

## FINAL TRANSCRIPT

**Optiva Inc.**

**Fiscal 2018 Third Quarter Earnings Conference Call**

**Event Date/Time: August 9, 2018 — 8:30 a.m. E.T.**

**Length: 27 minutes**

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Optiva Inc. Fiscal 2018 Third Quarter Earnings  
Conference Call

**CORPORATE PARTICIPANTS**

**Danielle Royston**

*Optiva Inc. — Chief Executive Officer*

**Anin Basu**

*Optiva Inc. — Chief Financial Officer (Interim)*

**CONFERENCE CALL PARTICIPANTS**

**Anshu Deora**

*Raymond James — Analyst*

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## PRESENTATION

### Operator

Good morning, everyone. Welcome to the Fiscal 2018 Third Quarter Earnings Conference Call for Optiva Inc. At this time, all participants are in a listen-only mode.

Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at this time for you to queue up for a question.

Before beginning the formal remarks, Optiva would like to remind listeners that today's discussion may contain forward-looking statements that reflect current views with respect to future events. Any such statements are subject to risk and uncertainties that could cause actual results to differ materially from those presented in these forward-looking statements. Optiva does not undertake to update any forward-looking statements except as required.

I'd like to remind everyone that this call is being recorded today, Thursday August 9, 2018.

I will now go ahead and turn the call over to Danielle Royston, Chief Executive Officer of Optiva Inc. Please go ahead.

**Danielle Royston** — Chief Executive Officer, Optiva Inc.

Thank you, good morning, and welcome to our 2018 third quarter earnings conference call. I'm Danielle Royston, CEO of Optiva, and I'm joined today by our Interim CFO, Anin Basu. On today's call, Anin will provide a brief commentary on our financial results, and then I will discuss my thoughts on our quarter.

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To remind you, our plan for our Company is threefold: We need to fix Customer Success, we need to restructure our company, and we need to invest \$100 million to create market-leading products.

So with that, I'm going to turn the call over to Anin. Anin?

**Anin Basu** — Chief Financial Officer (Interim), Optiva Inc.

Thank you, Danielle, and good morning, everyone. Please note that our complete financial statements, Management Discussion & Analysis, and earnings release for the quarter are available on SEDAR and on our website, and I encourage you to review them at your convenience.

As you can see from the release of the statements, our revenue for Q3 2018 has come in at 32 million, with a net loss of 3.5 million. As many of you are quite familiar with the financial reports, I'm not going to go over the numbers on today's call. I would be happy to answer any specific questions during our Q&A portion of this call.

Today I want to provide you with an update on our restructuring plan, gross margins, and the related-party contracts.

On restructuring, we have made good progress in the quarter in both workforce reduction, as well as closing offices and reorganizing our legal entities. We have recorded a restructuring charge of 50.8 million year to date. That includes the charge of 1.6 million in Q3. While most of the expenses related to severance costs to outgoing employees, it does include costs related to exiting offices and data centres globally.

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Our restructuring liability at June 30, 2018 is 20.6 million. We paid approximately 19 million in the third quarter. Overall, our restructuring is progressing, and we will continue to implement the plan.

I wanted to take a minute to talk about our gross margins. Our gross margin in Q3 2018 is approximately 70 percent compared to 57 percent in the same quarter last year. The higher-than-normal gross margin in Q3 is a combination of a few factors. We are beginning to see the impact of our restructuring and resulting efficiencies in our internal operations.

Additionally, in Q1 and Q2 of fiscal '18, we made provisions for expected losses on certain contracts that resulted in lower gross margin in those quarters. We partially utilized this provision in Q3 as we made progress towards completion, which resulted in our gross margin being higher this quarter.

Finally, the revenue mix this quarter also had a positive impact on our gross margins. I want to caution you that we do not expect our gross margins to stay at this level long term, as it is temporarily higher due to the factors I just described.

Now I wanted to give you an update on our contracts with our two related parties, Crossover and DevFactory. The total costs incurred in this quarter with Crossover amounted to 7.8 million. As for DevFactory, this quarter we incurred a cost of 11.4 million, with the majority of these costs being invested in customer success, restructuring, and product innovation that Danielle will refer to shortly.

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As I've said before, we believe these investments contribute to our goal of having great products, great people, and enable us to be a leader, that help us to bring innovative products and drive customer success to our customers.

That about covers it for my portion, and with that I'd like to pass the call back to Danielle.

**Danielle Royston**

Thank you, Anin. And I'd like to take a moment to thank Anin for his leadership and support over the past year. He's done a great job for Optiva as Interim CFO in addition to his VP of Finance role.

As you may have read from our press release in late July, we have named Ken Taylor as our CFO, who will be starting next week. I'm excited to have him join the team.

The single most important question investors should think about when they think about Optiva is, where is the long-term revenue headed for this company? The reality is is that we continue to shrink. As we evaluate our forward revenue base, we are holding to our long-term revenue range of 90 million to \$120 million.

There are three keys to our plan to fixing and turning the Company around—fix Customer Success, restructure the Company, and invest \$100 million to fix the products. So let's take it one at a time.

First, Customer Success. Our Customer Success program is our program that works with each customer to align our work to our customer's most strategic goals, create the plan to deliver

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against those goals, and then ask our customers, did we achieve the goals. We have begun to gather feedback for the first six months of the year, and we expect to move up about 5 points from where we were before to the low 30s. While this is a few points higher from our previous measurement of 27 percent as of December of 2017, as I said before, this is a very long, important process where you literally have to fix each customer one by one.

We asked some notable customers that have moved across the line and into the yes territory. We've put together a plan, executed that plan, and now that customer is really seeing us as a partner and not just as another vendor, and we turned a no customer to a yes. We have other customers where we have closed out big projects in the last six months, some of them only very recently. These customers are not quite ready to give us the thumbs-up. They want the delivery and the change to cure for a bit more. However, they are indicating that we are inching closer to the line, and with just a bit more work, they are seeing the change and the improvements we've made to reposition as a partner and an asset to them.

And then there's still the others, projects still in the ditch. We still have a good handful of projects where customers aren't feeling the change, and the yes isn't yet into view. For these customers, we are still pushing hard every day, doing what we can to get them across the line.

And as I have said before, revenue will converge with customer success. So this remains a big focus for our team to make sure we are fixing customers and getting them to where they see us as a partner, not a vendor.

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Moving to item 2, we need to restructure the Company. We've invested \$51 million in restructuring, and we reduced our spend by about \$30 million. We continue to work to reduce our expenses and have an additional \$20 million in line of sight.

With a shrinking revenue base, the restructuring side of our work has to do with managing our expenses. If our revenue continues to shrink, we will continue to adjust our expenses, and for a software company that means adjusting our headcount. As I have said before, our plan will work up to a 25 percent loss of revenue from \$120 million.

Which brings us to the third item, investing \$100 million in our products. Last year, I announced the plan to invest \$100 million to revitalize our products, and so far we are about a third of the way into our plan. If you have been following this closely, you have noticed we have pivoted our product roadmap very strongly towards cloud. In fact, with each passing day, I am more and more convinced that the future of telco lies with moving them to the public cloud.

This is hugely disruptive, and for our investor community, I want you to know that this is also hugely risky. We are leading the industry with the move to the cloud in an industry where everyone is saying that it won't work. On top of that, even if it does work, this is an industry that moves notoriously slowly, with sales cycles easily taking 18 to 24 months. As an innovative disruptor, it will take time to convince the telcos that not only will it work, but that our performance and total cost of ownership savings claims are achievable. So we are starting to go out and share the

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messages with—share this message with customers and prospects. But I want you to understand that I expect growth will take years to materialize.

For all of our investments, we have gotten some nice advancements in our products. Aside from a big investment in quality, we made a couple of significant announcements. The first announcement was for the Optiva Charging Engine and the work we've done to move the application to Kubernetes. Kubernetes is Google's product for containerization of applications to make them more efficient deployments on servers, allowing organizations to speed up their time to deployment and optimize every last dollar from their hardware investment.

This announcement means that the Optiva Charging Engine is now cloud-ready and can work in any cloud, private or public. This is a first step to prove to the world that we are not only talking about the cloud, we are making the investments we need to make cloud a reality for telco in 2018.

The second announcement was regarding the availability of the Charging Engine on Google Cloud Spanner, Google's distributed, highly available, transactional database. This development and innovation is key to delivering on our promise of 10 times the speed at a tenth of the cost. With this database, we can replace Oracle as our database and leverage a new innovative database that is not only better, it's cheaper for telco to provision and capacity plan many, many months in advance, to be able to be give them the ability to autoscale not only the compute power, but also autoscale the database provisioning. No other database in the world is able to do that. To be able to reduce the

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tens and sometimes millions of dollars, hundreds of millions of dollars telcos spend with Oracle is disruption that everyone is excited about.

Investors and customers alike ask me about our partnership with DevFactory and if we are getting the expected value from the relationship. Let me tell you, we could not have done these advancements without them. Their speed and scale coupled with their ability to deliver has allowed us to accelerate our innovation. To have that partnership in our toolbox is the competitive advantage we need to revolutionize our products and accelerate telcos moving to the cloud by ten years.

And so how is this playing out with our customer base? Last year, one of our largest customers was going to kick us out. From their perspective, we were a critical vendor managing their monetization strategy for their millions of subscribers, and we were in trouble. On top of that, we didn't have a great vision for them for why they should stick with us. For this customer, the cloud vision and progress has allowed us to get our foot back in the door. We still don't know if it'll be enough to save them in the long term, and as I mentioned, this is a hugely risky move. The upside is that we started a project around cloud for them and we may be successful. If not, we will lose them. Like I said, the stakes are really high.

Finally, as you know, I've been pushing to get to cash flow breakeven by the end of our fiscal year. We are continuing to push hard for this goal, investing as much as we can in our products to take advantage of the cloud opportunity, cutting costs aggressively for restructuring to fund our

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investments, while at the same time trying to deliver Customer Success. We are pushing as hard as we can to get to that goal, but it will be close.

I remain encouraged about our progress and where we are headed. We must continue to focus and execute, but with the advancements this quarter and the encouraging news from the customers, I feel we are on a great path.

At this point, we're ready to open up the call for Q&A.

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## Q&A

### Operator

At this time, if you'd like to ask a question, please press \*, and the number 1 on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from Anshu Deora with Raymond James. Your line is open.

### Anshu Deora — Raymond James

Good morning, guys. So recurring revenues increased quite substantially this quarter. So what is the trend there?

### Anin Basu

Hi. It's Anin. The recurring revenues currently is still trending at around 20 million, 21 million a quarter. This is—I wouldn't say it's a substantial increase. It's pretty flat if you kind of look at it for the past few quarters, and it's a matter of renewals and the timing of renewals with our

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customers that have support arrangements with us. We do expect that number to actually decline, knowing some of the customers that have already notified us that they are leaving our platform. And what has happened is, because our software is very sticky, their implementation with our competitors' systems are likely delayed, which is why they are kind of extending it pretty much on a quarter-to-quarter basis. So we do expect as part of the overall revenue that to decline as well in the future quarters. I would say that it's kind of holding steady at around 20 million, 21 million at this time.

**Danielle Royston**

And just to add to that, I think the percentage mix has changed, and I think that is due to us wrapping up and finishing on some of our professional services deliveries. And so the recurring revenue from a number perspectives is relatively flat. The percentage has changed because professional services has reduced.

**Anshu Deora**

Okay. That helps. And I guess now that you've been at Optiva for some time, where do you see margins next year?

**Anin Basu**

The margins historically, again, if you look at our past few quarters, have been around the mid-50s. We believe that with our restructuring efficiencies, and other, if you kind of take out the noise, it'll be around in the range of low-60s initially. We are still working through our restructuring

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plan. I wouldn't say we are at steady state. There will be some amount of volatility resulting from the product mix, revenue mix that we have every quarter. But somewhere higher than what it was in the past, but I would say low 60s.

### Anshu Deora

Okay. And in terms of the contract loss provisions, does that impact gross margins going forward? And what's the long-term gross margin I guess more specifically? You mentioned after the restructuring, you're going to be at low 60s. But is that your ideal gross margin going forward?

### Anin Basu

Sorry. Let me correct you. Not after the restructuring. After the restructuring is way out there in the future. While we restructure, I would say the gross margins would be in the range of low 60s. In terms of the—what impacts our gross margin the most is really the product—the revenue mix in any particular quarter. The higher the recurring or support-type revenue with higher margins, the margins tend to pick up.

The impact of lost—or provisions we made in the last contract is that the quarter in which we booked these provisions, the margins were lower. And because as we complete these projects, the costs are utilized against that provision, it's not charged to cost of revenue. And that is why as we draw down these provisions, the margins look better in the quarter in which we are drawing down these provisions. So there is still about a couple of million left in those provisions. The

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drawdown will be dependent upon progress made in those projects in those quarters, and I would expect that the provisions will be drawn down for probably the next couple of quarters.

### Anshu Deora

Okay. Thanks, Anin. And next year, do you expect to be cash flow breakeven as well? Or positive?

### Danielle Royston

At this point, we're kind of—the only message that we put out there is the goal is to run cash flow breakeven in our Q4, and we haven't—and we don't give guidance for the future year. So that's about as far as we're willing to commit at this point.

### Anshu Deora

That makes sense, Danielle. On the multimillion renewal of the Tier 1 APAC CSP that you press-released earlier, what's different at Optiva? I know you touched on this, but more specifically when it comes to this renewal, what made that CSP decide to go with Optiva? Decide to renew with Optiva again? And you also mentioned in that press release that there is some consolidation in their market. Is M&A disruption an issue? Could be an issue for Optiva there?

### Danielle Royston

Okay. So there was two parts to your question. What's different about Optiva? A couple of things with this customer. I think this customer is excited about the Customer Success message and seeing the change in our organization. And typically, when I came into this organization, most

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customers were renewing 12 months at a time. Most of our contracts were like that. We had a few, a handful of multiyears. But this product is a multiyear commitment. This isn't something that you can rip out within 12 months and swap out. It's a voluntary heart transplant. So our customers take a swap-out project very, very seriously. It's very consuming and very disruptive.

And so I think one nice sign from this commitment is that it's a multiyear agreement, and I'm hoping that more and more customers start to realize that sort of the precarious financial standing that we had in the relatively recent past, those days are over, and they're willing to commit to us for multiple years. And so that's really exciting. I think they're listening to our vision around our products and I think they're willing to give our vision a try. They agree with it and they think it's right. And so that's very encouraging.

Now it's exactly the amount of time you would need to swap us out, so if we are unsuccessful, there may not be a renewal after this. So I think there is still that risk. But at least where we are right now, they're like okay, we're listening, we like what we're hearing, we like your vision, we're willing to sign a contract that's longer than the 12 months that we signed before. And I think it's still a little bit about wait and see and see how you do. And so like I said in my message, it's all about execution. There's a lot of things that need to come together. This is a long process that is not going to be quick, and I keep trying to encourage the investor community to have this very long-term outlook on—this is not going to be a quick turnaround. If I had pixie dust, I would use it, but I don't and it's just going to take a long time.

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And then your second—what was your second question again? Do you remember?

**Anshu Deora**

Yeah. So you mentioned that there's some consolidation in that market in the press release. So I was wondering whether M&A disruption in that market, would that be an issue. I'm not sure which market—

**Danielle Royston**

Yeah.

**Anshu Deora**

—in APAC that it's referring to, maybe India. I'm not even sure, but yeah.

**Danielle Royston**

So anytime there's some consolidation anywhere, not just in Asia-Pac but anywhere, there is a risk that you're the losing vendor. And we see it all the time. I mean, there's a new person that comes in and he or she likes their system, you may lose just based on that, just based on a relationship. That's why I think Customer Success is super important because to differentiate a relationship. But if you're really seen as a strategic partner, when those kinds of events happen, you have a slightly—you have a little bit of an edge there if they really do believe that you are focusing your company for their benefit and their gain. And yes, there is that risk at this account. So there is a competing product. It is one of the major competitors of ours, a company that is very, very large, and they could pivot to the other vendor. So back to it's a three-year agreement, that's exactly the

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amount of time you would need to swap out, so that's kind of like the sort of bad way of looking at the situation.

On the positive side, I think they are responding to our messages and they like what they're hearing. So it's good news/bad news, I think. I don't know. It's a little bit of both.

**Anshu Deora**

Okay. Yeah. That helps, Danielle. I guess last question for you would be, you're talking a lot about Customer Success and that certainly seems like what you should be focusing on. But, Danielle, how should we see licences growing? And what's the timeline for that? Just because trying to get an idea of whether potential new licence sales or new software subscription sales offset those declines with existing customers.

**Danielle Royston**

Yeah. While we've been focused on primarily fixing and working with our customers on Customer Success, and then certainly fiscal year '18 has been heavily focused on the restructuring plan, I've not really pushed the sales team to go get new licences and new sales from new customers. We certainly have been servicing the customers we have, and there's been expansion there, and as Anin mentioned, customers that are leaving, extending and leaving a little bit more slowly. But it's a little bit like walking and chewing gum at the same time. It's really hard. And I stress this with my team a lot. It's very difficult to fix a company and at the same time go chase growth, because they kind of are orthogonal to each other. If you're focusing on growth, you want a

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lot of stability and not a lot of change at the Company. If you're working on fixing the Company, you want a lot of change really fast. And so they kind of work against each other.

So I have purposely taken '18 and said, take your foot off the gas in chasing new customers, let's focus on fixing our customers who—if you recall a year ago, we were at about 20 percent customer success which is a horrible score, and we had a ton of restructuring to do.

As I said in my message, I see Customer Success coming up, I see higher numbers coming into view. I think we have a unprecedented opportunity to take advantage of the message of moving telco to the public cloud, and I feel I am unique on this message. I think I am ready with my products. And so we're going to start to push on that gas, but—the pedal there, to start to get new customers, and sell the cloud products and features to our existing customers.

But like I said, this is not going to take months where you're going to start to see that revenue tick up. It may be years out. So I think when you guys are thinking about your models, my revenue goalpost of 90 to 120, I'm going to still hold to that. I mean we are still shrinking, I still expect us to shrink. We're going to start to push on that gas because I think this is a temporary window of opportunity, but it's really risky. It's kind of all or nothing. We're betting the Company on this idea, and obviously we think it's going to work. But it's going to take time, and I caution you think in years, not in months.

## Anshu Deora

Okay. That's all for Danielle. Thanks so much. I'll pass the line.

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**Danielle Royston**

Cool. All right.

**Operator**

There are no further questions at this time. I'd now like to turn the call back over to Ms.

Danielle Royston for closing remarks.

**Danielle Royston**

All right. Well, everyone, thanks for listening. Always great to talk with you. Look forward to our next call, which is in December, to discuss our Q4 and fiscal year. And good luck with earnings season. Thanks. Bye.

**Operator**

This concludes today's conference call. Thank you for joining. You may now disconnect.

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