

Transcript of
Calian Group Ltd.
Calian Third Quarter 2022 Conference Call
August 11, 2022

Participants

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Analysts

Amr Ezzat - Echelon Partners

Deepak Kaushal - BMO

Michael Kypreos - Desjardins Bank

Presentation

Operator

Good morning ladies and gentlemen, and welcome to the Calian Third Quarter 2022 Conference Call. At this time all participants have been placed on a listen-only mode, and the floor will be opened for questions and comments after the presentation.

It is now my pleasure to turn the floor over to your host, Mr. Kevin Ford, CEO and President. Sir, the floor is yours.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Thank you, Alley. And good morning, everyone. I welcome you to Calian's Q3 fiscal year '22 earnings call from Calian's headquarters here in Ottawa, Ontario. With me is Patrick Houston, our Chief Financial Officer.

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'm pleased to report another very strong quarter for Calian across several key performance metrics. Despite the pandemic, the Ukraine conflicts, and supply chain shortages, Calian continued our growth momentum. In Q3, we achieved our highest quarterly revenue to date. We achieved record gross margins. We continue to expand into the U.S. and Europe. And we continue our journey to diversify our customer base.

So let me elaborate. Gross margins this quarter were 30%. This is an all-time high and represents a significant milestone. Two years ago, our gross margins were 21% and through our efforts organically and through M&A, we have made significant progress. Revenue was also at an all-

time high level of \$150 million. This performance was even more impressive given supply chain slowdowns and project starts being delayed.

You've heard me speak frequently about our efforts to diversify our revenue both geographically and by sector. Just a few years ago, more than 70% of our revenues came from government of Canada. As of this quarter, commercial revenues have outpaced government revenues, and our expansion at the U.S. and Europe continues to go very well. We're able to do this while continued to grow our legacy Canadian government business. Each of these milestones is a significant indication of our strategy and action, and further motivates our team to continue to execute against our plan.

As a reminder our four pillar growth strategy contains of innovation, continuous improvement, customer retention, and customer diversification. Last quarter, we launched our innovative digital health platform. In Q3, we partnered with a precision health care company that will leverage our digital health care platform to deliver the product to Canadians more on this later.

You've also heard me speak about our goal to be a billion dollar company. And we continue to improve invest in technology that helps us scale and grow our organization in an efficient manner. Our customer retention efforts are the foundation of our business.

In Q3 our ability to rewind mandates with existing customers remain strong. Of the \$190 million in new contract signings, \$90 million were customer renewals. As mentioned, our customer diversification strategy continues to achieve momentum this quarter, and contributions of Computex and SimFront posted impressive results, which helps us expand our revenues into the U.S. and Europe.

Our four piston engine model offers diverse solutions to markets around the world. Our four piston engine consists of advanced technologies, health, learning and IT and cyber solutions. Advanced technology to health faced headwinds in Q3, also learning and ITCS clearly had tailwinds. It showed the strength of our diversification this quarter again, and still generated record revenues and record gross margins, despite those headwinds.

I will now share an update on each of our segments. The ITCS segment posted impressive revenue growth of 109% this quarter, and a 76% increase for the nine month period ended June 30, 2022. Gross margins increased 15 percentage points and profitability increased 115% in the three-month period.

Our strategy to first become a leading provider of information technology and cyber and to be able to meet customers' needs across Canada and United States as delivering results and resonating with the customers. We're also increasing our reoccurring revenue streams, as more customers adopt our managed services platforms.

I'd like to share a few of the customer stories to demonstrate our ability to provide high quality services across many IT sectors and help those customers execute their business objectives. Coterra Energy is a U.S. based gas and exploration company that is quickly expanding. We've

partnered with them to support several initiatives from hardware infrastructure and network support to more recently rolling out our security operations center.

Our sockets of service offering for Cottera provides an artificial intelligence and human integrated threat hunting, awareness training, and most importantly remediation when a cyberattack happens and is available 24/7.

Omni Logistics is a rapidly growing global supply chain logistics company and a very competitive intense supply chain management sector. Omni partnered with Calian as we understood the complexities of a global environment, and offer them the ability to quickly bring on new logistical sites as their business expanded.

Italian experts met with Omni team to evaluate current and future needs and help them construct a comprehensive plan to support their fast paced journey. We are now building, configuring and deploying the first phase of the solutions from a logistics. This customer stories demonstrate our ability to provide high quality services, which gains customers trust to partner on additional capabilities and our broad product portfolio.

Today, our ITCS offers cybersecurity to enterprise cloud migration demand services, we listen to the complex challenge that our customers faced and offer them solutions. Solutions that cross all four of our operating segments. For example, our ITCS segment, our health segments are a great example of how we work together to cross sell. The two segments came together invested R&D and a virtual care delivery platform. And we were honored to be recognized in this quarter by Microsoft Canada, who awarded us -- who awarded Calian their 22 Health Care Impact Award.

Moving on to Health. Our Health segment saw tremendous demand at this time last year as we help Canadians respond to COVID-19. As our work ended, the demand normalized. Our ability to replace that revenue with contributions from different parts of our business, like the ITCS segment, speaks to the success of our four piston engine and diversification agenda.

Revenue contribution from the health segment was \$40 million, which was down 22% from this time last year. 14% of that decline was attributed to the reduced need for COVID related services. In addition to the declining COVID-19 response engagements, the company saw slow demand for patient support programs and clinical research as projects came to an end, and new initiatives have yet to kick off.

Despite the reduction in revenue during this transition period, we remain optimistic about our market position and have a three pronged approach to drive future growth. The first is technology. Calian Nexi is an example of innovative technology that resonates in the healthcare market. It transforms healthcare delivery using automation, analytics, and machine learning. And Nexi can enable the healthcare industry to be more productive as it deals with less resources.

The second is further focus on the pharmaceutical market. This quarter Sensar, Inc, announced that Canada or Calian will provide the technology platform and nursing network for the mobile test administration of Syantra's innovative blood test that can identify breast cancer.

As pharmaceutical companies develop innovative and life changing solutions, Calian is well positioned to help them develop and bring those medications to market. The losses diversification we're expanding our current offerings into the U.S. and looking for M&A targets to further accelerate our market traction.

Before we move on to the next segment, I want to reiterate and say how proud I am for our efforts from our team that they've demonstrated over the last two years of COVID as a help Canadians respond to the pandemic. Calian and our staff remain on ready so that we can step up quickly to help Canadians again if needed.

For Advanced Technologies, we saw this segment revenue decreased 11% year-over-year. We ended the quarter with revenue of \$39 million. In our space division we have seen the timing from our feet of contract awards and project commencement lengthen.

As we near the conclusion of some of our existing contracts, new initiatives have yet to begin. We have partially offset this by an increased demand for our software services, which now has the largest backlog of work that we have ever recorded.

Despite this, we have managed to replace these revenues with sales at significantly higher gross margins in our terrestrial division. Our entry into the GNSS antenna sector continues to be the highlight in Q3. Demand in multiple markets, including electronic vehicles and mining continue to be very strong with an increase of 57% compared to the same quarter of the previous year.

Our nuclear business continued to do well in Q3. We're also working with customers on new band aids, including analysis of small modular reactor technology. Part shortages continue to be an issue slowing down our delivery speed for our hardware based solutions. Our teams are working hard to find the solutions to bring those key parts into practice and catch up on our backlog.

Moving forward we will organize the Advanced Technology segments to ready ourselves to respond to ever evolving market demand. The segment is now organized into three areas of business space, defense, and terrestrial as we believe this focus will support our growth objectives and provide focus on key marketing segments.

And finally our Learning segment showed considerable revenue and margin expansion in the quarter. Revenue increased 23% compared to last year and close the quarter at \$22 million. In the last 12 months learning as achieved a revenue of \$87 million it is on track to break the \$100 million year level for the first time in company's history. This has been the results of our expansion into Europe as well as expansion of our services to introduce more technology assets into our trusted and experienced delivery methods. Gross margins continue to track in the right direction ending at 26% this compares to 23% in fiscal '21.

Our acquisition of SimFront and SimWave continues to be a highlight. Technology assets and synthetic learning environments as well as our virtual reality and augmented reality have allowed us to expand our Canadian presence within militaries and commercial customers.

Now our Chief Financial Officer, Patrick Houston will discuss results and key performance indicators. Over to you Patrick.

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Thank you, Kevin. This quarter saw our balanced performance across the four segments. When put together resulting in several of our key performance indicators at all-time highs. Revenue was up 10% versus the same period last year. This is in line with our objective to deliver consistent double-digit growth. But perhaps more importantly, we've been able to expand our margins ahead of our revenue growth. This has been through multiple initiatives which have offset cost pressures we have seen due to current economic environment.

We also managed to record \$190 million in net new contract signings, which will help us as we enter FY '23 starting in October. This also continues our recent trend of new signings exceeding our revenues and maintaining a strong backlog position across all four segments.

As Kevin mentioned, our diversification efforts are showing meaningful progress quarter-over-quarter. Both our legacy government business and our commercial business are now equal contributors and we still see the ability to grow both of these in coming years. Business outside Canada now has reached 33% of our overall revenues. We continue to see M&A opportunities to help our efforts to grow business in Europe and the United States.

Our recent acquisitions in cyber, learning, and GNSS antennas are performing above expectations and delivering strong results. This has helped offset revenue reductions year-over-year due to COVID response work coming to an end in our health segment.

Our cash performance was strong this quarter. Cash flow from operating activities was just under \$20 million. This was through strong business performance as well as positive working capital of \$8 million. After earn out payments of \$5 million, and dividend and CapEx we ended the quarter up \$9.4 million on net cash as compared to Q2 of this year. This puts us in a strong balance sheet position to continue to execute our strategy of organic and acquisitive growth with committed debt and cash on hand of over \$120 million and the ability to further expand this liquidity with our current lending syndicate. This balance sheet strengths and track record of profitability and excellent cash flow conversion will be an asset as we continue to allocate time and effort on our M&A agenda.

With one quarter remaining in our 2022 fiscal year, we're still on track for another record year our fifth consecutive all time high performance. Adjusted revenue down to reflect a few factors. The first being delays and signings of new work in our space division of advanced technologies and our Health segment. And the second being supply chain delays preventing us from fulfilling orders in Advanced Technologies and ITCS. We now expect revenue in the range of \$560 million to \$585 million.

We have maintained our EBITDA guidance reflecting stronger gross margin momentum as seen in this quarter's performance, as well as pacing our investments on various organic growth initiatives. EBITDA remains in the range of \$61 million to \$65.5 million. Adjusted net income

has been increased to reflect more favorable tax effects as our business expands internationally as well as reduction in costs below EBITDA. We now expect adjusted net income in the range of \$44 million to \$48 million.

Finally, I must caution the revenues and profitability realized are ultimately dependent on the extent and timing of future contract awards, customer realization of existing contract vehicles and any impacts due to COVID-19 and the conflict in Ukraine. Our guidance does not incorporate any additional M&A activity and should we close any new opportunities and their contributions would be incremental. Please see our press release and MD&A for a detailed reconciliation of our guidance.

I'll now turn the call back over to Kevin.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Thank you, Patrick. I want to once again thank our staff as Calian for the amazing efforts over the past couple of years through pandemics complex economic uncertainty. I am extremely proud of this amazing team for their dedication and commitments as we execute and work hard to deliver yet another record year for Calian. From time to time, we've received questions about our ESG strategy. And we're looking forward to publishing our inaugural ESG report later this year, along with our Q4 results in November. We have a strong balance sheet to execute capital deployment on our M&A agenda, and as I look forward, we will definitely be leveraging that position of strength.

We will continue to introduce technology across all of our existing customer base, new market verticals to differentiate our offerings and maintain the gross margin record that we set this quarter. We will continue to increase our recurring revenue models across all of our segments. And we are going to continue to expand into new markets across Canada, demonstrate market leadership across all of our four segments that will lead to significant cross sell opportunities in the future as we've seen those opportunities daily.

Speaking of leadership in the future, I'd like to take this opportunity to give you an update on our management team. Jerry Johnston, our CIO has decided to retire from Calian. His many contributions to Calian have been significant across many of the leadership roles he has performed for Calian. I also want to personally thank him for his support to me and my transition as CEO, as well as his valued input and guidance since my arrival at Calian. All of us at Calian wish Jerry a healthy and happy retirement. I'm happy to announce today that replacing Jerry will be Michael Molnar [ph].

Mike will begin in September and brings with him a host of technology international business experience. And we really look forward to his leadership in the CIO role. Welcome, Michael. As I know you're listening. Gordon McDonald, President of our Health segment has recently announced his plans to retire in 2023. We will shortly begin a search for Gordon successor. And while Gordon continues to lead our Health segments until a suitable successor is found. And again, more to come on this. But again, Gordon, thank you for your leadership over the years. I

look forward over the next nine months to work with you on a successful transition. And with that, Ally, I'd like to now open the call to questions. Please open the call for questions, Ally.

Operator

Thank you. Ladies and gentlemen, the floor is now open for questions. [Operator Instructions] Thank you. Our first question is coming from Amr Ezzat with Echelon Partners. Please go ahead.

Q: Good morning, Kevin and Patrick, thanks for taking my questions. Can you give us a breakdown of the main moving parts, that result is of the revenue guidance revision, does it mainly stem from the space division which could be very lumpy or are there other areas that's caused that guidance revision?

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Yes, big space. Certainly there's two major factors Amr, the first one space obviously that is along to our business with bigger projects, generally lower margin profile. So we did see some of those, which we expected to start in Q4, if it had gone to the right, and then help we have won some new contracts this year. But the pace at which they've started has been slower than expected. So I think those two things kind of contributed to a pretty slight reduction in our revenue, I think we're still going to finish strong in Q4. And we offset that obviously with higher margin.

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

And Kevin, just want to comment [indiscernible]. The other element we are dealing with frankly, we have a backlog of stuff to ship here. And both in Advanced Tech and ITCS. And we were literally waiting for parts. So again, I wanted to take a conservative posture on the revenue guidance. If these parts and everything comes in, I'm confident we're going to continue on our growth momentum on revenue. But the one thing I've always promised shareholders is honesty in the context of transparency. So right now I'm just concerned on the supply chain on some of that backlog.

So we do have quite a bit of backlog. I'm just not confident, we're going to be able to relieve that backlog between now and Q4. Hence why I wanted to bring down that revenue guidance slightly.

Q: No, that makes sense. I mean, what's pleasantly surprising to me at least is that you've maintained your EBITDA guidance despite being in a very high inflationary period. Can you comment on that? What's surprising you to the upside is it really the IT side which continued to perform extremely well.

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Yes, absolutely. IT has been performing well and helping on the margin side. I mean, we are seeing some of the cost pressures. I mean, we're not unique or anything from that perspective.

But I think all those initiatives, we've been talking about working hard to bring those margins up. I've more than offset kind of any of those costs right now. So I think, we're just focused on continue to deliver those initiatives and make sure that that keeps happening.

Q: Okay, so on IT specifically, when we look at the gross margin obviously there's Computex which I think is higher GM but heavier on OpEx. The 40-ish percent gross margin that you guys delivered is that like sustainable? How do I think about this number? Are there any sort of one-offs in there?

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

No, I think for the short-term, it's sustainable. And the mix wasn't unusual or anything this quarter is I think it was the first full quarter, I think, for having Computex in there. And in our Toronto based iSecurity tech business is also performing very well. So I think it's a good benchmark here. And I think, obviously, we'll keep that as we expand, keep trying to improve there.

Q: Okay, maybe one last one, like how do I think about fiscal '23 growth in terms of organic versus acquisitive growth and I'm obviously not looking for a number here. But from where you stand, you feel that it continues to be lower organic growth here and most of the growth driven by M&A, is that fair?

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

I think for me the goal is to continue our double-digit growth posture, mix with both organic and M&A. And as we look at the four segments, clearly, with our IT group, our Learning group, we're seeing good both M&A and organic growth opportunities. Our Health Group, as well as we replatform rebase line with our Nexi platform, organic growth opportunities and Advanced Tech, as I mentioned, we do have a strong backlog of opportunities. Our Software Engineering Group, as I mentioned again, it's got more backlog ever had. So I'm confident we can continue both Amr as far as the numbers we'll get. We'll take that up as we head into guidance into next year.

But despite some of the headwinds, I want to reiterate there's still quite a few tailwinds across all of our segments, and I am confident we're going to keep our double-digit growth posture as we head into next year. That's my commitments and my team's commitments.

Q: Okay, I'll take that as the stars are aligned for a very big year in fiscal '23.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Thanks, Amr.

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Thanks, Amr. Appreciate that.

Q: Thanks, I'll pass the line.

Operator

Thank you. Our next question is coming from Deepak Kaushal with BMO. Go ahead.

Q: Hi, good morning, guys. Thanks for taking my questions. I've got two themes that I want to cover, one on the demand side. So you mentioned delayed projects, and projects won, but delayed start impacting guidance. But I think in the MD&A. And the other section, you talked about budget cuts and project cancellations. Where are you seeing that in the business? And is that factoring into some of the guidance conservatism?

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Yes, you are seeing, I'd say it's different behavior in different segments. Really, I think in this Space group, it's been more given the economic environment, people are looking at their CapEx, their financing costs, and kind of trying to replatform, I think those deals still come, I think it's just been kind of a reset here in the short term. And then we'll see a different behavior in health it's been, availability of resources has really been hard. I think everyone's seen that in the news. We're working extra hard to try to get those resources to fulfill the contracts. So I think it's been a bit of a different journey to the segments. But we don't think it's a long-term thing. I think it's just as we readjusted and be ready, we're still pretty optimistic about the outlook in both of those segments.

Q: Okay, thanks. So to be clear, are you seeing anything being canceled on the customer side whether you want it or not?

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Not significantly, no.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Hi, Deepak, it's Kevin. I think it's more delays where we're seeing is, especially if anyone's dealing with any kind of financing elements of their deployment. So we expect more delays and unnecessary cancellations. And that's what we've been seeing. We've got projects we've won, we just have not started as we wait for the customer to resolve any final financing details that they need to do to move forward, especially large capital programs.

Q: Okay, that makes a lot of sense. And that's helpful color, thank you. And then just second question on the gross margin, you're at 30% now, I know there's a lot of moving parts. I'm just wondering the prospect of being able to sustain that through next year. And how much of that incremental gross margin you can convert to EBITDA given the various OpEx profiles of businesses? So maybe just to start on that, what are the kind of moving parts on gross margin, if you win this once this big AT contract come through this gross margin come down again, or can

momentum in ITCS keep it up at the 30% level and then how much of that can you convert to EBITDA?

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Yes, I mean, we're trying our objective really going to next year is to maintain or exceed the 30%. So that's our objective going into next year, obviously, we've got cost pressures and different mix issues, as you highlighted. But I think we've got a lot of positives as well, there is ITCS momentum with margins above 30% are strong. So, I think again, it's balancing the four pistons and bringing all those things, but the objective is not to go backwards here in gross margins.

And on a conversion to EBITDA, I mean that's one thing we have shown our ability to do, right, take the gross margin, convert the EBITDA and convert the cash flow, which you really saw this quarter. So I don't think that changes, I think we continue on that and do what we were doing now into next year, but at bigger scale.

Q: Okay, and so just a follow-up on that, I think Amr mentioned that, that the OpEx is high on the Computex side, what's the nature of that and you get some benefits now that it's part of Calian Group and what's kind of the magnitude of that?

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

The biggest one is on the Salesforce. I mean, it's a very sophisticated and diverse sales force, which is really driving the revenue growth there. So I think, we're glad to bring that in. It's a different model than we've had. But I think it's bringing that diversity and reach in the U.S. So I think we're happy with that. And now we're really just optimizing it and pushing as much volume as we can.

Q: Okay, thank you. That's helpful. I'm looking forward to your Q4 and your guidance for next year. Thanks again.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

That's great. Thanks, Deepak.

Operator

Thank you. Our next question is coming from Michael Kypreos with Desjardins Bank. Please go ahead.

Q: Good morning, everyone. Thank you for taking the question. My first question is going to be on the Health segment comparison. Was there any benefits from COVID last year that impacted such as absenteeism this quarter? And is there any feedback from the launch of your new virtual care products so far, any additional color?

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Yes, sorry, can you just restate your first question? Just want to make sure I understand it?

Q: Well, it was a two part question. Just any benefits from COVID in the last quarter of last year that really saw a difference in prices this year. And were you impacted by any absenteeism in Health segment?

Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

Yes, so Mike 14% of the decrease in health kind of year-over-year was related to the kind of COVID business that we had last year, that obviously isn't happening right now. And then Kevin, you want to speak to the Virtual Care?

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Yes, so basically, so we just got going on the Virtual Care platform. And I would say, good discussions happening with customers, there's a funnel being built. So I'm cautiously optimistic, actually, we'll see good traction there. But I'll update that more as we get into next year because as we just launched, I want to make sure, I set expectations correctly. But we're excited by the Microsoft award is a demonstration of their support in the context of our Virtual Care, our Corolar Virtual Care platform, as well as our Nexi platform as well as our Health segment as well. So I'm confident both are relevant, both are going to be needed. And I'll update as we look forward on guidance on our expectations on that. But right now, we're just coming out of the box. But so far, so good.

Q: Perfect, thank you, and maybe just a second one, on M&A since we finished with a very strong cash position, since the market has seen some depression in the past couple of months. Have you seen valuations of any possible targets come down or it's really been the status quo?

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

I think we've seen a massive readjustment, I think certain sectors where maybe in Health specifically where the valuations were a bit too high last year, I think those have come back. But again, we're looking for, our history has been good acquisitions with strong track record growth profile. And for those companies I think they demand the valuation they do. But we're so confident, we've got a good pipeline. And we're confident we can execute more M&A, just like we have here in the next short while.

Q: Perfect, thank you for the time, and I'm looking forward to Q4.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Thanks. Thanks so much.

Operator

If there is no more questions or comments, I will hand it back to Mr. Kevin Ford for any closing statements.

Kevin Ford - Chief Executive Officer, Calian Group Ltd.

Okay, thank you. Thanks, Ally and again, thank you everyone, for attending today. In my closing thoughts, from my perspective, this quarter was another step on our journey to a billion dollar company. Double-digit revenue growth, expanding our margins, diversifying into new markets and customers, increasing our cash flows, increasing our recurring revenue streams. And being in a position to continue to execute accretive M&A in support of our profitable growth objectives. I still feel we're well on track to our growth momentum and objectives that we set for ourselves.

I'm confident in our team at Calian to not only fulfill our core purpose of helping the world communicate, innovate, learn, stay safe and lead healthy lives. But based on those last few metrics, I'm also very confident in our ability to sustain our profitable growth momentum. So with that, I'd like to thank you again for joining today. We look forward to talking to you in Q4 for full-year results and guidance for next year. And any other questions please don't hesitate to reach out, with that Ally, we can now close the call.

Operator

Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your lines at this time and have a wonderful day and thank you for your participation.