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Optiva, Inc.

Second Quarter 2022 Financial Results Conference Call

August 10, 2022

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Todd Coupland, *CIBC Capital Markets*

Brad Hathaway, *Far View Capital Management*

Jason Senensky, *Chapter Twelve*

PRESENTATION

Operator

Good day and welcome to the Optiva, Inc. Second Quarter 2022 Financial Results Conference Call.

For your information, today's conference is being recorded.

I would now like to turn the conference over to your host, Ali Mahdavi. Please go ahead, sir.

Ali Mahdavi

Thank you, Elaine.

Good morning everyone and thank you for joining us for the Optiva Second Quarter 2022 Financial Results Conference Call.

Joining me this morning are Optiva's Chief Executive Officer, John Giere, and VP of Finance, Dinesh Sharma.

If you have not seen the second quarter earnings news release, which was reported yesterday after the close of market, it is available on the Company's website at www.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 website.

Following Management's presentation and remarks, we will conduct a Q&A session.

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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 is 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 the market.

I'll now turn the call over to John.

John Giere

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

I will begin with a summary of our Q2 performance, our progress in stabilizing the business, and provide my view on what we observe in the marketplace. Then I will hand the call over to Dinesh, who will provide a financial summary of the Company's results for Q2.

The second quarter represented another period of steady progress in the execution of our strategic (audio interference) plan. We continued to drive the revitalization of the Company during the quarter as we worked to stabilize baseline revenue amongst our incumbent customers. In parallel, we advanced deeper into our new customer sales cycle, which will contribute positively to the future growth of our business.

The total contract value of bookings this quarter amounted to $12.5 million, with a couple of deals shifting at quarter’s end into Q3. For reference, this shift totaled $3.5 million TCV, of which we’re in the final steps of closing as we speak. To put things in perspective and ensure our stakeholders appreciate the time and effort that goes into our sales cycle, a recent new customer success took 14-plus months, starting from the presale’s discussion inquiry through to contract signature. This timeframe serves as a guide regarding the length of our new customer sales cycles and the subsequent lag in time to revenue recognition.

Total contract value for the year-to-date period stands above our plan at $45.4 million, and we are very positive about the growing new logo pipeline we have in place. We continue to grow more visibility into our legacy customer revenue roll-off, which we are managing carefully, as evidenced by our healthy EBITDA results over the last eight quarters. We continue to expect the results from our increased sales efforts and new customer wins to deliver net revenue growth at solid margins over time.

The strength and innovation of our R&D team, with 22 net new hires this year-to-date, coupled with our sales team's coverage increase over the last 12 months, has proven to work very well to identify and address the needs of our existing and prospective customer opportunities. These sales and R&D investments have been vital to our success to date in revitalizing our performance thus far and are critical to securing new customer opportunities in the future.

We also added more bench strength to our robust and seasoned Management team with the appointment of Craig Clapper, who recently joined Optiva to run our Global Managed Services and Support group. I have known Craig over many years, and he brings 20 years of executive leadership experience in the telecom and IoT sectors, working with Aeris, Tait Communications, and Ericsson over the course of his career. His appointment will reinforce our ongoing efforts to grow and successfully service our mission-critical work to deliver the highest quality support to our customers around the world.

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We recently announced that Optiva and Jio Platforms Limited entered a strategic go-to-market partnership during the second quarter. Jio Platforms will offer its cloud-native 5G network infrastructure to telcos globally with Optiva's future-ready, end-to-end, converged charging engine to accelerate the monetization of 5G services and use cases. This partnership will empower leading telecom operators to unlock consumer, enterprise, and private 5G business opportunities through innovation and scale.

On the product front, we announced the achievement of our fifth TM Forum Open API certification—recall, we had none of those when I joined last year—now placing Optiva in TM Forum's Open API Conformance Silver Tier. Achieving the best industry standards certifications and signing TM Forum's Open Digital Architecture Manifesto shows our investment in innovation and next-generation product modernization. Open API's certification enables our next-generation product portfolio, providing telecom operators with a foundation for creating innovative offerings, having a 5G-ready BSS, partner ecosystem facilitation, and standardization to accelerate monetization growth.

We will remain on track with the results we've accomplished in recent quarters while maintaining business discipline in our commercial and operational costs. These actions resulted in continued strong gross margin of Optiva performance. As noted earlier, we continue to carefully manage the ongoing revenue timing risk that is a byproduct of attrition in our legacy customer base. We also continue to release new products and ramp new customers into full production, enabling us to recognize new revenue in our plan.

We have many dependencies determining the timing of our new customer revenue ramp, such as our product development and delivery, customer sales cycles, and field delivery timelines. These make it challenging to pinpoint today a specific timeframe when this net new revenue growth will be secured. Thus, it is important to note that until we see revenue ramp-up from new contracts outpace any remaining attrition from legacy customers, we may see proportionate movement across our income statement.

In summary, we continued to execute against our sales strategy with customer momentum, as evidenced by our bookings progress. New sales are essential to achieving the net revenue growth of Optiva in the future. I can assure you that the building blocks are laid, and the time will come when we can share with you when we expect to achieve net new revenue growth.

Moving forward, our strategic path remains unchanged, with a continued focus on completing our business stabilization work through the year and pivoting to becoming a leading software vendor in our domain. We will drive growth through leveraging the cloud technology and the underlying economics of the cloud, 5G adoption, and focusing on software license growth, which will contribute to the top line and provide solid gross margin levels over time.

The net impact of our actions in Q2 resulted in revenue demonstrating stability of $15.4 million, total contract value of Q2 bookings was $12.5 million, strong gross margin at 71%, Adjusted EBITDA margin of 24%, and a healthy balance sheet cash with $26.4 million in cash to support our growth.

Now I would like to turn the call over to Dinesh for a more detailed quarterly financial review.

Dinesh Sharma

Thank you, John, and good morning, everyone.

A reminder that Optiva's second quarter results were released after the close 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 June 30, 2022, the Company's revenues decreased to $15.4 million, within the Company's revenue stabilization levels. The change by revenue type for the quarter ended

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June 30, 2022, is a $1.8 million decrease in support and subscription revenue, $0.9 million increase in software and services revenue, and no change in third-party software and hardware revenue.

Gross margin for the second quarter remained strong at 71% compared to 78% during the same period in 2021. The decline in gross margin is attributable to higher headcount costs related to higher software and services revenue, the impact of higher customizations with lower margins, and lower percentage of revenue from support and subscription revenue that has a higher margin.

Total operating expenses in three months ended June 30, 2022, decreased to $8.3 million as compared to $9.7 million in the same period last year. Excluding depreciation and amortization and share-based compensation costs, total operating costs in the quarter ended June 30, 2022, decreased to $7.2 million or 47% of total revenue compared to $8.6 million or 53% of total revenue for the same period last year. The decrease in overall operating expenses, excluding depreciation and amortization and share-based compensation costs, is mainly attributable to lower general and administrative costs.

Sales and marketing expenditures increased to $2 million or 13% of total revenue compared to $1.9 million or 12% of total revenue compared to the same comparable period. The increase at three months ended June 30, 2022 is mainly due to higher headcount and costs related to ramp-up of sales efforts.

G&A expenditures, excluding depreciation and amortization and share-based compensation costs, decreased to $2.2 million or 14% of total revenue from $3.6 million or 22% of total revenue compared to the same comparative period. The decrease is mainly due to lower compensation costs, lower professional fees, lower allowance for doubtful accounts, and lower legal costs.

R&D expenditures remain unchanged at $3.2 million or 21% of total revenue from $3.2 million or 20% of total revenues compared to the same comparative period. As a result of foregoing, Adjusted EBITDA amounted to $3.7 million during the second quarter of 2022, representing the eighth consecutive quarter of Adjusted EBITDA margin exceeding 20%.

As a result, the Company reported a net loss of $0.5 million in the second quarter of 2022, compared to net income of $1.3 million during the corresponding period in 2021. Excluding the impact from change in value of warrants, the Company had a net loss of $0.7 million versus a net loss of $0.2 million during the corresponding period in 2021.

We will now open the call to questions. Operator, please?

Operator

Thank you.

We take our first question today from Todd Coupland of CIBC. Please go ahead.

Todd Coupland

Good morning everyone. Thanks for the time today.

I had a couple of questions, and I'll just sort of build-up. Firstly, OpEx, $7.2 million, is that more or less a run rate number at this point? You've added a few headcount, but what does that look like in the coming quarters?

John Giere

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I expect it to stay in that range. We do have some R&D—I think we've expressed before the difficulty of our R&D staffing worldwide. It's not just us, but across the group. So, expect that to be in the range, but it might go up a bit more.

Todd Coupland

Okay.

Then when I look at the EBITDA margin, north of 23 quarters in a row, I more or less view that as the business has stabilized. I know you talk a lot about stabilization still before you can grow. I don't know if you can qualitatively talk about helping us bridge from what appears to be a stable business to growth. Just take us through your thoughts on that.

John Giere

Okay, and I welcome Dinesh to add any commentary. As I indicated, EBITDA will have a bit more—there's a bit more OpEx, particularly around R&D, when we complete what we need to do from a staffing standpoint, which will have somewhat of a downward effect potentially on EBITDA. We've said we expect it to be in the 20% range through the course of the year, the way we typically are operating, but from a stabilization—I guess, that's a good question, Todd. What I'm suggesting to you is we have a good handle on our customers and where they're at. As I noted, there's ongoing customers that will eventually attrit from the business.

When you look at—there are still some remaining areas and customers where we continue to work on convincing them to stay with Optiva on a long-term basis, perform an upgrade, and become more of a long-term customer than they currently are today. So, stabilizing the business, getting our new products out with high quality to our customers on a timely manner. Also, looking at the new sales cycle, we've built up quite a strong pipeline of new logos, but now we have to close those logos in order to show the net new growth we need to get as we work our way through the remaining legacy attrition.

Todd Coupland

Okay. When you look at that pipeline, could you just give us some general comments on the look of the customer? I think in the past, you'd said sort of midsized telcos globally. You'd had some business in Eastern Europe. I imagine you're probably not focused there now. Just talk about what that looks like in general terms.

John Giere

Yes. Our strength of products today currently resides in the tier 2s and tier 3s. We do have, interestingly enough, some selective opportunities in Eastern Europe, as well as we've had good success in the Middle East. We've ramped up our focus both in North America and emerging markets in APAC last year. At the end of last year, we did get one new customer in the APAC region. That was a small customer. Again, tier 2s and tier 3s.

Our initial customer logos have a bias toward MVNOs, but we are now beginning to make more headway with some of the group opcos and other Tier 2s and Tier 3 customer base. The strength of our BSS product is it's an end-to-end suite with all the capabilities of billing, and our strength of our charging product is a best-in-class, best-in-breed charging product that fits well in the tier 2, tier 3 domain.

Todd Coupland

Okay.

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I apologize if this question comes across as a (inaudible) question but just trying to understand this partnership that you commented on with Jio Platforms. I guess they're providing the cloud infrastructure, and then you provide the charging and billing engines. I thought you were on the Google Cloud. How is that different from that? Is this just an easier packaged go-to-market partnership, and so that's why you did this? I'm just missing a technical piece here.

John Giere

No, not at all. Thank you. It's a good question.

So, let me elaborate just a little bit because there is a distinction. With Google, Google has a private cloud—or a public cloud, of course. They're going to operators direct with the Google data center and cloud platform and saying, "We'd like to provide you and sell you cheaper, better data center capacity," let's call it. To use that capacity up, Google needs partners whose workloads can go on to that capacity. We announced, of course, last quarter, our partnership with Google, and that is already beginning to produce a funnel and, we think, opportunity that we're very close to getting in one instance.

That would allow us to then deploy our system on the Google Cloud platform. The infrastructure is contracted between Google and operator A. We provide the software, and they buy it through the Google Marketplace, where we're listed as an application, if you will.

Jio is a bit different. Jio is an operator today. About three or four years ago, they put themselves in business. If you're not familiar with Jio Platform, it is owned by the Ambani family, one of the wealthiest families and investors in the world. So about three or four years ago, they put together a Company and decided to go after the 4G market from scratch. They went from zero to 450 million subscribers currently today. They are a powerhouse operation and brand amongst operators in the world. They sit as—if not the largest, close—they're just behind one of the Chinese operators.

What they're doing, though, is taking an interesting pivot. They've decided, "Hey, we're building our own network, a good deal of it from scratch." Much like if you've heard of the company Rakuten, they are now putting together an end-to-end solution that they're going to go out and offer to their operator community, fellow operator community, as a turnkey operation. Now that could be turnkey packet core network, they build microcells, and we're one of the ecosystem partners they've identified specifically for the charging.

So, they're just launching this. They're going out. They feel there's strong opportunity in emerging markets and other areas where their strength, their brand, their experience—the difference between them is they are marketing this as coming from an operator who works at scale, operates, and innovates at scale. They have some 2,500 developers alone focused on building their network and their equipment, essentially their own, and so you would be sourcing from them an entire turnkey end-to-end solution. We potentially could be a part of it if the billing part is what the operator wants to acquire as well.

Todd Coupland

Thanks for the clarification. Do you feel that that is an important development in the market for conservative carriers to get more comfortable with moving on to the cloud? Do you need these trusted hands, if you will, experienced hands, to be deploying?

John Giere

I do. I think it's early days, but I think it's an extremely interesting strategy and concept. There's no doubt they have instant global recognition, particularly in emerging markets. For our benefit, that makes it easier—it assists us in reaching those markets which are difficult sometimes, Africa and Middle East.

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More so, APAC, if you know what I mean. Their brand is well, well regarded. Their results are—they're able to sell—I don't recall, but they sold part of their unit. I think it's by Meta. So, the brand, the capability, and skills will be quite reassuring. Different from a Google. Google's expertise is in the core data center. Reliance's expertise is actually operating at scale, 400 million plus network, yes.

Todd Coupland

That makes a lot of sense. In terms of the (multiple speakers)

John Giere

Todd, I would just (inaudible) sorry, maybe this helps to be clear. There are different channels to market going after similar customers but with a different value proposition. That's probably the—really the nut of it.

Todd Coupland

That's super helpful. If we think about this partner as an opportunity or channel for you, do you view it as transformational or incremental to your plan?

John Giere

I think it has the potential to be transformational. I'm just going to need to demonstrate a little bit more. It's just in the early start, but I do believe it has the potential to be transformational. Much like any numbers of businesses that transition to an owner-operated model, where you just turnkey something and you become the face of the brand, I think there is great transformational potential, but I'll acknowledge it's very, very early to determine what's the willingness of operators to release what they might initially consider their core capability.

Todd Coupland

Yes. Okay. Last question from me. Thanks for being patient.

So, AT&T—I think it was AT&T that said at the low end of the market, they're starting to see some cellular bill payments stretch out because of the economy, gas inflation, the consumer being pinched. Are you seeing any of that? If that actually starts to spread in the market, how does that impact your run rate business?

John Giere

Yes. At this time, we've not seen that. We do not have a very significant presence in North America, so that doesn't have as much resonance. When I look at other parts of the world, there is no indication of operators having challenges or declines in their services. A good portion of our customer base is reliant on prepaid so those are always, of course, trued up month after month, so their effect, it might be difficult to trend right now.

At the moment, we haven't seen that with our operator base. Given most of our maintenance and support engagements are longer term, a year, two years, three years type things, they normally are locked in place.

Todd Coupland

Okay, but is a recession a risk to your run rate volume?

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John Giere

I don't see that evidence of that. I guess I would say, if you look at all the essential goods and services—irrespective of AT&T's comment, I do think I noted that myself, generally, mobile has been such an essential service. At least I haven't detected anything in our customer base. No one's expressed anything. I'm frequently talking to them. I was just in the Middle East visiting customers. They're expanding in the Middle East there for a lot of other reasons. Demographically, they've got a young demographics, etc.

Todd Coupland

All right, John, I really appreciate you being patient with my questions. Thanks for all of that.

John Giere

No, not at all. They're very good questions. Thank you.

Operator

Taking our next question from Brad Hathaway of Far View Capital. Please go ahead.

Brad Hathaway

Hi, John and Optiva team.

I appreciate all the detail, and I appreciate all your efforts to stabilize the business, John. I may sound a bit like a broken record, but I guess I'm curious if you have any thoughts you can provide, kind of big picture, on how you see the opportunity for Optiva five years out from now. What do you see is kind of, I guess, the scale, if you get this right, of the opportunity you're pursuing?

John Giere

Well, at a macro level picture, there's going to be a transformation of the billing BSS business from today's—still primarily bare metal or virtual versions to tomorrow's cloud version. So that transformation is in its early stages. It's beginning to take place. It's taking place right now. There's conceptually a number of different ways. There's, as we talked about, the Google-Microsoft channel. There's the operator-led organic—their own organic transformation. Then there's now beginning in the marketplace the likes of a Jio, which similarly to, I believe, an analogy would be Rakuten, but a different company, a company, coming out of retail looking to build 5G networks.

So, we're in the early innings of that transformation, which is going to take place over perhaps a decade-long period here. Additional winds at its back will be the broad adoption of 5G mobile, the broad adoption of automation to a larger extent, which are going to contribute to the ability to run these systems, these networks, including the network's software or applications like ours more efficiently and effectively, which will drive an OpEx gain or efficiency and a service flexibility that will prompt people to make that transformation.

Brad Hathaway

Okay. Great.

Obviously, one of the benefits of your business is how sticky the customers are. Optiva being a key example. The company was as close to death and then had a pretty terrible shareholder battle, and still,

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you were able to keep a significant amount of revenue. So, I guess how does Optiva—how are you expecting to gain significant new revenue? How do you plan to win new business in this transformation?

John Giere

It's a bit why I spent some extra narration on the timeline, and I know, Brad, you're familiar with it because we've talked about it. What we have to do is climb our way back up. There is good news—or a positive side is there's a large stickiness, as you said. Unfortunately Optiva damaged that if you will, but that is what it is. Now we're on the rebuild effort, which will stabilize the business, maybe going back to Todd's earlier question, is generating new logo accounts, new logo opportunities, taking them through the presales to the sales and contract cycle, and into the field.

It does take some time to build that momentum. Achieving new reference ability, having successful project implementations, starts to have an accelerator effect for us. As it currently is, we're in the very early stages. We've got a couple of logos. We're beginning to add some more. We'll start putting out our new capabilities on automation to deliver our new version products with a higher level of automation and field capability. They'll start to prove themselves, and that will start to give us more traction in our customer opportunities.

So, it's a cumulative effect that takes place over, I'd call it, from post-signature, another 9 to 12 months, where we're going (audio interference) get more momentum to the products. It was important—and I noted that we have the APIs. Those are 5G items. So, we're beginning to put in our products, the 5G capabilities, that our customers will be looking for that allows them to both adopt our product and carry it forward into the future.

Brad Hathaway

Okay.

I have no interest in any kind of precision here, but order of magnitude, is there anything quantitative you can kind of discuss about the long-term opportunity you see for Optiva?

John Giere

In terms of—I think we were talking earlier about the direction and the transformation into the cloud, the market trends of 5G and automation. Was there—maybe help me understand the question, maybe then, Brad.

Brad Hathaway

I guess what I think myself and other investors, I'm assuming, would love to have a better sense of is the size of the goal we're playing for here. So, if this works and we look out five years, is there any kind of order of magnitude of what you see is the scale of Optiva at that point? Just giving a sense of we know where we are now, we know where we've stabilized at, we see the potential profitability. You've obviously looked at the pipeline and the true addressable market for Optiva, and so, I'm curious, if we look out long distance, like, again, just really rough order of magnitude, if you're successful, how big would Optiva be?

John Giere

Well, at a macro level, the marketplace is billions of dollars. It would be naive to sort of take a round number off of that, but I think as the opportunity develops, our opportunity from the standpoint of both a market opportunity is to, as we noted earlier, securing the wins, getting the referenceability. As we progress through those toll gates, Brad, we'll get an opportunity to start going after some of the markets

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we haven't attacked in the past, such as North America, such as large operators in APAC, or at least haven't attacked in the recent past. This is a progressional. So, I see the opportunity, as over the course of the next five years, to step into broader market segments with a greater reach. So that would be one area.

I also think the opportunity for the Company is to transform out of a services-orientated market and operation, which we are and which the entire domain is, and gradually progress our way toward becoming a software market, which brings with it increased value, as you know. Then ultimately, there's a SaaS model opportunity that I think is going to take place on the back end of that. It's going to take some time for that. This marketplace has more conservative buyers, and so they're traditionally reluctant to take a jump of that magnitude.

Brad Hathaway

Got it. Okay. Excellent. Okay. I think that's all I have. Thank you. I appreciate the stabilization and looking forward to eventually seeing you transition to growth.

John Giere

Yes. I know. I appreciate your knowledge of the Company and your questions. Thank you, Brad.

Operator

Thank you.

We move our next question to Jason Senensky of Chapter Twelve. Please go ahead.

Jason Senensky

Hi guys. Thanks for taking my questions. I just have a couple of small ones.

The first one was on the July 5 news release, where you talked about shareholder approval to remove cash interest restrictions on the debentures. Can you just provide a little more color on why that was necessary?

John Giere

Dinesh?

Dinesh Sharma

Yes. I think there was some restrictions based on who our shareholder investor is and how much interest we can kind of pay to them based on I think the market cap or something, so we removed that restriction because those debentures were kind of bought from one of the shareholders—were transferred from one of the shareholders to the other shareholder, and there was a cap on the interest we could pay. So that was removed, Jason.

Jason Senensky

I see. So effectively, it was to facilitate like a secondary market transaction that occurred with EdgePoint?

Dinesh Sharma

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Yes, that's correct.

Jason Senensky

Do you think you have additional capacity to raise more capital under these debentures today if you wanted to?

Dinesh Sharma

There is additional capacity but right now, we're not looking into that, Jason.

Jason Senensky

Okay. Just my other question, it's a small one.

In the quarterly presentation, you give the headcount numbers for the Company. I think this quarter, it was 366, and last quarter, it was 390. I know you mentioned, I think, adding 22 people in R&D. I don't know if that was a misprint, but outside the R&D organization, it seems like there was a pretty significant decline. Can you give some color on what was going on there?

John Giere

Yes. We had a historical outsourced support augmentation group, which bought part of that in-house and eliminated through, frankly, some automation. So, when that contract came up, we did not renew it. It was a third-party support group.

Jason Senensky

Was that crossover at DevFactory, John, or something else?

John Giere

No, it was something else. It was predating that. It was a support augmentation that the Company had used to augment some of its global support services.

Jason Senensky

Okay. All right, thanks very much for taking my questions.

John Giere

Certainly, Jason.

Operator

Thank you. As we have no further questions, I would like to turn the call back over to Mr. Ali Mahdavi for any additional or closing remarks.

Ali Mahdavi

Thank you. Once again, on behalf of the Optiva Management team, we'd like to thank you for joining us today. Apologies for the technical glitch that we had. Should you have any further questions or follow-ups,

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feel free to send me an e-mail. We look forward to speaking to you again on our third quarter conference call. That concludes today's call. I'll pass it back to the Operator to close things off.

Operator

Thank you, sir. Ladies and gentlemen, that will conclude today's conference call. Thank you for your participation. You may now disconnect.

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