Optiva Inc.

Full Year 2019 Financial Results Conference Call

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CORPORATE PARTICIPANTS

Ali Mahavi, *Investor Relations*

Anin Basu, *Interim Chief Financial Officer*

Danielle Royston, *Chief Executive Officer*

CONFERENCE CALL PARTICIPANTS

Todd Coupland, *CIBC World Markets*

Robert Young, *Canaccord Genuity*

Steven Li, *Raymond James*

PRESENTATION

Operator

Good morning everyone. Welcome to the Optiva Inc. Full Year 2019 Financial Results Conference Call. I would like to remind everyone that today's conference is being recorded.

I will now go ahead and turn the call over to Ali Mahdavi, Investor Relations. Please go ahead, sir.

Ali Mahdavi

Thank you Operator. Good morning everyone and thanks for joining us for the Optiva financial results conference call for the three month period ended December 31, 2019.

Joining me this morning are Optiva's Chief Executive Officer, Danielle Royston, and Interim Chief Financial Officer, Anin Basu.

If you have not seen the news release which was issued late yesterday, it is available on the Company's website at optiva.com, as well as on SEDAR along with our MD&A and financial statements.

I would also like to remind you that a replay of this call will be accessible via the Investors section of the Company's website. Following the commentary, we will conduct a question-and-answer session with analysts only. 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 are 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.

Additionally, you may be aware the Company is currently subject to a proxy contest that could see two of seven Board members replaced at our annual and special meeting to be held on May 12 of this year. While the proxy contest is pending, the Company is constrained in its ability to undertake financing transactions, including transactions that require TSX approval. While the contest is pending, the Company may be delayed in executing on previously announced plans that require external funding through the issuance of subordinate voting shares.

I will now turn the call over to Anin for his financial review of the quarter. Anin?

Anin Basu

Thank you Ali. Good morning everyone.

A reminder that Optiva's results for the quarter and 15-month period ended December 31, 2019 resulting from the change to a calendar year-end were released yesterday. Our results are presented in accordance with the International Financial Reporting Standards and presented in U.S. dollars unless otherwise noted. The comparison of our quarter ended December 2019 is against the quarter ended December 2018.

I wanted to discuss the following three items regarding the December 2019 quarter on our call today: one, declining revenue trends and the gross margin; two, the loss for the quarter; and three, an update on our related party transaction.

The Company's revenue during the quarter was lower by 26% to $20.5 million and continues to show the declining trend we have talked about in previous calls. The port and subscription revenues were lower when compared to the same period in 2018 mainly due to the discontinuation of support to customers who had previously notified us of their exit. The Company's gross margin for the quarter was 72% as compared to 69% during the same period a year ago. The higher gross margin is mainly due to a one-off on-premise software license delivered in the quarter.

While operating expenses in the quarter decreased by 22% to $13.8 million when compared to the same period last year, overall we had a loss of $16.9 million. This loss was mainly due to two reasons: a charge of $7.4 million recorded within finance costs for the quarterly revaluation of a Series A warrant, and an incremental $5.1 million charge for income taxes related to certain foreign subsidiaries that are in the process of being reorganized. While our total costs including research and development have reduced as compared to the same quarter in Fiscal '18, we remain focused on specific projects that improve customer success and cloud innovation where we rely on the services of two of our critical vendors, which brings me to the discussion on our related party transaction.

During the quarter, the Company incurred $5.7 million of costs towards R&D on cloud innovation with DevFactory, which is an affiliate of ESW, Optiva's largest shareholder. During the quarter, the Company also incurred $3.8 million in costs associated with its access to skilled workforce in Crossover, another affiliate of ESW.

I will now turn the call over to Danielle.

Danielle Royston

Thanks Anin and good morning everyone. Thank you for joining us on today's call.

Over the past few years, Optiva has been on a mission to aggressively turnaround the business and change its strategy to become a cloud company. We've gone from having to rescue the Company from secured lenders to reducing our annualized operating expenses by $94 million. We've gone from a loss from operations of $53 million in Fiscal 2016 to income from operations of $11.6 million for the 12 months ended December 31, 2019; and we announced a plan to focus solely on the telco industry and pivot from on-premise enterprise software to public cloud SaaS software; and a $100 million investment to revamp and revitalize the Company's BSS products to become cloud native.

We truly believe that over the next 10 years, everyone in the telco industry will be selecting or be using public cloud-based BSS and charging systems. Cloud concepts are now present in every RFP and we see competitors forming strategic partnerships with the major public cloud vendors, which is further validation that we are headed in the right direction.

The flip side of that and the primary reason for our pivot to the cloud is that we also believe all the legacy on-prem Bare Metal revenue at Optiva will eventually shrink to zero. Unfortunately, we don't know exactly when each customer will leave and cannot predict when the cloud growth will kick in, so I'm thankful we have made the difficult transition to our flexible cost structure while we live through the revenue decline associated with this transition period, the departing customers and the move to cloud.

Recently, we were excited to announce a successful deployment pilot with one of the world's largest telcos, Vodafone Idea Limited, to deploy Optiva's charging engine on a universal private cloud. This is not any ordinary pilot. The pilot is keyed into 4 million subscribers and serving up 1,000 transactions per second on (inaudible) data charging transactions. It is a great example of that our technology works, that we were delivering, and our customers are receiving the benefit.

We continue to make progress with other customers as well. Truphone, our fully public cloud deployment running on Google Cloud Platform and Google Cloud Spanner, went live as well and we expect yet another customer deployment to the public cloud to go live in the coming months.

Sadly, the biggest telco event of the year, Mobile World Congress, held annually in Barcelona, is cancelled due to the fear of the coronavirus. Many vendors and operators orient their sales and marketing plans around this event, and while we agree the safety of all our communities is of paramount importance, it is a notable marketing opportunity loss for us this year.

We finished another cycle for our customer success program covering the period through June to December and we're trending to finish just over 50% of the revenue, reporting to us that they feel our objectives and goals are aligned with the ultimate success and that we are a key component of their growth. This continues to improve, and the positive trend provides us with great confidence that we are on the right track. As mentioned on previous calls, it will take time to get to our ultimate goal of 100%, and I remain encouraged by our forward momentum as we continue to (inaudible) each customer on our quest to achieve 100% customer success.

While our migration to the public cloud strategy with major telcos additions results in gaining momentum, remember it will take time, but with our early adoption of the transition to the cloud, we hope to benefit the most.

Finally, to address the elephant in the room and to address what everyone is wondering about, what is going on with the proxy fight and what will happen. For now my response is I am operating under the assumption and hope that this will all be resolved, and I continue to focus the operations of the business on moving to cloud.

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

Operator

Thank you very much, ma'am. Ladies and gentlemen, if you'd like to ask a question over the phone today, please press star, one on your telephone keypad now. That is star, one to ask a question, and we'll pause for a moment to allow people to signal. Thank you.

Our first question today will come from Todd Coupland from CIBC. Please go ahead, your line is open.

Todd Coupland

Hi, good morning everyone. I have a couple of questions, if I could. The results in the quarter seem to be roughly in line with your lower downside revenue scenario. Just wondering if you could update us with your thoughts on that downside case for the Company over the next couple of years.

Danielle Royston

Hi Todd, it's Danielle. We've had this number out there for a while with (inaudible) as I sort of refer to them, sort of this long term revenue (inaudible), and the reason why we put the number out, it's not so much guidance but more expectation setting around how low we feel the revenue could go before it flattens out and we start to see some growth. My most recent estimate, I think was in the analyst presentation that we put out in January. Previously we had spoken about $75 million, but we do see continued downward pressure especially if you start to consider things like exiting non-core assets, especially as you start to consider the transition into more of a SaaS model, where we feel that professional services revenue will eventually just be eliminated. I mean, it won't go completely to zero, but it will be a lot different as we start to really enforce more the product outlook and really start to enforce more of a new customization sort of perspective. We put that out in January. It is kind of a different way to start to think about transitioning into SaaS. Professional services would go away (inaudible) of non-core assets to really focus the business on the cloud business, and so I think we have it in the 30s, the mid 30s.

Todd Coupland

My second question had to do with the pilot. I think Vodafone India started fairly recently, so judging by your comment, it's up and running, processing or supporting 4 million subs and 4,000 transactions a second. What other learnings would you say would be useful for us to understand with that, I guess mid-transition pilot, given it's not full public cloud? Any further comments on that would be appreciated.

Danielle Royston

Yes, I mean, I think the really big telcos have a natural nervousness around the public cloud. It's a really big transition for them, right? I can't stress it enough, I don't think people really realize. It's not akin to changing iPhone versions, or even Blackberry to iPhone. It's really like comparing some brand new phone to iPhone kind of transition, from a technology perspective, right? Today they run it on-premise themselves. They have legions, I mean thousands of people supporting their IT operations, and to sit there and say, hey, we are going to hand it over to Optiva, Optiva is going to run as a managed service and we're super cool with that, it's very scary for them.

I think the bigger they are, the more likely they're going to take a journey to private cloud. The private cloud is, like you said, it is not public cloud, it is more of on-premise, and so the pilot is successful, it's running now, and we want to run it on—I think we want to run it for 60, 90 days, and kind of have all the other wonderful experiences that you have with running a system like this, like capacity increases and decreases, outages, rolling out plans, rolling out a feature, and kind of experiencing the new technology and the new way of working. You know, at the end of the day it still is on-premise software. It's going to be more expensive than even what we're running today.

There's not really what I call hard saving, like we still have to buy all the machines, they still have to have a lot of people, they're still paying to other data centers. They might have what I'll call soft ratings, which is, for example what used to take months to do and plan for an upgrade, now it takes a minutes, an hour, and you're starting to see the operational speed up (inaudible) kind of market, and so I guess there's little cost in that, but it's not necessarily bottom line hitting.

This is a huge project for us, I can't stress that enough. This customer was more than 30 versions behind our main related version of the product. We've had to go through that and they're such a massive customer. India is 300 million subscribers, or at least our portion of it, running six different origin sites around the country, with a mirror of disaster coverage of 12, so for us, it's like 12 different upgrades and they're not—you know, everyone likes to think that they're exactly the same. They're not exactly the same, so it is 12 separate upgrades that we had to do. We did that first to mitigate the risk of such a significant shift in technology to the private cloud.

We did the private cloud pilot as—we funded that, they did not pay us for that pilot. It was a risk that we both took on that, really obviously up to the task to succeed given the history of the Company, given the size of the Company, but I'm super grateful that literally the entire team pulled together; Management, engineering, finance, everyone, working models, working projects, the team on the ground to make it successful, and I think we've shocked the world and we're really excited about it.

Todd Coupland

Great, that's great color. One last question if I could. Just on the announced desire for a capital raise, should our assumption be that gets put on hold until you sort out the proxy issue?

Danielle Royston

Unfortunately yes, I think that's a good assumption. We're just a little bit concerned with what's going on.

Todd Coupland

Great, thanks for the color. Appreciate it.

Operator

Our next question today comes from Robert Young from Canaccord Genuity. Please go ahead.

Robert Young

Hi, good morning. Maybe just to continue Todd's question, are there any other things that you'd highlight you're prevented from doing? Can you monetize some of these non-core assets, or what other things that you have in the roadmap you outlined, Danielle, recently that you might not be able to do until then?

Danielle Royston

Yes, I think Ali's portion of the script describes that we're doing the best that we can. We hope this gets resolved as quickly as possible. Yes, it's putting some constraints on us and it is unfortunate.

Robert Young

Is there anything specific that you wouldn't be able to do? I mean, would all the other potential for selling, say, the GSM-R business or something like that is all that is put off until after it's resolved? Is that correct to think that?

Danielle Royston

Yes, you know—again, difficult to discuss. Doing—you know, pushing as much as I can where I can. Things like the railway business might be a little bit easier. The closer you get to the BSS business might be a little bit harder.

Robert Young

Okay. You said that you'd lost a marketing opportunity with the Mobile World Congress cancellation. Is there anything you can say about the momentum on the cloud side, anything about your pipeline of sales calls, RFPs, interest that the Vodafone Idea pipeline pilot has created? Is there anything you can talk about there?

Danielle Royston

Yes, I think there's a lot of inbound interest. I think we believe this is an easier move and sale the smaller the operator is, or the more they're sort of on that MD&A kind of path where they don't have the large operations and scale already, and they're not really experts in running mission-critical revenue-centric application. I'd say we're seeing a lot of traction around that and the sales cycles go a little bit faster and a little bit easier, the bigger you go, sort of moving up market to the Tier 1.

I think the pilot's opening doors. I think people were really watching this project to see if it was going to be successful. Competitors were watching it, other large telco groups, and seeing that success. I don't think it was a surprise for us. We knew at least we could do it, but I think it was surprising so it's opening doors. (Inaudible) it's kind of creating the opportunity to do new kinds of business meetings, so we're doing lots of video conferences right now and just trying to keep that business moving forward. I think it's impacting everyone equally, the global pandemic and how it's impacting business. But yes, we're just trying—it's opening doors at the bigger side, and it's bringing some of the smaller guys to us and sales are quicker, a little bit quicker.

Robert Young

Okay, and then just to clarify something for me, the pilot that you're running 4 million subscribers, that's on the private cloud of Vodafone Idea—

Danielle Royston

Correct.

Robert Young

And so the next step would be to open it up into the different circles, but how easy would it be to port that onto your public cloud GCP-based engine, if the decision was to go that direction?

Danielle Royston

Yes, you know, Vodafone had this idea—Vodafone India—made a decision to move to the private cloud into our technology years ago. I spoke to them about the pilot in late 2017, 2018, and so they're really committed to their private cloud. They have a super big private cloud vision, they signed multi-year agreements with IBM and Red Hat. I'm probably really turning—I'm blue in the face, I keep telling them, you should really get a—public cloud is going to reduce your cost, and they're struggling for various reasons in their own end marketplace and I really think that they should do that, not just because I think it's the right thing but because I think it would really help them, and they were committed to the private cloud.

I think we're going to do that and roll that out, and that's a pretty significant project as well, right? But deploying the private cloud in India, that would not be our work, that would be IBM's work to set up this—you know, all these different sites across—you know, there is lots of rural areas in India. Once that's set up, we would start to roll out our piece, and I think that's a multi-year effort.

To answer your other question in terms of how easy it is to shift, it's pretty easy. I'll say that with a star just because this is a pretty significant deployment, so it's not going to be—I wouldn't say months, but it would be probably a year, and then if you want to get full benefits for switching databases from Oracle to GCV to Scanner, I'll say that's going to be a pretty tricky move and that will take some time as well.

Robert Young

Okay, understood. Okay, that's it for me. Thanks for the (multiple speakers).

Danielle Royston

Yes, thanks Robert.

Operator

Our next question comes from Steven Li from Raymond James. Please go ahead.

Steven Li

Thank you. Hi Danielle. In terms of customers that have indicated they are leaving the platform, how much more of the support revenue is at risk?

Danielle Royston

I think you can just—you know, given my words around future revenue, you can still just do a straight line on the percentage, the mix of revenue that we have today to kind of work out (inaudible). I think I mentioned 70%, 80% support, so 70% to 80% of that number. It's pretty in line (inaudible), it's not outsized (inaudible).

Steven Li

So meaning all of these customers have already indicated to you they are leaving, or are you talking about maybe transitioning to the cloud?

Danielle Royston

Well, there's a set of customers who are just leaving and I think there's a set of customers that are at risk, right? I think customers listen to these calls, understand what's going on in the business, see what's going on with the letters that are flying around from our various investors, and it's difficult to make a five to 10-year decision with us given that situation, right? It puts pressure on making decisions. There is a good chunk of revenue that loves to bring up these issues with me as we're trying to sell to them, so I'm going to characterize that revenue at risk.

It's not necessarily a big group that are saying, we're leaving, here is our termination notice; but that they continue to be concerned with our ability to invest, our declining revenue makes them nervous. All these things are great excuses that they like to give us, so if they can't make a decision, we can't move forward.

Steven Li

Got it. Okay, thank you.

Danielle Royston

You're welcome.

Operator

We have no further questions at this time. I'd like to turn the call back over for any closing remarks. Thank you.

Ali Mahdavi

Thank you Claire. On behalf of the Optiva team, we'd like to thank you for joining us for today's call. We look forward to further reporting on our results in the coming months.

That concludes today's call. I'll turn it back to Claire to wrap things up. Thank you.

Operator

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