Optiva Inc.

Third Quarter 2022 Financial Results Conference Call

November 9, 2022

CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Todd Coupland, *CIBC*

Jason Senensky, *Chapter Twelve Capital*

PRESENTATION

Operator

Good day, everyone. Welcome to the Optiva, Inc. Third Quarter 2022 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 Mr. Ali Mahdavi, Investor Relations. Please go ahead, sir.

Ali Mahdavi

Thank you, Operator, and good morning, everyone. Thanks for joining us this morning.

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

If you have not seen the third 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 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 actual events or results to differ materially. Any information regarding forward-looking sta tements 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 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.

I'll begin with a summary of our Q3 performance covering three areas, our continued progress in stabilizing the customer and revenue baseline, our success in executing our plan that is advancing the business forward, and as well, provide commentary on the market catalysts we are seeing in the market today and how they will benefit us. Then I will hand the call over to Dinesh, who will provide a financial summary of the Company's Q3 results.

The third quarter represented another quarter of steady progress in executing our strategic plan. We continued to drive the revitalization of the Company during the quarter as we further stabilized baseline revenue amongst our incumbent customers.

In parallel we advanced another quarter deeper into our new customer sales cycle, which gives us growing confidence that these new logos will contribute positively to the future of our business in the quarters ahead.

We are starting to see momentum build in our business thanks to two significant market catalysts working in our favor. First, cloudification, be it public or private, and second, 5G rollouts which are picking up pace and leading customers to actively evaluate their options for procuring a modern BSS charging solution with us as a well-positioned BSS software solution provider.

This quarter, total contract value nearly doubled compared to Q2 and amounted to $24.7 million for Q3, which represents the culmination of nearly 18 months of intense work rebuilding the salesforce and moving our customers through these long sales cycles. We continue to see robust pipeline growth going into Q4 and on into the new year.

On a year-to-date basis, TCV now stands at $70 million, and we remain particularly excited about the growing new logo pipeline we have in place. The increasing number and depth of our dialogs with both new and legacy customers is driving and informing our product portfolio ahead.

As a result, we are intensely focused on building and delivering a software platform that is nodular in architecture with a high level of embedded automation that will 1) result in faster customer installment and deployment timelines; 2) significantly accelerate our customers' new service velocity; and 3) provide a large library of use cases out of the box, thus reducing a high level of customization and operational management overhead required for traditional solutions that today encompass 85% of the installed customer base worldwide, according to Omdia research.

In summary we understand well what it takes to address the cloudification and 5G requirements for our market and invest in our product portfolio to fit our customer and market requirements and support their journey to the cloud.

This quarter it is particularly evidenced by what I refer to as the customer superfecta, for those who might do horse trading, we delivered in Q3.

First, a customer win-back from one of our competitors, which is a tremendous validation of our strategy and execution thereof.

Secondly, we announced a successful customer upgrade where we migrated over 7.2 million subscribers onto a new BSS release delivered by our R&D team.

Three, a new customer win, but uniquely showing that our investment in creating a Google partnership delivered, already in the first six months of what we expect is only the early innings, of the mass market opportunity ahead for us in our partnership with Google.

Lastly, another incumbent customer upgrade, TSTT, where we are delivering an innovative capability to support their next generation cloud convergence offerings.

All these achievements are validation and proof points for our team that the business is moving in the right direction, planning customer routes (phon), and with that in place, is now advancing towards increasing success and future growth.

On the product front, we recently announced the launch of our first 5G telecom charging solution to be transacted through the Google Cloud Marketplace. Optiva's Charging Engine is pre-integrated with Google Cloud, enabling our customers to rapidly procure the software. The SaaS converged solution enables customer service providers to rapidly procure software, connect to existing architecture, and monetize 5G and IoT use cases.

In addition, the cadence of our new product releases is picking up steam, and to use a phrase, it is now showtime for us with regard to customer delivery. This is evidenced by our third consecutive quarter of more than $4 million run rate in the Professional Services revenue.

On the customer front, we announced that Telecommunications Services of Trinidad and Tobago, TSTT, the largest communications service provider in this country, selected Optiva for cloud modernization using Optiva's next generation full BSS stack. The partnership includes a five-year subscription services agreement with Optiva. The TSTT and Optiva partnership brings to light cloud technology business benefits to serve customers better, improve flexibility, and address the dynamic market in Trinidad and Tobago.

As mentioned earlier, we also announced a deal with Digitel and the successful launch of the new Optiva next general BSS platform. Our solution enables Digitel to offer its 7.2 million customers a converged digital experience, unlocking innovation and new revenue growth opportunities with ease and agility to create new service offerings built around such market trends as VoLTE, 5G, and IoT.

I am pleased with our team's focus as we remain on track to further stabilize revenue and gain more confidence and precision in our visibility for the future despite external and macroeconomic headwinds in the global markets of today. We continue to manage our business carefully, as evidenced by our beater results over the last nine quarters.

Going into Q4 and next year, our focus will remain on operational performance. We will continue to fine-tune our overall costs as we grow into the next phase of our business, as, for example, what we have done with reducing our G&A costs, which allows us to direct our resources more productively.

To that point, the strength and innovation of our R&D team, coupled with our sales team's coverage increase, is proving to work very well to identify and address 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 are vital to securing new customer opportunities in the future.

Moving forward, our strategic path remains unchanged with a continued focus on finishing up our business stabilization and progressing our ongoing pivot to becoming a leading software vendor in our domain. We will drive growth through leveraging cloud technology, automation, 5G adoption, and focus on delivering software license growth which will contribute to the top line and increase gross margin levels in due course.

The net impact of our actions in Q3 resulted in revenue demonstrating stability at $15.2 million, total contract value bookings of $24.7 million, continued strong gross margin at 72.2%, an Adjusted EBITDA margin at 22% and continuing our streak of nine quarters, what I would qualify as a very tidy balance sheet with $18.3 million in cash to support our future growth.

In closing, I want to highlight the success of our team in cleaning up our balance sheet over the last one and a half years, most recently included resolving another challenge left behind by previous management's actions. I'm extremely pleased with the successful conclusion of our settlement agreement with a legacy customer resolving all outstanding claims arising from the prior period. As a result, we're now well positioned with a clean and healthy balance sheet going forward.

Now, I will 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 our (audio interference) 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 September 30, 2022, the Company's revenues decreased to $15.2 million, within the Company's revenue stabilization levels. The change by revenue type for the quarter ended September 30, 2022, is a $1.5 million decrease in support and subscription revenue, $0.1 million increase in software and services revenue, and $0.1 million decrease in third-party hardware and software revenue.

Gross margin for the third quarter remained strong at 72% compared to 79% during the same period in 2021. The decline in gross margin is primarily due to impact of higher customizations with lower margins ordered by customers compared to the previous period and lower percentage of revenue from support and subscription revenue that has a higher margin.

Gross margins may fluctuate as the Company proves out its cloud-native model and product capabilities to new and existing customers when they onboard the public or private cloud in future periods.

Total operating expenses in three months ended September 30, 2022, decreased to $6.9 million as compared to $8.2 million in the same period last year. Excluding depreciation and amortization and share-based compensation costs, total operating costs in the quarter ended September 30, 2022, decreased to $6 million, or 40% of total revenue, compared to $7.3 million, or 44% of total revenue, for the same period last year. The decrease in overall operating expenses is mainly attributable to lower G&A costs and lower R&D costs, offset by higher sales and marketing costs.

Sales and marketing expenditures increased to $2.5 million, or 17% of total revenue, compared to $1.8 million, or 11% of total revenue compared to the same comparable period. The increase in three months ended September 30, 2022, is mainly due to higher headcount and costs related to ramp up of sales efforts, increase in sales commissions due to higher bookings and higher marketing spend.

G&A expenditures decreased to $1.4 million, or 9% of total revenue, from $3 million, or 18% of total revenue, compared to the same period. During the three months ended September 30, 2022, some contractual disputes were settled, and the remaining provision was released, aggregating to $1.6 million, which has been recorded as a recovery in the G&A costs. Excluding the recovery from the settlement, the G&A expenditures in the three months ended September 30, 2022, remained the same compared to the same comparative period last year.

R&D expenditures decreased to $3 million, or 19% of total revenue, from $3.4 million, or 20% of total revenue, compared to the same comparative period. The decrease is mainly due to decrease in cloud-related costs, offset by a ramp-up of Company's in-house R&D team as compared to the same period last year.

As a result of the foregoing, Adjusted EBITDA amounted to $3.3 million during the third quarter of 2022, representing the ninth consecutive quarter of Adjusted EBITDA margin exceeding 20%.

The Company reported net income of $0.9 million in the third quarter of 2022 compared to net income of $3.8 million during the corresponding period in 2021. Excluding the impact from change in value of warrants and the gain and release of the provision, the Company had a net loss of $1 million for the three months ended September 30, 2022, versus a net income of $2.1 million during the corresponding period in 2021.

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

Operator

Thank you. We will now take our first question from Todd Coupland from CIBC. Please go ahead.

Todd Coupland

Yes, good morning, everyone.

I wanted to ask for your updated views on getting revenue growth. Obviously, the trends are there and well established, and you have your target part of the market you're going after and it looks like you're seeing some good case studies in terms of the target market either coming back to you or upgrading. That's constructive. At least that's how I view it.

But I'm interested in what's your expectation for that actually to drive revenue growth, and when might you start to see that?

John Giere

Hi, Todd, this is John. Thanks for joining.

So, you narrated it quite well. I think you've got the narrative, which is we've now put in place the customer stabilization demonstrated by recovered accounts, demonstrated by renewed maintenance and support agreements. As we go into our planning period for next year, we're putting together a plan that I feel very optimistic about. We have work to do. It's early, still the first half of November. We expect to have our plan locked down over the next couple of weeks. With that, we're looking into next year. We're looking at the Q4 momentum.

The new logo cycle, as I had said before and in my remarks, I've noted the 18-month is a longer cycle, Todd. It takes longer, but we're feeling increasingly confident that we've built up the new logo opportunity and pipeline to where it'll materialize going into next year. I think that's why I feel optimistic going into next year that we will be putting together a plan with a positive outcome, but that work is being done as we speak.

Todd Coupland

If you start to land some of those logos, is that just a steady improvement if that starts to happen, or will it be jagged and potentially some volatile results, hockey stick, when those deals land? What will actually be the impact when that starts to take place?

John Giere

You know, I'm anticipating—they vary, of course, by size, right? It's difficult to say, big ones to the small-sized ones. Over time, not initially, I anticipate we're planning for an increasing amount of them to be possibly Google Cloud orientated, or even our other partnership with Microsoft, which would be a different way of rolling out because you roll out much quicker and faster, but on a smaller base because you're doing a SaaS model. But I don't see that in the initial wave here.

There will be some of that, but the initial wave will be built around how the business works with perpetual licenses, professional services rollout with ratability against that rollout, and then after turnover to support.

So, other than the size of the deal, I don't expect volatility in that sense. But yes, given it's still a Capex budget, Todd, we'll likely have—like our bookings, we'll likely have certain quarters where you outperform and other quarters where you have a decent, steady stream. Q3 in the summertime, as an example.

Todd Coupland

Okay. I had a competitor question. I was asked by an investor whether you're starting to see Tucows in the charging market. I didn't think so, but I just wanted to check in on that.

John Giere

I'm sorry, who was that, Todd, that I see?

Todd Coupland

Tucows. It's a domain registration company, a tech company that's based in Toronto, internet domain registration company, but I had someone ask me whether or not they had, like, a foot in the BSS charging market. I didn't think so, but I just wanted to make sure I had that right.

John Giere

Not certainly on my screen. I had not heard of the name. I thought you said two cows, and I was thinking oh, maybe I (multiple speakers).

Todd Coupland

Yes. So, it's Tucows—t, u, cows. It's a Toronto-based tech company. They've played around the margin in communications infrastructure, but as far as I know, they weren't involved in carrier software. But it doesn't sound like that's the case, or you're not seeing it.

John Giere

Well, you know, carrier software has that built-in barrier to entry, which is you have to be extremely resilient, high availability, there's a whole bunch of things that make that (inaudible) challenging.

Dinesh Sharma

I'm familiar with the company because I'm in (inaudible) but haven't heard them enter this space.

Todd Coupland

Yes, I didn't think so. Could I just ask a question on operating leverage? You've been kind of holding steady in the 20-ish percent EBITDA margin for a while. What does that look like once revenue starts to grow? Will it hang in that 20%, 25% range, or is there operating leverage?

John Giere

We want to stay in and around the 20% range initially because one of the things that is important is as we're increasing our customers and they are starting to—I talked about showtime, Todd, and what I meant was every release now is going into customers, and the pace is picking up quite a bit. We still have what I would call technical and market debt in R&D that we're in need to keeping this strong cadence of releases so that we can get out to customers, get it installed, upgraded or new, and start doing the ratable professional services and start recognizing the revenue.

We still have a period here where I think we're going to—on the EBITDA side, we're not going to sacrifice the growth opportunities on the EBITDA side to overachieve in EBITDA. Some of that's been a result of not being able to ramp up our R&D as fast as we would've liked. Not a lot of it, but a bit of it, so I think that's important that we do that and deliver those releases.

Todd Coupland

That's great. Appreciate the color. Good luck, guys.

John Giere

You bet, thanks.

Operator

We will now take our next question from Jason Senensky with Chapter Twelve Capital. Please go ahead.

Jason Senensky

Hi, guys, good morning. Just a quick one. In the presentation, and I think in your prepared remarks, John, you mentioned a win with a tier one I think North American CSPL (phon) (inaudible) Google Cloud. I could be wrong. I don't think you press released anything there, but as far as I know, that was your first win. That does seem like a pretty big development. Is there any additional color you could provide on, I guess, the value the customer saw, what the discussions were like there?

John Giere

Yes, the customer is making their own announcement. It's related to their own introduction of a new service. I'll be careful to say that it's a North American meeting and communications company, and they're setting up to make a mobile offering.

I think what's very, very interesting about it is we did it on the Google Cloud Marketplace, which envisions a future more and more on a software transactional basis, so what's important to understand is this customer's looking to get up on a SaaS-based model, grow incrementally, be able to roll out their installation and deployment more quickly, get the service up and running, and then incrementally continue to add new capability as time goes on.

Using the Google Marketplace, we were the first in the world to do that, and so I think it was something I wanted to highlight as it's an investment we made in putting together this Google partnership with an approach of how can this be a win-win. For Google, it's a win. They get to put workloads onto their core network, their data center network. It facilitates the transaction to be able to transact through Google, but we'll still be doing the installation, deployment, and the other aspects to get the system up and running.

I'm intrigued and excited about the opportunity that lies ahead with this kind of market model.

Jason Senensky

Congratulations on that, that seems like a big win. Maybe just a couple more small ones. You'd mentioned in the news release the TCB bookings year-to-date of $70 million, and I think there was a comment there that the $70 million was ahead of your annual target. I just wanted to clarify, does that mean that you were budgeting sort of less than $70 million for the year and as of through the first three quarters you were already ahead of your annual target, or what did you mean by that?

John Giere

Yes, so we typically set a pace quarter-by-quarter on how our bookings will go, of course both in the quarter and cumulative, and as of now, what I want to share there is that our total bookings for the end of quarter three is ahead of our plan. As I think I indicated, I anticipate we'll finish the year above where we thought we would be, which means we have a strong bookings going into next year.

Jason Senensky

I see, okay, so you're ahead of your plan through the first three quarters, but you're not—it's not as of the end of September. You're ahead of your annual plan.

John Giere

Yes, we'll have another Q4 here, which will add to our bookings total and likely bring us, we expect in the course of the year, ahead of where we originally planned our bookings to be. Which again puts—to my comments about having momentum and opportunity going into the new year.

Jason Senensky

Okay. Then just the last two small ones, John, understanding that the credit markets have changed quite a bit over the last 12 months, is there anything happening in terms of that refinancing discussion at this point, or is that something that needs to wait for a better market or better financial results for the Company?

John Giere

Yes, I mean, we always keep dialog going on continually about our balance sheet, as we did with regard to resolving this customer issue that required continual communications and directions. I keep that dialog going. We don't have anything presently underway with regard to the debt structure.

Jason Senensky

Okay, and then a permanent CFO, again, is that something that is a priority for the Company at this point, or what's happening there?

John Giere

We've decided to move forward and defer that decision going into next year because we think given where we're shaping up in our growth profile and the way things are going, that role may evolve a slightly different way than we originally planned when we first had the opportunity to fill it. But as we do our planning into next year, we think that role may evolve, and we want to reflect that in our future decisions. For now, we're comfortable that we have a very strong team in place and is doing a very good job in terms of managing our responsibilities going into this year and related to our planning process.

Jason Senensky

Okay, so that's a pretty intriguing comment there, John, just in terms of how the growth prospects evolved and the role may end up being a bit different. Is that specifically to do with the potential for M&A at the Company, or what did you mean by that?

John Giere

Sorry, I didn't mean to intend on any specific thing, but the role is a different role than the one we had when we were in recovery mode. I wasn't (multiple speakers), Jason, to any particular aspect of it.

We've also recruited and hired in a VP of Finance, Poh Sim Gan, who is also (inaudible) somebody I've worked with in the past. He's formerly a CFO. So, we have in our team—and Dinesh as well here together—we have on our team quite a lot of confidence when it comes to the financial department, and that's stood us very well. It allows us to think about how the CFO role would be different given the strong performance of the people in the positions today.

Jason Senensky

Okay, so really appreciate the time, John. Thanks (multiple speakers) shaping up well, so thank you.

John Giere

No, thank you, as always, for your interest and participation, Jason. Thank you.

Operator

As there are no further questions at this time, I'd like to turn the call back to your speakers for any additional or closing remarks.

John Giere

Thank you, Operator. Once again, on behalf of the Optiva team, thank you all for joining us this morning. Should you have any questions, please feel free to follow up with me via email or by calling me directly. Otherwise, this concludes today's call and we look forward to reporting back to you on the back of our Q4 and year-end results. Thank you and have a great day. Operator?

Operator

Thank you. That concludes today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.