identities. If you think about one of the importance that Verizon has for us is it gives us the third of the US market on the consumer. You can start to create kind of common identities for uses that we think would be valuable with other carriers to be able to leverage that the authentication side which then provides additional opportunities on the Secure Mobility side.

We think of that, it's a good way -- a good question. We think of that as an additional channel that we can go sell into with these types of products.

Question – Greg Mesniaeff: Right, but you're not at that point yet, I assume.

Answer – Steve Waldis: We are talking to multiple carriers. We have not announced any wins with those carriers.

Question – Greg Mesniaeff: Got you. Just a final quick question. As you pursue ***cloud*** opportunities overseas, particularly in Europe, what kind of issues are you running into regarding storage and warehousing of data, as far as has to be local to that country. Thanks.

Answer – Steve Waldis: I think it's very big as you go to each market, which is part of the reason why we've kind of worked closely to make our software, which if we go back two or three years ago, wasn't as commercialized as it is today. That allows different customers to house it in country. We have multiple solutions. We have partners like in Germany with BCHS where they store obviously to their laws and country.

Most of those environments, either by law or just by comfort, want to have that data stored inside the country. So our software allows them to use a multitude of different types of virtualized platforms to run it on it. Really depends on the standard, which varies by carrier.

Question – Greg Mesniaeff: Right. Got you. Thank you.

Answer – Steve Waldis: Thanks, Greg.

Answer – Operator: Your next question comes from the line of the of Nina Kansu from JPMorgan. Your line is open.

Analyst: Nina Kansu, JPMorgan - Analyst

Question – Nina Kansu: Hi, this is Nina Kansu in for Sterling. Thanks for taking my questions. I just have a couple of quick ones. Just on the -- you mentioned the Verizon deal was all ***cloud*** and (inaudible) in the quarter and then we talked about the international success with it. I was wondering if you have any updates on the [15] million ***cloud*** subscribers by the end of 2017 metric or anything along that lines in terms of the ***cloud*** growth?

My second question is going to be on specifically on AT&T in terms of their ramping clo***ud.*** If you can give us a bit more color on that, that would be really helpful.

Answer – Steve Waldis: Sure. We typically don't update in year the different metrics for the clou***d.*** We try to do that on an annual basis. It is trending slightly better than what we had anticipated from an overall adoption in terms of our goal we laid out at Analyst Day.

As we sit with AT&T and others, not to comment on specific road maps, but we've made some new additions, which some of you may have seen, in terms of the app being updated. They've made some different changes to their sets. There's a certain roadmap that we're working with closely with them on in terms of how and when they will ramp it into different areas and how quickly that will come.

Question – Nina Kansu: Perfect. Thank you.

Answer – Operator: Your next question comes from the line of Samad Samana from Stephens Inc. Your line is open.

Analyst: Samad Samana, Stephens Inc. - Analyst

Question – Samad Samana: Just one follow-up question for me. In terms of the enterprise deals, could you give us any idea of what the average duration is, what the average a deal cycle lens looks like, just some metrics so we can think about how that business ramps as we think about 2017 and anything around the number of sales reps you have as you exit 2016?

Answer – Steve Waldis: Okay. Typically, the duration of those are typically one to two years in length. They're based on commitments for numbers of active subscribers and the functionality, they typically pay on a per-month basis.

Question – Samad Samana: How many sales reps do you have selling enterprise today?

Answer – Steve Waldis: We haven't broken that out. As we ramp it out, obviously we're adding more. We've spent some time thinking -- if you think about the sales cycle, it's typically is three to six months kind of process to convert from initial discussion to trial to actual commitment.

As we break out that business next year, we'll obviously be hiring more and more into those areas. One of the big benefits of the strategic partnerships that we got both from Verizon and Goldman is that we do get a lot of lead generation directly from those particular accounts. In Verizon's particular example, we actually got roughly 50 of the large enterprise accounts that will be transitioning over to us over the next year or two as we start to ramp up the service.

Question – Samad Samana: Great. Thank you.

Answer – Operator: I am showing no further questions at this time. I would like to now turn the conference back to Dan Ives.

Answer – Daniel Ives: Thanks, everyone, for joining us and we hope to see you on the road in the coming months. Have a good night.

Answer – Operator: Ladies and gentlemen, this concludes today's conference. Thank you for your participation and have a wonderful day. You may all disconnect.
