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Optiva, Inc.

Third Quarter 2021 Financial Results Conference Call

November 11, 2021

CORPORATE PARTICIPANTS

Ali Mahdavi, *Investor Relations*

John Giere, *President and Chief Executive Officer*

Ashish K. Joshi, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Brad Hathaway, *Far View Capital Management*

Todd Coupland, *CIBC Capital Markets*

PRESENTATION

Operator

Good morning, everyone. Welcome to the Optiva, Inc. Third Quarter 2021 Financial Results Conference Call.

I would like to remind everyone that today's conference is being recorded.

I will now go ahead and turn the call over to Ali Mahdavi, Investor Relations. Please go ahead.

Ali Mahdavi

Thank you. Good morning, everyone, and thanks for joining us for Optiva's Third Quarter 2021 Financial Results Conference Call.

Joining me this morning are Optiva's Chief Executive Officer, John Giere, and Chief Financial Officer, Ashish Joshi.

If you have not seen the third quarter earnings news release, which was reported yesterday after the close of markets, it is available on the Company's website at optiva.com and on SEDAR, along with our MD&A and interim financial statements. I would also like to remind you that a replay of this call will be accessible on the Investors Section of the Company's website. Following Management's presentation and commentary, we will conduct a Q&A session. Instructions will be provided at that time for you to join the queue for questions.

Before we begin, we are required to provide the following statements regarding forward-looking information, which is made on behalf of Optiva, Inc. and all of its representatives on this call. Remarks and answers to your questions today may contain forward-looking information about future events or the Company's future performance. This information is subject to risks and uncertainties that may cause actual events or results to differ materially. Any information regarding forward-looking statements are statements. Please read the forward-looking statements and risk factors in the MD&A as these outline the material factors which could cause or would cause actual results to differ.

The Company will not provide guidance regarding future earnings during today's call, and Management does not anticipate providing guidance in future quarterly or interim communications with investors.

I'll now turn the call over to John.

John Giere

Thank you, Ali. Good morning to everyone and thank you for joining us on today's call.

I am pleased to share the results of another quarter and a progress report on the rejuvenation of Optiva. Let me begin by highlighting some of our key financial metrics, followed by some commentary on the business during the quarter. Then I will hand the call over to Ashish, who will go further into the results.

To start, I'm very pleased with the progress and want to recognize the effort and performance of our fantastic team at Optiva, which resulted in yet another quarter of major movement in the right direction. During the third quarter, we continued to stay true to our guiding principles by ensuring that all strategies and activities were consistent with being a customer-centric Company, while also further solidifying the footing on all aspects of our business. Once again, we are extremely grateful and encouraged with the level of engagement we are experiencing with existing and now new customers.

We are seeing a noticeable positive change in culture and behavior at Optiva, which in turn is showing up in a great way based on current feedback from customers, who are increasingly viewing us as a strategic long-term partner who is willing to stand shoulder to shoulder with them to navigate through complex strategic decisions that will chart the course of their respective cloud futures.

To keep our house in good order and serve our customers with the utmost service, we continue to invest in our bench strength across all key functions. We define key functions as areas that we see having the most impact on revenue growth, which mainly include sales and R&D. To this end, on a year-on-year basis, you will note in this quarter, investments in sales were up 12.5%, R&D investment was up 43%, and the G&A spend was down 64%, which I will note includes some extraordinary items last year.

The net impact of these investments and prudent reallocation of capital is revenue increased on a sequential basis to $16.7 million. Year-to-date bookings increased to $24.1 million. Gross margins sits at a record level of 79%. We generated net income of $3.8 million, and the Adjusted EBITDA of $5.9 million represents a core strength in our business performance. As well, we have a healthy balance sheet with $32.8 million in cash to support future growth.

During the quarter, we were pleased to open our first Optiva Center of Excellence in Belfast, Northern Ireland. Since 2020, our (inaudible) team has grown, and it continues to do so through the strengthening and building of our talent. A critical element of our strategy includes creating R&D Centers of Excellence in key locations around the world. The Belfast center's focus will be on the development and delivery of Optiva's cloud native software solution, with an emphasis on accelerating our roadmap investment.

In news regarding customer wins, as previously noted, we are working with our first new customer, a leading Saudi-based telecom operator, who selected Optiva's BSS Platform early in the quarter for its new MVNO business line. The partnership enables the operator to deploy Optiva cloud-ready BSS technology on its state-of-the-art private cloud infrastructure.

large multinational telecommunications group that operates in the Middle East and Africa. We are extremely encouraged with the continued progress and our overall third quarter and year-to-date results. We continue to build and take decisive steps. We looked earlier in the year to stabilize our operations and customer base.

Through our responsive and focused efforts on operational efficiencies, cost savings, capital expenditure, and working capital optimization, we are well-positioned to work closely with new and existing customers to be their premier choice in the marketplace, as they look for a partner to solve their monetization requirements.

Now I am pleased to turn the call over to Ashish for a review of the quarter.

Ashish K. Joshi

Thank you, John, and good morning, everyone.

A reminder that Optiva's third quarter results were released yesterday. Our results are presented in accordance with International Financial Reporting Standards and presented in U.S. dollars unless otherwise noted.

For the three-month period ended September 30, 2021, the Company's revenue declined by $2.1 million from the previous year's number of $16.7 million. The change by revenue type for the quarter was $2.7 million decrease in support and subscription, $0.4 million increase in software and services, and $0.2 million increase in third-party software and hardware revenue.

As John noted, gross margin for the third quarter increased to 79%, compared to 75% in the same time period in 2020. The improvement in gross margin is primarily due to Company's cost structure optimization plan and lower third-party cost. The gross margin this year is higher as we also have fewer customizations, which have lower margin, and subscription revenue, which is lower, which has higher margins. We expect the gross margin may fluctuate and vary as we prove our cloud native model and product capability to new and existing customers as they onboard to our public and private cloud in future periods.

Total operating expenses in the three months ended September 30 decreased to $8.2 million, as compared to $12.2 million in the same period last year. Excluding depreciation, amortization, and restructuring costs, total operating costs in the quarter decreased to $7.8 million, or 47% of total revenue, compared to $19.9 million, or 53% of total revenue, for the same period last year.

Sales and marketing expenditures slightly increased to $1.8 million, or 11% of total revenue, compared to $1.6 million, or 9% of total revenue, same time last year. G&A expenditure decreased to $3 million, or 18% of total revenue, from $8.3 million, or 44% of total revenue, in the same time period last year. The decrease is mainly due to lower legal and advisory cost related to activities of the Special Committee of the Board, which we incurred last year, lower amortization and provisions. We also benefited from one time reversal of bad-debt provision, which was driven by strong collections and engagement with our customers.

R&D expenditure increased to $3.4 million, or 20% of total revenue, from $2.3 million, or 12% of total revenue, in the same period last year. The increase is mainly driven by continued hiring and investment being made in our roadmap. The team has now grown three times the size from where it was same time last year. As a result of these actions, Adjusted EBITDA and income amounting to $5.9 million and $3.8 million during the third quarter of 2021. This quarter, as noted, includes a reversal of bad-debt provision of $0.8 million.

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Operator

We can now take the first question from Brad Hathaway from Far View.

Brad Hathaway

Hi, guys. Congrats on another stable quarter. I think this is the third quarter in a row of Q/Q revenue growth and obviously very strong profitability.

I know the Company doesn't give guidance, but I'm curious, John, if you could talk a little bit about kind of what you want Optiva to be in kind of the mid-term and any way you could frame that because, I mean, obviously if you look in the markets, it looks like the Company is trading at well under 10 times trailing 12-month EBITDA. So, it suggests that people don't believe in the future here. So, I'd love to understand how you see the future and any kind of signposts you can give us for kind of the mid-term of Optiva now that we seem to have stabilized the top line.

John Giere

Yes. So, Brad, thanks. Good to talk to you. Appreciate you joining.

I think, consistent with what I've messaged before, we're really focused on buttoning down the business operations, and that, as I said, would go through the end of the year. Although I have to concede, I think we're making progress quicker than I could have hoped, which is great. We are certainly looking at—when you start looking at the mid-term, we're looking at options. We're putting together plans around organic and inorganic growth. I think the Company has an opportunity to capture a strong position in the market.

The market's in a significant amount of flux with the introduction of cloud economics, not just the cloud infrastructure, but the economics, the introduction of 5G, which is changing the business model as well as the business offerings. Then, you look at overall the introduction as well of mobile edge and some of the other technologies out there, we're going to play actively in that. That's why R&D is such an important focus for us. So, I feel like we're going to be able to take a better position and increase our share of both thought and mind share as well as I hope market share in the marketplace going forward.

Brad Hathaway

Okay. Thank you for the quantitative overview. I understand that mostly this year has been about stabilizing the business post some of the disruptions, but I just want to reiterate, at some point, if you could give kind of a more quantitative thought about what you think this Company could be in three or five years. I'm not talking about precision, but just kind of some kind of more broad quantitative overview. I think that would be very helpful.

John Giere

Yes. I think you've come to understand how I operate, Brad. I make sure that we're fact-driven and we're results driven. So, I think you're spot on. That notion, that idea is in my mind. Again, I'm pleased with the progress we made, probably quicker than I could have hoped. So, I think that's going to give us the right to play in a much bigger way.

Brad Hathaway

Fantastic. That's all I have. Thank you.

John Giere

You got it.

Ashish K. Joshi

If I can just add, John to your comment, I think we've noted this before. We have 70% increase in our sales coverage right now. We believe we have a qualified pipeline, which is the best we've seen in the last three to four years. We believe we have an operation, which is coming together really well. So, if you look at the ingredients for growth, I think we are getting there. I think as John alluded to, I think this Company is about to turn corners and go.

I think we've talked about in the last quarter call, I think this year is of stabilization. We don't want to overcommit and underperform. I think we are in a very good position. With all the investment we are making, I think this Company, it's prime time to start moving in the direction that everybody anticipates us to be moving to. So, I feel really good about where we are right now.

Brad Hathaway

Understood, and I appreciate that. Thank you for those thoughts. I mean, I guess where I struggle is—we have trailing 12-month revenues of $67 million. If we look out a few years, and you're successful, and this starts growing again, I don't know what we should think about as a very wide goalpost for what would be success in 2025 or something like that. So that's, I think, where that would be useful to kind of have some thoughts around that.

Ashish K. Joshi

Yes, noted, Brad. We will issue the guidance when we think is the right time for us to do that.

Brad Hathaway

Fantastic. Thank you very much and congrats on the stabilization.

Operator

We can now take the next question from Todd Coupland from CIBC.

Todd Coupland

Hi. Good morning, everyone.

I had a couple of questions. Firstly, on the revenue, $16.7 million, I know there has been this narrative around your revenue in transition, and customers leaving and new ones coming in. Has that more or less stopped now? So, the customers you have are the ones you expect to keep, and you can focus on adding others to the cloud offering?

Ashish K. Joshi

First of all, good morning, Todd. I think we feel really good about our customer engagement right now. We have a really good understanding on the retention rate and the long-term partnership they want to have about the narrative from the past. We are adding new customers. We are growing more revenue with that base. We are introducing a new product, as we've noted in our Investor deck. So, we are more focused on the growth from our new product, new customer base.

So, I think the narrative around the bottom, I think that's probably something we've talked in the past, but I don't think that's something that Management is concerned anymore as we head into the future.

John Giere

Yes. I'll add one little overlay there. I said it early on that it would take—we'd go through the first year and see how every customer, many of them who hadn't been connected with—I now would tell you that we feel pretty confident, very confident in fact, that we're past those issues now. As we go into next year, our plan reflects a normal course of business. We've worked through every account, and each accounts we've had renewal discussions. We know their roadmaps and where they're going, or if they've already declared, they had exited, we've already worked that into the model.

So, we are turning into a new year with I think a high level of confidence of what our customer base is and how it will move forward. So, as Ashish said, that past narrative I think is behind us. I'm not going to say I think. It is behind us.

Todd Coupland

Great. That's helpful. Then, just in terms of the bookings moving up, are those with existing customers, new customers? What are the reasons you feel you're getting selected, which is driving that increase in bookings?

John Giere

Yes, so I—thanks, Todd, for that. As I said before, there's kind of three indicators as I look at the business. One, you start looking at, okay, are we getting the CRs and the daily in and out of the business, and those have picked up quite a bit, but the big one starts to become are people, to the previous question, now signing up, doing upgrades, entering multi-year engagements? We've had a significant increase in that.

The next is new customers. We were fortunate, quite frankly, faster than I could have imagined, we did acquire through just speed and agility, a customer already, but I can see that pipeline filling. So, most of this, Todd, is customers we're engaging again, I would say. I don't have a specific number, but a large portion of it is those existing customers, but you're going to see this start to reflect more and more new customers as both we look at this quarter and going into next year because we've been seeding the ground now. One of the things that we always say is, we've got to write, not read RFPs, and we're now beginning to get into those sales cycles.

Todd Coupland

Okay. Then, just feature, set, service, what are the things that are resonating, which is bringing these upgrades and interest from new customers?

John Giere

So, I think maybe I'll use the example of our just announced MVNx offering. It's on the website. There's a page link to it under our customer piece. It very much typifies the message we're giving customers, which is resonating hugely. We're going to get you time to market very quickly, 90 days or less. We're going to allow you flexibility to configure and change plans in a matter of hours versus days and weeks. I mean, at

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So, we're significantly changing the dialogue to talk to people about a product. "You're buying a software platform, and we're delivering one. You're going to be able to use that to address use cases, business models, new customer segments, without having to continually call on somebody in the background who's an expert. The experts you will be looking for is for new ideas and ways you can go to market quicker and faster."

Todd Coupland

Do you feel that the platform as is, where is its place in the market, its competitive edge? Is it going to be sort of mid-tier international carriers? Is it a Tier 1 offer? Can you just talk about realistically where this product is and where it might be over the next year or two? Thanks.

John Giere

Sure. So, I'll talk about today, and then I'm going to look out on our roadmap, and by the way, it's charging and then it's BSS. So, in the charging market, we play across the globe, and we have scale, reliability, all of the ingredients to address markets up and down the stack, although we're primarily focused on what most people would refer to as the Tier 2 markets. Those would be leader and operators in individual markets, if you will. We, as you may know, have less penetration in North America these days.

So, on the charging side, we have a highly flexible, highly reliable, highly dependent product that performs well at scale. We've made investments in that, and as we go forward, those investments will start allowing us to have a greater level of broader capabilities inside that product, but I think overall we'll be well-positioned to address the majority of the market opportunities.

The BSS is where our sweet spot is. It's a best-in-class suite, so it's fully integrated, has all the components to run out of the box. We play best in markets where, let's call it the 10 million subs market, or even less of course, where we can provide a one-stop shop. That actually works well from our product messaging, which is the more and more we automate, which we're making significant investments in automation and significant investments in features and functionality, the spinoff that gives a very, very flexible, good TCO platform in the market.

Todd Coupland

Okay. That's great framing.

In your view, the sort of the 5G cloud transition, more flexibility with these mid-sized operators, what is the growth rate of that segment of the market with these secular drivers?

John Giere

Well, I think the good news for us is we haven't missed that window. If you look at broad analyst coverage on 5G, the amount of subscribers, the stages, the investment cycles, we're still in the ramp investment cycle in 5G. So once those systems are deployed, you'll see more capability in the system, which then can be translated into money in the operator pocket: dedicated network, slicing channels for gaming or other types of use cases, fixed mobile access where they can combine fixed and mobile access into one offering.

So, that will make a dynamic effect on the billing side of the business and the need to become quicker and faster, again, working on the cloud economics. Those two forces are going to help us position our

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part of the 5G story. Forty percent of an operator’s Opex today is spent on acquiring customers. They have difficulty doing that, particularly for targeted segments. An MVNO could be a vital way to reach new segments, and we think that’s an area where there’s growth opportunities, as an example.

Todd Coupland

Right. That’s helpful. Also, I want to ask about profitability, 25% EBITDA margin. Was there anything unusual in the quarter? Why did you get there? Is the business running at full potential at 25%? Just talk about those dynamics a little bit, please.

Ashish K. Joshi

Sure. So, I think as we’ve noted, we benefited from $800k off bad-debt reversal. So, that was one element. The second element was we also benefited from increase in the sequential revenue that we saw this quarter. As you know, we are trying to move 100% in-source from our capability standpoint. We’ve continued to invest in R&D, continued to invest in sales, but I think we are doing it at a much more cost-efficient way than we’ve ever done in the past. So those dynamics, I would say, are attributed to maintaining a healthy margin level.

I think, as you would see in the quarters, we will start to balance out growth with profitability. We are seeing a good, qualified pipeline for us to head into that direction. So, we will see more balancing, but I think we are a very strong Company. Our operations are performing really well. We are staffed up in our G&A function. We are almost staffed up in sales and R&D, but we’ll continue to invest more and more in those areas. So, I expect to maintain those healthy margins, but balance out growth and profitability.

Todd Coupland

Okay. I think the first questioner asked a little bit about this, but have you put out any long-term margin targets for the business once you get to a level you think is sort of, I guess, a new level or operating model? Can this business generate 30%, 40% EBITDA margins over the medium term? Any color on that? Thank you.

Ashish K. Joshi

Look, I think, as I said, we want to balance out profitability with margin. Our focus would be to start growing our base. As you know, when you implement or deploy new customers, you know you have got lower margin on your (inaudible) side. So, I think we will be balancing out margins. I mean, if we want to just be a margin Company, this business has already demonstrated we can operate at very, very high margins level. So, I don’t see a challenge in that, but our focus as a Management team is to start growing our base, start growing revenue, either through existing customers, upgrading them to the new platform, or acquiring new customers. So, we would always be focused on balancing growth with profitability, but I think last five quarters we've demonstrated. This Company is so strong in its core operation that we can continue to generate healthy margins if we choose to do that.

Todd Coupland

All right. Thanks. Thanks for taking all my questions. Appreciate the color.

John Giere

Sure. Thanks for joining.

Operator

We can now take the next question from Brad Hathaway from Far View.

Brad Hathaway

Excellent. Sorry. I had to jump back on for one more. Is there any thought as to the ability to refinance the debt on the balance sheet? Obviously, I think that is also an overhang having that expensive capital.

John Giere

Hey, Brad. Yes. In fact, when I looked to your earlier question about defining the future and creating the vision for the three-to-five-year plan, I think this is a good example of a priority I need to address, so I can fully scope what that plan would look like. It would allow us both inorganic and organic options to a greater level of capability. So, that's a great question. I should've said it earlier, this is a top priority of mine to address this issue because this unlocks our ability to look at the mid- and long-term options with a very different scope. We're discussing with various parties, various options. There's a good deal of interest in the market.

I'll be clear, of course, I've got to balance interest rate with dilution, and we won't do anything that would be materially dilutive to the shareholders at all. That's an important part of us. At the same time, we want to take advantage of a marketplace where interest rates are quite a bit more favorable than the current one we're operating under.

Brad Hathaway

Got it. Is there any kind of timing restriction as to when you could refinance? That is, if you have found some willing banks.

John Giere

So yes, I guess, I'll have to say, stay tuned, but we're moving forward in discussions, yes.

Brad Hathaway

Understood. I appreciate your focus on minimal dilution. I think that will be appreciated by the shareholder base.

John Giere
Thanks for that question, Brad. Appreciate you joining.

Operator

It appears there are no further questions at this time. I'd like to now turn the call back over to Ali Mahdavi for any additional or closing remarks.

Ali Mahdavi

Thank you. Once again, on behalf of the Optiva team, thank you for joining us this morning. Should you have any follow-up questions, please feel free to reach out to myself. We look forward to speaking with you again on our next quarterly call. That wraps up today's call. Have a great day. Operator?

This concludes today's call. Thank you for your participation. You may now disconnect.