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Optiva Inc.

Fourth Quarter 2019 Financial Results Conference Call

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C O R P O R A T E P A R T I C I P A N T S

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C O N F E R E N C E C A L L P A R T I C I P A N T S

Robert Young, *Canaccord Genuity Corp.*

P R E S E N T A T I O N

Operator:

Good morning, everyone. Welcome to the Optiva Inc. Fourth Quarter 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.

Ali Mahdavi:

Good morning, everyone, and thanks for joining us for the Optiva Fourth Quarter 2019 Financial Results Conference Call.

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, it is available on the Company's website at optiva.com as well 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 via the Investors section of the Company's website. Following the presentation, we will conduct a question-and-answer 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 today. Remarks and answers to your questions today may contain forward-looking information about the 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.

I'll 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 fourth quarter results were released yesterday. Our results are presented in accordance with International Financial Reporting Standards and presented in U.S. dollars, unless otherwise noted.

The Company's fourth quarter revenues declined 15.3% to $23.1 million. The decline in revenues was mainly due to lower software and services orders as we continue to focus on customer success and invest in our cloud strategy. Support 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 fourth quarter was 65% as compared to 67% during the same period a year ago and is comparable to previous quarters after normalizing for loss provisions that were taken in prior quarters.

Total operating expenses in the fourth quarter of 2019 decreased by 53% to $11.3 million when compared to the same period last year. Excluding depreciation, amortization and restructuring costs, total operating costs decreased to $13.8 million or 60% of total revenue compared to $21.5 million or 79% of total revenue for the same period last year. The decrease in overall operating expenses is mainly attributable to streamlining our general and administrative costs by continuing to reduce professional fees, facilities and offices globally and closing down legal entities in various jurisdictions. While our total costs in research and development have reduced as compared to the same quarter in Fiscal 2018, we remain focused on specific projects that improve Customer Success and cloud innovation.

During the quarter, the Company incurred $6.3 million of costs towards R&D and cloud innovation with DevFactory, which is an affiliate of ESW, Optiva's largest shareholder. During the quarter, the Company also incurred $5 million in costs associated with its access to skilled workforce through Crossover, another affiliate of ESW.

As a result of the ongoing cost optimization and efficiency efforts, the Company generated $1.2 million of cash from operations when compared to the $14.2 million used in the same period in 2018. Cash and balance sheet management remains a priority. As of the end of the quarter, cash balance, including restricted cash, was at $37.7 million.

I will now turn the call over to Danielle. Danielle?

Danielle Royston:

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

Two thousand nineteen has been a very exciting and dynamic year as we continue to successfully execute our strategic objectives. We finished another cycle for our Customer Success program covering the period from January to June with close to 50% of the revenue reporting to us that they feel our objectives and goals are aligned with their ultimate success and that we are a key component of their growth. This 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 fix each customer on our quest to achieve 100% customer success.

We continue to invest heavily in cloud innovation and remain focused on our sales and marketing resources to maintain our position as a leading vendor in the transition to the cloud. During the quarter, as part of our $100 million cloud transformation plan, we invested $3 million on our transition to the cloud. Each quarter, we balance this discretionary investment spend against our stated objective of ensuring operations remain cash flow breakeven. Consequently, the investment spend can vary by quarter, and it really highlights our variable cost structure we've implemented with our related party partners of DevFactory and Crossover when compared to our previously highly fixed cost structure.

Our sales leads and opportunities continue to grow, and we're encouraged by the robust interest in our cloud vision from our customers and new prospects. Our flow of RFPs into the Company is significantly increased as compared to the number of RFPs we received in 2018, and so far this year, we've completed more than 20 TCO analysis.

We announced a new customer win with a customer who will be using our multi-tenant BSS platform on the public cloud. This is the first new logo we've added in close to three years. And we announced that we are engaged in a pilot program with the Vodafone Idea Ltd, India's leading telco service provider to deploy Optiva's charging engine on VIL's universal private cloud. Longer term, Vodafone Idea has plans to move to the public cloud, and I believe the large telcos will choose this route. First to move to private cloud to mitigate risk and adjust the new technology before making a leap to the public cloud. Public cloud will remain the ultimate destination for those who want to attain 80% TCO savings. We are obviously excited and thankful for this great opportunity to prove not only that our software works but we can deliver to the world's largest telco.

In summary, our migration to the public cloud strategy with major telcos is showing results and gaining momentum. Remember, it will take time but with our first-mover advantage and early adoption of the transition to the cloud, we will stand to benefit the most. While we are building strong relationships with our customers every day, as mentioned previously, we continue to review all the known departing revenue, customers who have purchased another system and are planning to swap us out, and I will reiterate that I believe runway of our core business is closer to $75 million.

For the known departing revenue, we don't know exactly when each individual customer will roll off. Our Customer Success program ensures that while they're a customer, we are focused on their success, coupled with continued poor performance from their new vendor, keeps departing customers renewing well past their expected tenure with us.

As we don't have clear visibility when the cloud growth will kick in, it's an important reality of our business to understand, and while we are fortunate to have a flexible cost structure, to ensure we remain cash flow breakeven while we live through the inevitable revenue decline associated with this transition period with departing customers.

During the past number of calls, I've discussed our ambition and desire to raise additional capital to invest in accelerating our cloud strategy. We continue to research the possibilities on this front should we elect to move forward. We will continue to prioritize our goal of investing for cloud against other discretionary spending. Focusing on customer success, managing our expenses and getting to the cloud as quickly as we can remain our top priorities. It's an exciting and ambitious strategy and we're excited to make this transition.

At this point, we are ready to open the call for Q&A.

Operator:

Thank you. If you would like to ask a question please signal by pressing star, one on your telephone keypad. If you're using a speaker phone please make sure your mute function is turned off to allow your signal to reach our equipment. Again press star, one to ask a question. We will pause for a moment to allow everyone the opportunity to signal

We will take our first question from Robert Young from Canaccord Genuity. Please go ahead. Your line is now open.

Robert Young:

Hi. Good morning. So with customer satisfaction steadily moving upwards, that $75 million of baseline revenue, are you getting more confident in that number? Or are you getting more confident that you can stay above that number? Just trying to get a sense of how realistic that $75 million scenario is.

Danielle Royston:

Rob, it's Danielle. Yes. That $75 million number what we did is we took all the known leaving revenue across the Company of all the customers and, basically, just subtracted it from—we've sort of bundled it up and figured out how much that is and subtracted it. And that assumes everyone leaves on one day. So it's a pretty pessimistic view of our business and that's kind of the way I like to plan, right, kind of worst-case scenario and make sure you have enough cash, your expenses are in line, you have a good plan and move forward from there. If it never gets that bad, then you're great, you're in good shape. It may be the case that we never see that low, that would be wonderful. But you always have to plan for the worst case that it happens all at once, and you're not surprised and you're prepared for it. So customers sometimes say that they're renewing and then they surprise you, and so it doesn't really account for any surprises. But again, we took a pretty pessimistic look, and we can touch the low water mark here. Then we have a plan against that.

Robert Young:

Okay. Then maybe backing off of that very pessimistic view, would you still say that 2020 is going to be a shrink year in the non-cloud business?

Danielle Royston:

Yes, I do. I do believe revenue will shrink again in 2020. I wish I didn't have to say that. It's a bummer but it's just a reality. The cloud revenue, the time for that to kick in, it's just a different kind of revenue, right? We're transitioning from a perpetually licensed model with a lower maintenance percentage that's charged into annually recurring revenue and its licensing and support all baked in. So the numbers are really going to change, right? You're not going to see the, sort of, like, big one-time revenue recognition. You're going to have a more steady, and we're excited about that. That's like more repeatable, dependable revenue. I think that the big dollars, we will have a higher average sales price than your average SaaS company, let's say, just because of the nature of what we're doing. But I don't believe the super big telcos are going to move to the public cloud first, right? So it's going to be the smaller players and therefore, it's going to be smaller dollars. So to build up to replace millions of dollars, $5 million, $10 million, that's going to take a little bit of time to get that momentum going. I mean I think that it will be cloud growth. I just don't think it will eclipse the growth, and so as a result, yes, it will be another shrink year.

Robert Young:

Okay. I think a couple of quarters ago you said that a baseline kind of market sizing for the cloud might be about 5% of telcos might consider it. Are you seeing that number changed? You said you're getting a lot of incoming RFPs and a lot of interest, you've had some great announcements recently, and so would you say that baseline is maybe a little higher now or carriers getting more open to the cloud?

Danielle Royston:

You know what, I don't even remember saying that now that you mention it to me. But if you would ask me again, I think, yes, it will be a higher number, and the reason, just to give you evidence of that, is really in our RFPs, we've started to see—at first, RFPs were pretty much like they were in the old days, right? We need a system deployed on premise, integrated to blah biti blah, with 15 integration—15 customizations. Just this year, I'd say in 2019, my sales department is telling me, we're starting to see RFPs with cloud requirements. Is your software cloud native? What public clouds do you support, right? Do you use containerization? What other databases do you support? And so it's kind of nice to have the messages that we've been saying for what feels like two or three years of me talking about public cloud kind of come back to be and repeated in the form of an RFP.

So I do think more telcos are thinking about the advantages of cloud, they're really starting to investigate it. This year, when I travel, I'm running into IT departments that are starting to analyze how to shift all their applications into public cloud. So I really thought this transition will be sort of a linear transition where we would keep talking about it and gradually telcos will get on board, but I see more of a step function kind of adoption, where there was like not a lot of talking and then one day, all of a sudden, everyone was talking about Kubernetes. Then no one was talking about public cloud, then everyone's asking me about GCP. So it's really like a step function adoption, and yes, I would say it's greater than 5% for sure.

Robert Young:

Okay. Then when they go through the step function upgrade cycle starting their own private cloud, can they get the benefits of GCP in that deployment? Or like there's lots of other technology to bring it to bare. But can you prove the whole TCO in this case and in their private cloud?

Danielle Royston:

That's a great question. It's really difficult to achieve TCO savings on the ground in a private cloud. Private cloud is almost like fake cloud. It's fancy on-premise system. It's pretty expensive to install. You still have to buy all the machines, you still have to have all the people, and you don't really get the software benefits of the public cloud, right? You can't really use elements of GCP on the ground. I would say there is no savings, especially hard measurable, right, where you just sort of see it fall to their bottom line. You might get some soft savings. I call them soft, they're harder to measure. But for example, you might get more utility out of your—the capacity of your servers on the ground because you're using a containerization system where you can schedule jobs on to unused compute power when you need it. So there are some savings, which are still—it's still—the cash is still spent. So I would not call it true savings.

The one exception on using GCP technology on the ground, I'd say, is Anthos, which was announced at this year's Google Next by Thomas Kurian, CEO of Google, and what it is, is this great little system that you can install in a private cloud, and it allows you to manage the compute resources in any cloud, whether it's your private cloud or any of the other multi-vendor public clouds, Google's, Amazon's, Microsoft's. And we are building our technology on Anthos because, like I said in my script, we believe public cloud is an ultimate destination, and if it is, this is the right technology to pick if you're going to go private cloud because it allows you to begin with the private cloud in a closed environment and then when you're ready, literally, sort of, like, open up a portal and start to leverage GCP resources and it makes that transition very seamless, very easy. So that's like the only component, for example, you can't use Spanner on the ground, you can't use the elastic computive (phon) GCP on the ground, but if you're using Anthos, it starts to open that up, and so we're a big fan of that.

Robert Young:

That's a lot of great information. Thank you. Then last question for me would be around, you said you're scaling the R&D spend based on your quarterly cash flow breakeven. Are you seeing enough market adoption that you'd like to accelerate that a little bit now? Or are you still going to stick with that scaling of the R&D spend using a crossover and the other vendor?

Danielle Royston:

Yes. Yes. No. If I had more money to spend, I could spend more money in product. I mentioned it again in my talking points that we continue to look at raising additional capital, and we're looking at all different ways to do that. We have a little bit of the luxury of time, right? We're not, like, in dire need of it. We're managing our own expenses. We're self-funding our investment. But, yes, if I had more money, I would probably spend it in two areas, right? Accelerating my product investment, right, getting more product out faster, and then I would probably spend it in sales and marketing. I'd have a bigger sales team. I would host more webinars. I would go to more shows. So there's a lot of things that sort of are on the DRS shopping list that I wish I could spend more money. But right now, we are running cash flow breakeven. We're serving off some discretionary spending that we would otherwise return as profit or using that profit to invest in our future. I think our vision is pretty strong and sound. It's well received and starting to get traction, and if we had more money, I think we could go faster.

Robert Young:

Okay. Maybe the last little one. The cash on the balance sheet. How much of that do you need to keep there? I mean you're trying to sell to big telcos. They like to be a strong balance sheet and presumably need some for operations. How much of that balance sheet cash can you spend? And then I'll pass it on.

Danielle Royston:

Yes. I think in this year we need a little bit extra cash more than usual for working capital. We had some open litigations, we had some trapped money in certain countries that take a long time to get out. And we're simplifying our operations, and a big part of that plan is—as Anin mentioned, is reducing the number of entities, which shockingly takes forever to do, you'd be so surprised how long it takes to, to unwind an entity in some of these countries. I believe actually starting this quarter, we're going to start to see that cash balance kind of reduce, we've simplified some things and cleaned up some stuff, and we're going to use it to run an efficient business, pay off some debts that we have, a payment here and there that's overdue and maybe spend a little bit more on dev and sales and marketing, right? We're going into MWC next quarter. So I will see you there, hopefully I'll see you there again, but the end of February, we'll be at MWC. So we're right in the thick of, should we buy a banner in the hallway? Should we do a digital truck outside of the south entrance kind of stuff. I'd say, yes, we'll use some of that cash, and we think we can take it down a little bit, and we'll continue to be really conservative on that to make sure that we have enough cash to run our business, don't want to run out of money but then using it for our investments.

Robert Young:

Okay. Thanks. Great to hear the positive attitude and still rational but more positive. Thanks.

Danielle Royston:

Yes. Thanks.

Operator:

There are no further questions at this time, I would like to hand the call back to Ali Mahdavi for any additional or closing remarks.

Ali Mahdavi:

Great. Thank you, Operator. On behalf of the Optiva team, we'd like to thank you for joining us on today's call, and we look forward to speaking with you again on our next quarterly conference call and keeping you up to date on the developments in the Company. That concludes today's call.

Operator:

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