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Optiva Inc.

First Quarter 2022 Financial Results Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Brad Hathaway, *Far View*

PRESENTATION

Operator

Good morning, everyone, and welcome to Optiva Inc's First Quarter 2022 Financial Results 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 morning, everyone, and thank you for joining us this morning for the Optiva First 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 first quarter earnings news release which was reported yesterday after the close of market, it is available on the Company's website at Optiva.com and on SEDAR, along with our MD&A and internal financial statements. I would also like to remind you that a replay of this call will be accessible on the Investor section of the website.

Following management's presentation this morning, 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 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 earnings during today's call, and management does not anticipate providing guidance in future (audio interference) interpretations for investors.

I'll now turn the call over to John.

John Giere

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

Let me begin with a brief summary of our Q1 performance and our progress in stabilizing the business, as well as provide a view on what we are seeing in the marketplace. Then, I will hand the call over to Dinesh, who will provide us with a financial summary of the Company's results for Q1.

The first quarter represented another quarter of revenue stability, while we continue to increase bookings and necessary R&D investment to bring our new cloud product portfolio to market. We're making good progress in every area of the business, evidenced by the continued traction and trust we've built in terms of securing three existing customer upgrades this quarter, and the momentum we have with prospective customer opportunities around the globe, evidenced by our 40% year-over-year increase in qualified—that's sales driven—new logo opportunities.

With our first (audio interference) cycle completed, we are pleased with our efforts to improve the stability of our revenue base over the last year, as well as bring better visibility to the future plans of our customers. However, while we have a much clearer picture of the legacy customer revenue rollout, it remains a challenge to determine the precise timing as to when the revenue ramp-up from deploying new customer contracts into production will outpace the remainder of our legacy customer attrition.

In the meantime, we continue to grow our new bookings going into Q2 and our ability to have (phon) a strong, qualified sales (audio interference) to ensure we can achieve this transition to growth.

During the first quarter, we continued to increase our investment into R&D, as we've said before, with an important achievement in the release of the Optiva Charging Engine public and private cloud edition. It represents Optiva's first product release in four years and one that will require the continuum of such product release announcements through the remainder of the year. The new release enables operators who are not ready to move to the public cloud to reap its operational benefits while maintaining security control and adherence to telco regulatory requirements.

Two telecom operators, a Tier 1 and Tier 2 in EMEA, are currently transitioning to the new Optiva Charging Engine version on their private clouds.

Our investment in sales also continues to deliver positive results. New bookings in this quarter increased by more than tenfold to $19.7 million when compared to $1.9 million four quarters ago. Going forward, we will be transitioning from reporting new bookings to total contract value, or TCV, as a more traditional key metric to demonstrate our sales progress. This number stood at $32.9 million for Q1.

As we recently announced, our sales efforts resulted in securing a new logo, Salam, a leading Saudi-based telecom provider who selected Optiva's BSS platform to support its newly established MVNO integrated telecom mobile company. Salam Mobile selected Optiva at the end of an intense, competitive bid process to help them rapidly bring to market innovative digital services to the fast-growing consumer market segment. Salam Mobile has deployed the Optiva BSS cloud platform on its state-of-the-art private cloud infrastructure in under five months and is immediately taking advantage of its feature rich options to attract subscribers.

Strength and innovation of our R&D team, coupled with our sales team's tenacity, is proving to work extremely well in identifying and addressing the needs of our existing and prospective new customers. These sales and R&D investments have been critical to our successes in revitalizing our performance thus far and vital to secure new customer opportunities in the future. We are now actively engaged in creating and responding to business opportunities, both in our current as well as new territories, including, as I previously noted, our investment made the latter part of last year into North America and Southeast Asia, both of which are showing early promise.

By way of update, we continue to see great movement and attention from the market on the back of our strategic partnership with Google Cloud which was announced in January, whereby we have enhanced our market position, customer reach, and sales velocity.

As a reminder, our multiyear strategic partnership with Google Cloud facilities innovation specifically disrupting traditional industry, technology, and business models as the collaboration enables a faster-to-market timeline while providing our customers greater 5G monetization flexibility and significant operational cost savings. This collaboration is very quickly gaining strong customer interest and translating into a growing customer pipeline that is looking to accelerate their digital transformation to the cloud.

Our objectives remain the same. First and foremost, be customer centric. Understanding the challenges and evolving needs of our customers is paramount. Our investments in all areas of the business have proven to be measured, sound, and impactful, and now gaining traction with more and more customers who are entrusting Optiva as a premier global solutions provider for their telco BSS cloud strategies.

All of these actions continue to contribute to the strong growth in bookings and increased dialog and engagement with global telecom players, which bodes well for the future of our business.

As we move forward into FY'22, we are pleased by the results we have accomplished in the last quarters, maintaining business discipline in our commercial and operational cost control. These actions resulted in continued strong gross margin and EBITDA performance.

As noted earlier, we continue to carefully manage (phon) the ongoing revenue (audio interference) that is a by-product of attrition in our legacy customer base as we also release new products and ramp new customers, such as Salam Mobile, into full production, thus enabling us to recognize the new revenue in our plan. It is important note that until we see revenue ramp up for new contracts outpace our remaining attrition from legacy customers, we may see proportionate movement across our income statement.

Looking forward, our strategic path remains unchanged with a continued focus on completing the task of stabilizing our business and pivoting ourselves to a leading software vendor in our domain. We will drive growth through leveraging our technology and the economics that underline it, 5G adoption, and that will in turn have us focus on software license growth, which will all contribute to top line and improve gross margin levels in due course.

The impact of our actions in Q1 resulting in revenue demonstrating stability (audio interference); a 10-point increase in our new bookings compared to Q1 '21, with a total contract value of bookings at $32.9 million; continuing strong gross margins at 75%; and Adjusted EBITDA of $3.8 million, representing continued core strength in the business; a healthy balance sheet with $26 million in cash to support our growth.

Now, I will turn the call over to Dinesh for a more detailed financial review of the quarter.

Dinesh Sharma

Thank you, John, and good morning, everyone.

As a reminder that Optiva's first quarter results resulted 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 March 31, 2022, the Company's revenues remained unchanged at $16.1 million, the fifth consecutive quarter of revenues exceeding $16 million. The change by revenue type for the quarter ended March 31, 2022, is a $2.5 million decrease in support and subscription revenue, $2.5 million increase in software services revenue, and no change in the third-party software and hardware revenue.

Gross margin for the first quarter remained strong at 75% compared to 77% during the same period in 2021. The marginal decrease in gross margin is attributable to acquired investments as the Company proves its cloud-native model and product capability to the new and existing customers when onboarded to public or private cloud in future periods.

Total operating expenses in the three months ended March 31, 2022, increased to $8.8 million as compared to $6.8 million in the same period last year. Excluding depreciation and amortization costs, total operating costs in the quarter ended March 31, 2022, increased to $8.4 million, or 52% of total revenue, compared to $6.4 million, or 40% of total revenue, for the same period last year. The increase in overall operating expenses, excluding depreciation and amortization costs, is mainly attributable to higher sales and marketing and higher R&D costs offset by lower general and administrative costs.

Sales and marketing expenditures increased to $2.8 million, or 17% of total revenue, compared to $1.8 million, or 11% of total revenue, compared to the same comparable period. The increased in three months ended March 31, 2022, is mainly due to higher headcount and costs related to ramp up our sales efforts, including sales commissions and higher marketing spend.

G&A expenditures decreased to $3.2 million, or 20% of total revenue, from $4.5 million, or 28% of total revenue, compared to the same comparative period. The decrease is mainly due to lower compensation costs, lower legal and advisory costs related to activities of the special committee of the Board incurred last year, and lower stock-based compensation.

R&D expenditures increased to $2.9 million, or 18% of total revenue, from $0.5 million, or 3% of total revenue, as compared to the same comparative period. The increase is mainly driven by continued hiring and investments being made in our roadmap. Also, for competitive purposes, we note that under the Separation Agreement with ESW, an amount of $2.1 million owing to DevFactory was forgiven, which was credited to R&D expenses in the comparative quarter in 2021. Excluding the credit, R&D expenditures marginally increased to $2.9 million compared to $2.6 million last year, mainly due to the ramp-up of Company's in-house R&D team as compared to the same period last year.

As part of our ongoing focus on cost management and operational efficiencies, we have deployed certain technology and automation initiatives in a number of areas in the business which have and will continue to drive cost efficiencies on a go-forward basis. As a result of the foregoing, Adjusted EBITDA amounted to $3.8 million during the first quarter of 2022, representing the seventh consecutive quarter of Adjusted EBITDA margin exceeding 20%.

As a result, the Company reported a net income of $1.8 million in the first quarter of 2022 compared to net income of $16.7 million during the corresponding period in 2021. Last year's net income was mainly higher due to a financial recovery from the reduction in value of Series A and Standby Warrant by $13.6 million.

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

Operator

Thank you. We'll go ahead and take our first question from Brad Hathaway with Far View. Please go ahead.

Brad Hathaway

Hi, guys. Another strong quarter. Congrats on the continued operational turnaround.

I have a bigger picture question for you. The Company's done a great job of stabilizing revenue and showing consistent profitability, but obviously, I don't think you're quite getting rewarded for that in the markets. Part of the reason why I think that might be is I think there's still not a great picture of the long-term kind of what we're playing for here.

So, I'd love to maybe understand from you, John, you've now been there a while. I know the timing of the turn is difficult to predict, but if this turns and if this looks like what you think it can look like, what do you think it results in, if we're looking at three to five years? I mean, I know in the presentation the Company talked about the Rule of 40. Is that kind of the goal, to become a Rule of 40 company, or is there another way to kind of think about how you think this looks if it works?

John Giere

Hey, Brad, good morning. Thank you for joining the call. I appreciate your calling us.

The Rule of 40 is, to me, a measurement of how we're progressing day in and day out, if you will, toward our overall goal, which is to maximize our growth at a solid EBITDA profitability. I would say as we turn through the first support (phon) cycle, which I indicated to you is an important milestone, having completed now—Q1 and Q4 are our big renewal cycles—we have a clearer picture that looks promising as we look out a number of quarters, let's say, toward the end of the year.

What we're in the process now is positioning ourselves to what I see as four market forces that give us an opportunity to really grow. The first is the cloud, and that's clearly driving this market now. I think when I started a year ago, it was an afterthought, and now today, particularly the private cloud, as noted in our announcements, is strongly in the center of a value proposition, and that's where we're pushing really hard to push the envelope forward.

Underlying that is the hyperscaler economics that come with that. Our work with Google, as I noted, is picking up pace, and I think that will be something that'll be a factor in our growth. We'll also continue to work with the likes of Microsoft Azure, because I think their economics and the way they conduct their business is creating disruption in the market, which favors people like ourselves.

The third part, which I touched on, is about our automation, and I'll be talking more about that because we've increased that significantly. Where it first starts is in our back office. We've implemented an ERP system, as I've noted, and if you look at our G&A, it's coming down. Now, part of it is a function of less—a year ago we had, of course, the shareholder challenges and everything else. But the other part of it is systemic and methodical and proven in our operating model, which is also important for us as we look to go through this period here of finishing up the stabilization of our business and going forward.

When I look at those factors, the cloud, the hyperscaler, and the automation, it's all wrapped in a bubble called 5G. So, 5G is now beginning to hit the market with a vengeance, and we're starting to see new opportunities, I mentioned, with the group level companies. The likes of an Orange (phon) and Vodafone are renewing their look at the market to say, "Okay, how do we want to look in the future if 5G becomes a reality for them?"

Those four factors have me looking out in a positive manner as we do the blocking and tackling of the present.

Brad Hathaway

Got it, thank you. That was very helpful.

Maybe just to kind of push a little bit more, I think there's not a—I guess there's not a lot of question around your profitability given the amount of quarters you've now had with solid EBITDA margins. The bigger question is, what could the top line look like? You have, let's say, mid $60 million of annualized revenue pretty consistently now at this stable level, somewhere around there. If we look out five years, I mean, could you double that? Is there any way to think about can this become a 20% grow? Is there anyway to think about—again, this is a "if this works" question. But if this works, what does the top line kind of look like?

John Giere

I think we're reticent to talk about five years from now at this point, Brad, but as I said, when you look at the disruptive opportunity in the market where people are reassessing long-term decisions, we expect to play in those increasingly. I think when you recall a year ago when I started, it began with securing the base of business into M&S agreements, winning those upgrades, of which we've done now three in this last quarter, getting new logos, which takes a bit longer. We've been fortunate to get a couple; I mentioned Salam. But we're still in that sales cycle for new logos, to secure them and win them and contract them.

Now, that will be the foundation that allows us—and I think our product announcement this quarter is representative—to start putting fresh and new product in the market. It's been quite some time for us. As a result, we'll continue to feed our funnel as we work further and further up the food chain.

I think if you look at the overall market, there's going to be movement away from the cumbersome bespoke service intensive businesses—you're seeing that already—to businesses that are more out-of-the-box with strong domain knowledge, can provide managed service support where needed, can provide certain skill sets to allow an MVNO, for example, to get up and running quickly and faster. You have operators beginning to look at introducing secondary brands for segmentation.

As we make the market more out-of-the-box software orientated, we will benefit, and that takes some time for us to get people there.

Brad Hathaway
Got it. I appreciate that, and I appreciate—obviously, it's difficult. But I would say that going forward, the more kind of rough quantitative guideposts for the long term you can provide with the investor community, I think the better chance you'll get the cost of equity capital that will allow you to, I think, do some of the strategic things you might want to do, whether it's M&A or refinancing. So, I would urge you to kind of consider looking at that going forward.

John Giere

Thanks, Brad, and your feedback is always welcome. I appreciate your forthrightness. I think as we're progressing here, we're able to provide more and more visibility as we are on the contracts and things, because we're getting more and more command. It's been four quarters, and that's where you start to see some of the visibility of what you've been chasing.

Brad Hathaway

Got it. Understood, and once again, appreciate the efforts on the operational turnaround. It's been impressive to see the stabilization and the profitability. Thank you.

John Giere

Thanks, Brad. Have a good rest of the day.

Operator

With that, that does conclude our question-and-answer session. I would now like to hand the call back over to Ali for any additional or closing remarks.

Ali Mahdavi

Thank you, everyone, again for joining us this morning. We look forward to speaking with you all during our second quarter conference call. In the interim, should you have any questions, please feel free to reach out to myself, and we look forward to providing you further updates. That concludes today's call. Operator, over to you.

Operator

With that, that does conclude today's call. Thank you for your participation. You may now disconnect.