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Optiva Inc.

Fourth Quarter 2021 Financial Results Conference Call

March 8, 2022

CORPORATE PARTICIPANTS

Ali Mahdavi, *Investor Relations*

John Giere, *Chief Executive Officer*

Dinesh Sharma, *Vice President, Finance*

CONFERENCE CALL PARTICIPANTS

Todd Coupland, *CIBC Worlds Market*

PRESENTATION

Operator

Good afternoon, everyone, and welcome to the Optiva Inc. Fourth 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, Operator.

Good afternoon, everyone. Thank you for joining us for the fourth quarter 2021 financial results conference call. Joining me this afternoon are Optiva's Chief Executive Officer, John Giere, and VP of Finance, Dinesh Sharma.

If you have not seen the fourth quarter earnings news release which was reported earlier today, 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 the presentation, 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 made as of the date of this call, and the Company does not undertake to update any forward-looking 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 afternoon, everyone, and thank you for joining us on today's call.

Let me begin with a brief summary of our activities and performance, as well as provide my view on what we are seeing in the marketplace. Then I will hand the call over Dinesh, who will provide us with the financial summary of the Company results for both Q4 and the full year.

The fourth quarter represented the successful continuation of the strategic work we initiated when we launched our revitalization plan for Optiva back when I arrived in December 2020. We've made tremendous progress in every area of the Company over the course of 2021. During the period, we continued to further stabilize and rebuild the trust of our incumbent customers and the associated revenue base. We invested in sales, and it is paying off. We significantly increased new bookings year over year while maintaining business discipline in our commercials and operational control over our cost structure.

This resulted in strong gross margin in Optiva performance. The Company has turned positive on the rule of 40 metric, the first time since 2015. The combination of our business activities coupled with our financial performance during Q4, and the steady progress throughout the year, provided further validation that all of our efforts toward stabilizing revenues while executing on the early phases of our growth strategy are tracking extremely well.

Our R&D and sales teams are understanding, educated and solving for the cloud migration needs of our existing and prospective customers, which resulted in Q4 bookings of $26 million, a 12-fold increase over Q4 2020 and a robust customer pipeline entering 2022.

On a full year basis, we saw five-fold new bookings increase to $50 million compared to Full Year 2020. This success is primarily due to the solid in-house bench strength that we have built and invested in, in terms of our sales teams, which combined with our customer first approach is showing and I believe will continue to show results as we build for the future.

While we believe we are adequately staffed and invested in our sales structure, I'll note with increased coverage this quarter in APAC and North America, we continue to invest in the future by expanding our R&D talent. A critical element of our strategy includes creating R&D centers of excellence in key locales. To this end, in Q4 we announced that we've established a second R&D center of excellence in Bangalore, India, to accelerate telecom BSS innovation. With our local leadership team already in place, we aim to grow our headcount rapidly with high caliber engineers across a number of disciplines.

Since my arrival at Optiva, our R&D team has grown significantly, and continues to do so through, I'll note, the careful selection of our talent. In 2021 alone, we increased our R&D talent by 47%, growing with highly skilled individuals who are significant contributors to our recent successes. We have augmented our current key skill sets in the areas of dev ops, digital experience, micro service and agile development.

[redacted] our current product portfolio.

Needless to say, we are living in an incredibly exciting time at Optiva. As every day passes, we are becoming more confident with more conviction in the market opportunities ahead. Looking forward, our strategic path remains very clear, with the continued focus on completing our business stabilization work and pivoting to the becoming a leading software vendor in our domain. We will drive growth through leveraging cloud technology and the underlying economics it brings, 5G adoption, as well as focusing on software license growth, which will all contribute to top-line and improve gross margin levels in due course.

Regarding our customer wins, we won both incumbent upgrades, five, as well as new logos, four, over the course of this last year. I believe this is a strong endorsement of both our stability and future direction.

As an example, we signed a multi-year agreement with Omantel to upgrade Optiva charging engine to a cloud native architecture on Omantel's private cloud. This upgrade represents the next phase of Omantel's digital transformation strategy to use our technology in automation to drive superior customer experience and significantly improve time-to-market for new services. The upgrade will support new 5G business models and, as well, introduce our Optiva test framework into the market, which we believe will reduce deployment times up to 70% over current metrics.

To further strengthen our market position and customer reach, we announced in January a multi-year strategic partnership with Google Cloud to increase telecom customer success by enabling faster time-to-market, a more flexible 5G monetization capability, and deliver operational cost savings. Our collaboration allows customers to accelerate their digital transformation and journey to the cloud, be it public or private, and deployment on the edge with Optiva products that are available via Google's Cloud marketplace.

As many of you are aware, one of the key objectives has been to determine when and at what level revenues will settle, and when do we ultimately enter a phase of increased visibility into steady and long term revenue growth. Based on the combined efforts of our sales, marketing, and R&D teams in understanding our customer needs, problem solving our issues and developing solutions that fit these needs, we are seeing very positive and encouraging customer momentum. As such, we are cautiously optimistic that in the latter half of 2022 we could very well be in a position to talk about growth on the back of revenue stabilization.

Our level of optimism is a result of our customer-centric approach, which has accelerated our success on various fronts. We're hearing more and more from our customers telling us that we are their strategic long-term solutions provider of choice, and there to help them navigate through complex strategic decisions that will chart the course of their respective businesses in the cloud future.

The impact of our actions in Q4 resulted in a revenue demonstrating stability at a $16.2 million, our fourth consecutive quarter of $16 million; record breaking bookings of $26 million, which is again a five-fold increase over last's quarter; continued strong gross margin at 75% and Adjusted EBITDA of $3.6 million, representing the core strength in our business; and a healthy balance sheet with $30.4 million in cash to support our ongoing growth.

We are extremely encouraged by the continued progress in our overall fourth quarter and full year results. We continue to build on the decisive steps we took early in the year to stabilize our operations and our customer base. Through our responsive and focused efforts on operational efficiency, cost savings, good capital expenditure management, and working capital optimization, we were very well positioned to work closely with new and existing customers to be their premier choice in the marketplace as they look for a what Optiva is capable of doing in terms of gaining market share.

Before I hand the call over to Dinesh for his financial review of the quarter, I want to touch on the subject of this situation in Ukraine, and acknowledge the resulting pain and suffering it has caused the Ukrainian people. And I also want to be clear that we stand with the global international community in support of the brave people of Ukraine, who are defending their homeland, as well as our customers, employees, and partners who are either directly or indirectly affected by these tragic events. Our thoughts and prayers are with the people of Ukraine, and we certainly sincerely hope that all parties can find a peaceful solution very soon.

Now I'll turn the call over to Dinesh for a review of the quarter.

Dinesh Sharma

Thank you, John, and good afternoon, everyone.

A reminder that Optiva's fourth quarter results were released earlier today. 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 December 31, 2021, the Company's revenues were $16.2 million, the fourth quarter in a row of $16 million-plus. Revenues declined by $2 million from the previous year's comparative period. The change by revenue type for the quarter ended December 31, 2021, is a $2.3 million decrease in support and subscription revenue, $0.5 million increase in software and services revenue, and $0.2 million decrease in third-party software and hardware revenue.

Gross margin for the fourth quarter remained strong at 75%, compared to the same period in 2020. The strength in gross margin is primarily due to the Company's cost structure optimization plan and reduction in third-party costs. The gross margin for the full year was higher at 77% compared to 74% in the Full Year 2020, as there were fewer customizations with lower margins, higher licensed revenue, and there was still a high percentage of revenue from support and subscription revenue, which has a higher margin. We expect our gross margins may fluctuate as we prove our cloud native model and product capability to new and existing customers when they onboard the public or private clouds in the future period.

The operating expenses in three months ended December 31, 2021, increased to $10.7 million, as compared to $10.5 million in the same period last year. Excluding depreciation, amortization and re-structuring costs, total operating costs in the quarter ended December 31, 2021, increased to $10.3 million, or 64% of total revenue, compared to $8.7 million, or 48% of total revenue, for the same period last year. The increase in overall operating expenses, excluding depreciation, amortization and restructuring costs, is mainly attributable to higher sales and marketing costs and higher R&D costs.

Sales and marketing expenditures slightly increased to $2.6 million, or 16% of total revenue, compared to $1.7 million, or 9% of total revenue, compared to the same comparable period.

G&A expenditures decreased to $4.8 million, or 29% of total revenue, from $6.2 million, or 34% of total revenue, compared to the same competitive period. The decrease is mainly due to lower legal and advisory costs related to activities of the special committee that the Board incurred last year, lower amortization costs, offset by higher stock-based compensation and higher compensation costs.

R&D expenditures increased to $3.3 million, or 21% of total revenue, from $2.7 million, or 15% of total revenue, as compared with the same comparative period. The increase is mainly driven by continued last year.

As a result of the foregoing, Adjusted EBITDA amounted to $3.6 million during the fourth quarter of 2021, while net earnings were impacted by $3.2 million of finance costs related to interest and debentures and the increase in the value of warrants.

As a result, the Company reported a net loss of $3.3 million in the fourth quarter of 2021, compared to net income of $1.7 million during the corresponding period in 2020. Last year's net income included finance cost recovery of $2 million related to decrease in value of warrants, offset by interest and debentures.

We'll now open the call to questions.

Operator, please.

Operator

Thank you. We'll now take our first question from Todd Coupland with CIBC World Markets.

Todd, your line is open. Please go ahead.

Todd Coupland

Good evening, everyone. Thanks for taking my question.

I'm just going to work up and down the P&L if I could. So you've had $16 million of revenue for four quarters. Can you just talk about what still needs to flow through the system, which would allow you to get to that stable environment that you talked about in the second half of this year?

John Giere

Todd, thank you for joining us. Nice to talk to you again.

Quite simply, we are finishing up the work of customers. I think we've said this before at the risk of being too redundant, but it is true. The remaining customer attrition that's taking place is—I think what we're confident now is we have a good handle on who they are, pretty good handle on the timing. It does tend to vary sometimes by a quarter, early quarter late, and a good idea on the ones that we have already begun turning the tide on. In fact, we were recently notified by a customer they've gone and extended an additional year and put on hold to change out project. So we're hopeful that there's a couple of more of those in the system, Todd. We think we've got an eye on a few that we can settle out. That would allow us then to really have stabilized the puts and takes.

The growth will come both by increasing the services we can provide to incumbent customers, but the real key is the new projects that we're signing and bringing on. We announced one just a few weeks ago, a week ago at Global World Congress. Those projects take about anywhere from nine to 12 months to roll out, get customer acceptance. We're trying to shorten that timeline, but that's a typical cadence, and with our customer acceptance, our maintenance and support, or ARR, kicks in, and that'll start backfilling some of the attrition we've been experiencing.

Todd Coupland

And are you able to comment on sort of ex attrition what the underlying growth of the business is at this point?

John Giere

Not at this point. I did want to indicate that we think we see good signs in the latter part of the year where that growth will be rooted, but I'm taken at this point providing some indication. But I do want to make it clear there are these puts and takes change things by a quarter here and there. While we think we have a really strong visibility on it and how it's going to roll out, I want to be mindful that we don't want to misspeak, or misspeak too early in the events, before the events completely take place.

But we feel confident as we look into the second latter part of the year we can see where the stabilization is pretty well predicted. I don't expect any more surprises. And then some of that will be the timing of these new projects rolling in, Todd. They are predictable from our perspective. We have a project plan, but how they roll out on the customer premise can sometimes be a result of how the customer themselves project manage things.

Todd Coupland

Okay. You're calling out bookings in $25 million and $50 million Q4 and I guess for the last year. Will you be getting to a point where bookings will actually run ahead of, I guess, annual revenue? I don't know how long the bookings are for, if it's a year or a few years. But will you get to a point where that's like a reliable indicator to say, yes, okay, now we've got whatever the number is. If its $60 million, growing $75 million, like whatever that number, can you just talk about like what's in bookings and how we should think about that once you start to move into that growth phase?

John Giere

As I noted before, today our bookings is predominantly incumbent customers. And I think as I shared with previous calls, first goal is to get them to renew and stay with us. And we've been through a full year cycle on that. So we know what that looks like. The second goal is to renew on a multi-year agreement. And one of the things that we're starting to see, and we'll start sharing the data as it becomes more of a trend rather than individual data points, but the length of our revenue, our top 50% revenue, is growing.

Multi-year is starting to take on, and ultimately, it's multi-year with an upgrade. As I indicated, this quarter alone we signed three upgrades, five for the year. That's a very good sign that our customers are going to sign an upgrade and a multi-year support agreement. That's what we really want from the incumbent customers. We're just getting our first new orders. They're relatively modest, given where we're started from. So those orders and the revenue impact starts to get felt this year in 2022. And as we get a better sense of that going into the year, we'll start sharing with you a little more granularity on how those deals are coming together, and what their relative impact will be on both our ACV and as we already keep track of the TCV level.

Todd Coupland

Great. And just a couple more for me. When you think about the, I guess, catalyst for these new orders, you talk about 5G monetization and saving time of implementation going into the cloud, etc., private cloud that is, are those the primary catalysts to coming on board for your charging engine, etc.?

John Giere

As I noted in the press release, I can give a little color to it, there are a couple of factors, largely in this order.

reduces your OpEx requirements, even if you don't use it on a SaaS basis or a consumption basis, which we are trying to encourage customers to consider. The operational load is quite a bit lower. I mean, maintenance windows that typically take three or four evenings to do can be done in one evening. The upgrades, the releases are all much quicker.

That's because of a second factor that we've really put an emphasis on, but I think the market is starting to come around to, which is automation. Today we have a charter across the Company to automate everything we can do. And the goals in the course of the year is to be able to automate 90%-plus of a typical deployment, at least the first office deployment, 1.0. That would significantly cut lead times and significantly cut the overhead required for new customers. It'll be more difficult for legacy customers. But for new customers.

Cloud, automation, and then comes 5G, where the 5G is going to introduce new technology capabilities, lower latency, broadband access, fixed wireless access is an area we're seeing some interest in. So that's going to change the traditional billing environment and compel operators to create new packages with new attributes, new permutations which can often lead to at least an upgrade if not triggering a complete change out of the system.

Todd Coupland

Okay, great. Just a couple quick other ones here. So in the Ukraine or in Russia, Belarus, that part of the world, do you have customers? And if so, what's the exposure? And more broadly speaking, do you see it slowing any of the plans that you have for this year?

John Giere

First of all, we have a customer, lifecell. It's been a long-time customer of the Company. It’s owned by Turkcell properties, so it's owned by a Turkish conglomerate. It's a little bit early now, but the operator continues to be in business and provides service. I'd say it's a little bit early to fully understand the effect; but for us, the exposure would be about 1% to 1.5% of our current revenue.

Todd Coupland

Sorry. And that service in the Ukraine?

John Giere

That's a Ukraine operator. Otherwise we have no business in Russia. So, yes.

Todd Coupland

Okay. And do you feel like as a risk just of getting other decisions from the pipeline, when you're looking at the various opportunities how does this conflict or this war impact that?

John Giere

Not so far. I mean, pretty early days, but I really don't see any spill-on effect. It is highly concentrated to Russia and Ukraine, the parties involved, and at this point we don't have business in Russia and the Ukraine. As we’ve said, we have a customer with a long-time support agreement in place. We would like to do more with that customer over time, clearly, and we have a lot of activities ongoing, but some of that will be a function of just the last two weeks, and how that plays out. Although, I would say we're partly mitigated by the fact that it's a foreign owner, and particularly the party that owns it has a long-time commercial parties.

Todd Coupland

Great. Last question for me. OpEx is running $10.3 million ex D&A even with potential growth later in the year. Could you just talk about expected rhythm of OpEx over the course of 2022? Thanks a lot.

John Giere

Sure. And I'll defer to Dinesh to add some comments here.

At a macro level, we're staffed, with the exception of R&D where we still have some remaining headcount that we want to get in, so we can get to revenue quicker. Quite frankly, it's a little bit of a chicken and egg. We've probably caught the bus quicker than you could have anticipated, $26 million quarter is tremendous. We're in full execution cycle on the R&D side, as I mentioned in my comments, with a product refresh. So we will have a little bit more OpEx build there. But the remaining part of the Company is staffed at a level, including our sales, where we did close the gap on any remaining open items. So other than that, I expect it to be very consistent through the year.

Dinesh Sharma

That's correct. Our G&A expenditures, sales and marketing are pretty stable now.

Todd Coupland

That call for me. Appreciate the color.

John Giere

You bet.

Operator

Thank you. It appears there are no questions in queue right now. I'd like to turn the conference back to you, Ali.

Ali Mahdavi

Thank you again, Operator.

On behalf of the Optiva team, I'd like to thank everyone for joining us this afternoon. We look forward to speaking to you again when we report our first quarter results. That concludes today's call, and I'll ask the Operator to cut the line off. Have a great afternoon.

Operator

Thank you. Ladies and gentleman, this concludes today's call. Thank you for your participation. Stay safe.