Company: Calian

Conference Title: Calian’s First Quarter results

Moderator: Kevin Ford

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Operator: Good day ladies and gentlemen and welcome to today’s Calian's First Quarter Results Conference Call. As a reminder, today’s call is being recorded. At this time, I would like to turn the conference over to your host for today Mr. Kevin Ford, Chief Executive Officer. Mr. Ford, please go ahead.

Kevin Ford: Thank you Sarah. Good afternoon ladies and gentlemen. With me today is Jacqueline Gauthier, our CFO. We would like to welcome you to Calian’s First Quarter 2019 Conference Call. Despite mixed results this quarter; we’ve achieved several positive metrics with our largest quarterly revenues in the company history, as well as 20% growth in the profitability of our BTS division. The SED division continues to be very busy in all segments with a focus on current projects and new technology innovation.

In support of our customer retention pillar, we are very happy to report this quarter the re-win of our Canadian Army Simulation Centre contract with an initial value of 93 million and with options factored in, an aggregate contract value for the full nine-year period of approximately CA$170 million. With a duration of up to nine years, this win has helped grow our contracted backlog to CA$1.3 billion, which is a very strong foundation to support our growth agenda. Factoring in the CASC contract, our contract signings exceeded over CA$200 million this quarter, again another strong sign that our sales efforts are working.

I will now ask Jacqueline to review the quarterly numbers. Over to you Jacqueline.

Jacqueline Gauthier: Thank you Kevin. As Kevin mentioned, results for this first quarter are mixed. Our BTS division saw continued improvements in revenues and EBITDA, from strong performance and demand in all of its market segments. The SED division recorded a slower quarter than the prior year, driven by a few projects moving to the right and a slightly less favorable revenue mix in the quarter. However, these results do not change our outlook for the year as we continue to expect strong performance from both divisions. We also expect contributions from our most recent acquisitions, IntraGrain and Secure Tech to increase in the remaining quarters, due to seasonality of their business where the first quarter activity is typically minimal.

The profit for the quarter was CA$0.43 per share compared to CA$0.54 in the prior year; impacted by SED results, the negative impact of seasonality of IntraGrain and Secure Tech acquisition, the amortization of intangibles and the accretion of interest expense related to these two acquisitions. If we were to exclude the negative impact of IntraGrain and Secure Tech in this first quarter, net earnings per share would have been CA$0.50.

For the first quarter of 2019, revenues were up 5% from the prior year. The general business environment in 2019 is strong in both divisions. The company's healthy backlog and its recent acquisitions should provide for a solid year. SED revenues were down 16% this quarter. Although the division continues to work with a solid backlog of work, some ground system contracts are still ramping up.

Product sales continue to provide solid recurring revenues and interest continues to grow with some of our newer products, with new customers entering the mix. SED's other business units continue to be busy in a range of activities. IntraGrain activities did not play a major role in revenues this quarter, as its business is seasonal, and most of its activities will be reflected in the third and fourth quarter.

BTS revenues increased 13% this quarter. The acquisition account for only 4% of the growth with the remainder achieved through organic means. All service lines showed solid increase and demand for their services with existing customers and saw the benefit of various new wins. Gross margin continues to show an overall positive trend and was up again this quarter. Gross margin and SED, although less than in the same quarter of the previous year, was still respectable. It reflects solid execution across all business units, impacted by customer-driven development projects that until fully developed, result in lower margin.

In addition, the influx of new resources to fulfil project requirements continues to have an impact as these resources continue to be trained and ramped up. Gross margin in BTS continues to show improvement with most of the uplift being attributed to solid execution on existing contracts with new acquisition only accounting for approximately 0.2% of the increase.

Operating expenses have gone up. The costs have increased over the prior year due to the inclusion of the acquisition, Secure Tech, Priority One and IntraGrain; as well as continued focus on selling and marketing efforts and service line evolutions; improvements and expansion in our facilities; the expensing of share-based compensation in addition to certain one-time costs. We will continue to challenge discretionary spending; however, continued prudent investments are required to support the evolution of the company's service line. Our net cash position is now at CA$8 million following the acquisition of IntraGrain. Cash position in the near term will be impacted by additional working capital requirements at SED and the remaining payments due on our acquisitions.

Finally, please note that certain information discussed today is forward-looking and subject to important risks and uncertainties. The results predicted in these statements may be materially different from actual results. I'll now turn the call back over to Kevin.

Kevin Ford: Thank you Jacqueline. I really believe that Calian is at a pivot point in the company's history as we continue to invest in R&D and headcount to drive long-term growth for the company. Our innovation agenda is focused on new product development, developing tools to support our professional services in areas such as emergency management training; and also entering new customer segments. This quarter we invested another CA$650,000 in new product development and continue to increase our delivery in go-to-market resources to ensure that we have capacity required to support our growth. Our M&A agenda also continues to be a focus, with current priority being the integration of IntraGrain, Priority One and Secure Technologies that we completed last fiscal year.

We continue to proactively search for companies to support our growth objectives as we look to diversify our customer reach as well as evolve our services. I am also happy to report that our health service line with our business partner, Bayshore, has successfully completed the start-up phase of the healthcare-provider requirement contract with National Defense, launching the in service phase of this contract with DND, RCMP and Veterans Affairs. At now 69 consecutive profitable quarters, strong cash flows, a continued focus on our innovation agenda and our dedicated employee base, I am confident we will continue to make progress against all elements of our four-pillar strategic growth framework.

I also would like to acknowledge that this will be Jacqueline's last conference call as Calian CFO. On behalf of our board of directors, our shareholders and our staff, I want to thank Jacqueline for her dedication and years of service at Calian. Anyone who knows Jacqueline respects her work ethic, her passion for growth and her outstanding ability to manage a complex, financial, publically traded organization. She can be proud of her work here and the legacy she will leave with the company.

I am happy that she has agreed to stay on for a period of time to facilitate transition to Patrick Houston and as well support elements of our growth strategy. I would also like to formally

welcome Patrick to the Calian team. Patrick is a seasoned CFO and I am confident will bring an excellent toolkit in the CFO role to support Calian's profitable growth strategy.

In closing, traditional markets in which Calian operates are stable and management expects organic revenue and earnings growth in most or all of its service lines through the successful execution of our growth strategy. However, we must caution that revenues realised are ultimately dependent on the extent and timing of future contracts, as well as customer utilization of existing contract vehicles. Based on currently available information and our assessment of the marketplace, we expect revenues for fiscal 2019 to be in the range of CA$330 million to CA$360 million: EBITDA per share in the range of CA$3.60 to CA$3.90 and net profit in the range of CA$2.10 to CA$2.40 per share.

So with that I'd like to now open the call to questions, so Sarah, can you please open the lines for questions?

Operator: Absolutely. To the audience, if you have a question or comment today, please press star then one on your touch-tone phone. For those of you joining us today using a speakerphone, please make sure your mute function is turned off to allow your signal to reach our equipment. Once again to the audience, please press star then one if you have a question or a comment today. We'll go first to Deepak Kaushal of GMP Securities.

Deepak Kaushal: Oh hi guys, good morning. Thanks for taking my questions. Kevin... Jacqueline, I just had a quick question on the slowdown in SED. Is that related to the record satellite contract that you guys announced previously, and is there any changes – if so any changes to the 36- month ramp-up period for that and the expectation for 66% of that to come in 2020?

Kevin Ford: Hi Deepak, it's Kevin. So from my viewpoint, slowdown not necessarily with regard to SED, I think it's just the reality of what we're doing with this from a project schedule as we look at

the phasing of that program, which we announced last year, the largest ground system contract as you're referring to for SED. It's really just a schedule timing issue right now from my perspective. There is a lot of work going on with new technology there that frankly is quite exciting. So we're monitoring that project very closely.

So I wouldn't categorize it as a slowdown. I think it's just basically the reality of the mix of projects, so where we're ramping projects up, ramping other projects down. The division right now is extremely busy across all segments. So I don't really think it's a slowdown, I think we're just dealing with more of a timing issue.

Deepak Kaushal: Okay. Okay great. And then can you maybe perhaps discuss beyond that contract, particularly related to the satellite industry, what are you seeing in that environment of late compared to this time last year?

Kevin Ford: I'm still... we're still seeing lots of opportunity, frankly, as we... based on two factors, frankly. Number one is that our legacy customer base continues to come back to the SED division, whether it's for upgrades to current systems or for new mandates. So our current base has continued to be very loyal and I think that has just been deserved by the fact of the excellent delivery we've had over the years.

And then secondly, when you look at the innovation agenda at SED, I think a lot of people continue to look at SED as primarily a satellite segment, which I understand because certainly it has been that. It's just a reminder. The other segments we serve right now, the aerospace and defense is again going very strong with the acquisition of IntraGrain now in the AgTech piece, we believe we're just at the start of that journey and very excited. That market by our market research is growing 12-13% a year and we're just starting to entering that segment. So we believe there is huge opportunities there as well for the company. So even with our core satellite

business, it's good, our aerospace business is good, and then now the AgTech piece it's... we're pretty excited about where that could go for SED.

And the last point I'm going to make is just on the research and development we're doing at SED, there is other segments we're looking at beyond those three. So I'm still very positive where we are with SED across its broad spectrum now of customer bases as we move to not just a satellite core. So hopefully that answers your question.

Deepak Kaushal: Yeah, it does, thank you. Just going back to timing. I think Jacqueline mentioned seasonality at IntraGrain, sorry, pardon me, at IntraGrain, but I think in your press release you also mentioned seasonality in Secure Tech. I'm just kind of curious, is there seasonality impacting the revenue portion for that acquisition? Or maybe you can give out more...

Jacqueline Gauthier: Yeah, so they tend... they sell quite a bit to the government, so they tend to have a very high Q2. So they do a significant portion of their annual revenues in Q2. So both IntraGrain and Secure Tech had a negative impact in Q1, but we are very confident that they are going to pick that up in the next quarters, so Secure Tech in Q2 and IntraGrain in Q3, Q4.

Deepak Kaushal: Okay, and in terms of Secure Tech, is that something that is standalone versus things like DWP that you've acquired in the past? Or are you guys able to integrate and get some synergies around the cybersecurity acquisitions you've made over the past few years?

Jacqueline Gauthier: Yes, so we actually purposely integrated Secure Tech immediately with Calian, so they're part of our cyber team. And both Calian, Secure Tech and the DWP portion are all working together to attack new markets, to get into new markets.

Deepak Kaushal: Okay. Okay, excellent. And then Jacqueline, just on the cash flow side. You mentioned some increasing working capital requirements in SED. I'm just kind of looking over the

past few years EBITDA to cash from ops conversion, it bounces around quite a bit on an annual basis largely due to working capital requirements. What should we expect over the next two years in terms of... if we're taking round numbers, then you're doing about CA$30 million in EBITDA. How much can we expect that to convert to cash from ops and rebuild your balance sheet?

Jacqueline Gauthier: So basically the main element of our working capital is that large contract at SED that's going to be running for the next 36 months or so. We're expecting working capital requirements between CA$10-15 million at its peak so that's going to show up in the next few quarters for sure. And then once we get past the middle point of that contract, things should start reversing, and we're expecting that in the last 12 months we should be working capital positive on that project.

Deepak Kaushal: Okay, and when you think about capital structure – I know perhaps maybe this is a question for tomorrow's Investor Day and Mr. Houston – how do you think about debt to EBITDA and that kind of ratio in terms of returns? What are you guys comfortable with? Can you remind us?

Jacqueline Gauthier: So we've always said one to two times and I think that's going to stay for a while. It's something we discuss at the board on a regular basis, and I think we will just evolve as we continue to do acquisition and require additional cash, but for now this is what we're targeting.

Deepak Kaushal: Okay. Okay, thanks so much for taking my questions. I look forward to seeing you guys tomorrow.

Kevin Ford: Great, thanks Deepak. Appreciate the questions.

Operator: And once again to the audience, it is star then one for questions. We'll go next to Benoit Poirier of Desjardins Bank Capital Markets, excuse me, please go ahead.

Benoit Poirier: Yeah, thank you very much, and good morning Jacqueline, good morning Kevin.

Jacqueline Gauthier: Good morning Benoit.

Benoit Poirier: Yeah, just to come back on the large satellite ground system contract, just want to make sure that there was basically minimal contribution in Q1, and is the ramp-up still expected in Q2 mostly with the bulk reported or recorded in fiscal 2020 next year?

Jacqueline Gauthier: Yes, so we haven't changed the profile of that contract, so it remains the same as what we provided last time. So it's on track. I think it's just that there is quite a few players that are ramping up. We have a lot of suppliers that require to do some setup in getting ready for this contract. So I think right now everybody is in that phase of getting ready for the first milestone, but there is no indication that things are going to significantly slide to the right on that contract.

Benoit Poirier: Okay, and looking specifically for SED, Jacqueline, revenue or EBIT how should we look at the ramp-up over the next few quarters? The biggest increase will be done in Q3, Q4 or are we going to see even a good improvement in Q2 for SED specifically?

Jacqueline Gauthier: We don't provide guidance on a quarterly basis, so I'd hesitate to give any details there, other than we feel very strongly that SED is going to have a good year. And you have to cut off on the last day of a quarter end, and sometimes things are done and sometimes they're just not quite done. So it's very difficult to assess a quarterly number, but we feel confident about the year.

Kevin Ford: Just a reminder. From my viewpoint too, Benoit, I know the large ground system contract will take a lot of the focus over the next period of time as we deliver that and push our project through to delivery. But I'm also very positive on things happening outside the large contract, the research and development and our product development in certain areas, whether it's in [inaudible] or even cable and some of the areas and then IntraGrain as well.

So we appreciate, as I say, the size of our program, but I think for SED for the year it's going to be a combination of clearly that program as well as I think the other projects that are running right now, that are really, frankly, quite exciting in the innovation they're going to be bringing to the market, so...

Benoit Poirier: With respect to the working capital ramp-up that you talk about, the CA$10-15 million at the peak, where would you be at right now or what remains to be done in terms of ramp-up, in terms of working capital, Jacqueline?

Jacqueline Gauthier: I think we will be ramping up to that, let's say, CA$12.5 million by next quarter or beginning of the following quarter, so we're getting into that phase now.

Benoit Poirier: Okay, so basically you haven't ramped up the working cap yet, so there is another

CA$12.5 million, let's say, increase in the coming quarter or two?

Jacqueline Gauthier: No, we've started ramping up. It will be at our peak in the next quarter.

Benoit Poirier: Okay, okay.

Jacqueline Gauthier: In the most [inaudible], so probably a year.

Benoit Poirier: Okay, perfect. And for the guidance, obviously there is intangible, the accretion interest expense. Just want to make sure that the CA$210-240 million[?] basically take into account the amortization and the intangible in accretion interest expense. Am I right here?

Jacqueline Gauthier: Yes. Yes, it includes everything.

Benoit Poirier: Okay, and accretion interest expense, is it something that we should see in the coming quarter or it's basically just the one-time item?

Jacqueline Gauthier: So it's... it gets accrued over a period of two years. It relates to the earn-outs. So when we set up our earn-out liability, we need to discount it and then we need to bring it back up to the full amount at the time that it needs to be paid out. So whenever we have earn-outs, it's going to be consistent with the timing of the earn-out. So you will see this one on IntraGrain for the next two years.

Benoit Poirier: Okay, and basically should we expect kind of a similar amount to be recurring in the coming quarter?

Jacqueline Gauthier: Yes, so we acquired IntraGrain November 1st, so we have two months in this quarter. So we'll have three months in the following quarters.

Benoit Poirier: I see, and that would be stable over a two-year period. Okay, perfect.

Jacqueline Gauthier: More or less.

Benoit Poirier: Okay. Okay, perfect. And any impact from the IFRS 15 in terms of revenue recognition? Is there any impact at Calian?

Jacqueline Gauthier: Yes. So there is... the main impact is on warranty. So if you've looked at the financial statement, you'll see that for the... we restated last year. And over the course of the full year fiscal 2018, we will be recording an extra CA$0.5 of earnings per share, and it relates to having to record cost and revenue associated with warranties sooner that we did under the old rule. So that's the main impact.

Benoit Poirier: Okay. Is there an impact for fiscal 2019 though, Jacqueline?

Jacqueline Gauthier: Well, looking forward, it's hard to assess the impact because we'd have to do it the old way and the new way to see exactly what the impact is. Basically, we're using the new rules now. So in theory, if you take that further, we continue to recognize cost and revenue sooner on those warranty projects. So in terms of timing difference, there shouldn't be any, other than the mix of projects we have at any given time.

Benoit Poirier: Okay. So it's not like it's providing a big boost on the EPS for fiscal 2019, let's say?

Jacqueline Gauthier: No.

Benoit Poirier: Okay, perfect. And the last question for me. If we talk about the health services contract, would you be able to quantify what is the run rate and any colour about further ramp-up that that could be done with the other departments?

Kevin Ford: Yeah. So right now, that contract on any given year and again it goes up and down, but generally we're seeing the run rate in that CA$75-80 million range. The new customers that are coming through the new contract with RCMP and Veterans Affairs are ramping up. I think we've seen more uptake initially in Veterans Affairs and RCMP is not far behind. So we're still...

the primary customer right now is still National Defense and as Veterans and RCMP, number

one, grow aware of the contract, number two, understand how to use it nationally, we continue to see increased demand on that... on those segments as well.

Benoit Poirier: Okay, perfect. So CA$75-80 million in terms of run rate and Veterans Affairs is more advanced than RCMP in terms of ramp-up, right?

Kevin Ford: Yeah and again, just a... it's a smaller piece of that. The major customer is defense, for sure, and Veterans Affairs and RCMP, as I said, they're just now looking at a national governance around the contract. So we'll see... we'll see that... expect that to ramp over the next couple of quarters, but I wouldn't put it in any significant way at this point.

Benoit Poirier: Okay. Thank you very much.

Kevin Ford: Thanks Benoit.

Operator: And as a final reminder to our audience today, it is star then one if you have a question or comment. From Acumen Capital we'll go to Brian Pow.

Brian Pow: Good morning everybody.

Kevin Ford: Good morning Brian.

Brian Pow: Jacqueline, I just wanted to clarify again. You indicated that the seasonality related to IntraGrain would have impacted net income by about sort of CA$0.07. Is that what I understood from your comment?

Jacqueline Gauthier: Yes.

Brian Pow: Okay, and so is it really just in sort of the Q1 that they're, I'd say, in a loss position and then they ramp up for the balance of the year and be profitable?

Jacqueline Gauthier: So IntraGrain will tend to be in a loss position for Q1 and Q2 and then most of the revenues are in Q3, Q4. And for Secure Tech, they tend to be in the negative position for Q4, Q1 and they do most of their revenue in Q2 and the early part of Q3.

Brian Pow: Okay. And do you expect that to change in the... at any time in the future or will that always be the case?

Jacqueline Gauthier: Based on the existing business, that would stay similar. But obviously we're trying to expand in different areas, so that should be lessened in the future in terms of the impact.

Brian Pow: Okay. Alright. And then just switching to again the working capital. So again on the... on that SED contract, it sort of peaks at CA$10-15 million and sort of sits there. So again that's sort of like a work in progress. Is that the best way to think about it?

Jacqueline Gauthier: Correct. So on that project, we have to deliver approximately 20 units. So we always tend to be a few units behind in terms of getting the payment for the work that has been done. So initially we ramp up, then we continue to do work, but then we're paid on the previous units so that's why it stays at the CA$12-15 million for a year.

Brian Pow: Okay. Can you... then again just further on the working capital. Can you give us a little bit more insight on sort of the remaining payments on the acquisitions, sort of what you expect this year or next year?

Jacqueline Gauthier: So if you look at the balance sheet, we've got contingent earn-outs of about CA$8 million. I would say that more than half of that will be paid in the next year and then the remainder the following year.

Brian Pow: Okay, great.

Jacqueline Gauthier: Probably 60% this year.

Brian Pow: Okay, thank you. All right. Look forward to seeing you tomorrow. Hopefully the flights will allow us to get into Toronto, so enjoy your travel today.

Kevin Ford: Yeah, thanks, thanks Brian. We're getting pings[?] all over the place from people trying to get into Toronto. So if anyone is travelling today, if I suggest you get to the airport or jump to a train for those who have that option. Okay. Any other questions, Sarah?

Operator: No, it appears we have no further questions at this time.

Kevin Ford: Okay, that's great. So thank you everyone for attending the call today. I appreciate the questions, and I guess the next call will actually be Patrick and I sitting here talking about the next quarter results. So look forward to that discussion and I'll talk to you then. So Sarah, with that, we can close the call.

Operator: Thank you. And again ladies and gentlemen that does conclude today's conference. We thank you all for joining.