Company: **Calian**

Conference Title: **Calian's Fourth Quarter Results**

Moderator: **Kevin Ford**

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Operator: Good day, ladies and gentlemen, and welcome to the Calian's Fourth Quarter Results conference call. As a reminder, this conference is being recorded. I would like to turn today's conference over to Mr. Kevin Ford, Chief Executive Officer of Calian Group. Please go ahead.

Kevin Ford: Thank you, Carrie, and good morning, ladies and gentlemen. With me today is Patrick Houston, our CFO. We'd like to welcome you to Calian's Fourth Quarter and Fiscal Year 2019 Conference Call.

I'm very happy with our annual results. We, again, posted record revenues with annual revenue of 343 million and revenues of 90.9 million for Q4, crossing the $90 million quarterly revenue mark for the first time in company history. This, also, is the company's 72nd consecutive profitable quarter. Our results demonstrate the strength of our diversification and the impacts of our growth framework. More importantly, they highlight the strength and dedication of the more than 3000 people at Calian who continue to be the engine that drives our growth. I want to thank them for their incredible efforts.

Calian's acquisitive and organic growth strategy, the investments in our innovation agenda, combined with solid financial management is working. We've closed nine acquisitions in the past eight years, including two in the 2019 fiscal year, while achieving positive organic growth and a continued profitability.

I'm equally proud that our total shareholder return in 2019 was 21%. With this financial growth, we're also evolving the company. That is why with these results we've announced a change to our operating segments. The new reporting segmentation announced yesterday is an important development for our shareholders. As we shift away from the two-divisional construct, which I believe we had outgrown. Going forward, we will report in four operating segments. First, Advanced Technologies, which encompasses our legacy Systems Engineering Division, IntraGrain, SatService and a portion of engineering service that resided in our legacy BTS division. And the remaining BTS services have been split into the Health, Learning and Information Technology segments.

This new segmentation better reflects our diverse services and markets. I am proud to say that our new segmented view shows growth across all four of our lines of business. I will now ask Patrick to review the quarterly and full-year numbers. Over to you, Patrick.

Patrick Houston: Thank you, Kevin. We finished the 2019 fiscal year with record results achieving 12% revenue growth and 7% EBITDA growth, year over year. For the fourth quarter of 2019, consolidated revenues were up 16% from the prior year. We also finished the year with a backlog of over $1.3 billion which is higher than what we started the year with. This demonstrates our ability to both retain and diversify our customer base.

I'm very happy to present shareholders with the new four-segment view of Calian's operations. These four segments help simplify the company for shareholders and provide them with a clear lens into our diverse business. You can find further information, discussion and a view of current year and prior year performance of these four segments in our 2019 Financial Statement in MDNA[?].

All of the four segments drove Calian's record year with positive revenues and earnings contributions. Advanced Technologies' 2019 revenue was 109 million, up 11% from the previous year. Health's revenues were 115 million, up 16% from 2018. Learning ended the year at 63 million, up 3% from the previous year. And I.T. revenues were 54.5 million, up 22% from 2018.

We continue to believe that Calian's diversified profitable growth engine is one of the company's unique strengths. Gross margin for the year on a consolidated basis was 21.8%. This is an increase from 21% in the previous year. Our focus continues to be the introduction of products and services into new markets in order to increase our gross margins.

Operating expenses were up year over year as a result of acquisitions and investments in capacity and innovation, the expensing of share-based compensations, and certain one-time costs related to current year acquisitions. Selling and marketing, administration and facility expenses have increased as we scale the overall business and enter new markets. We continue to manage operating expenses while ensuring we invest where required to position the company for long-term profitable growth.

Adjusted net profit per share for the year, which removes non-cash charges related to acquisitions was $2.43 per share. That's an increase of 7% compared to last year's adjusted EPS of $2.27. Please see our reconciliation of adjusted EPS in our press release and MDNA.

Earnings per share for the year were 255 per share, up approximately 23% from the previous year. This increase was partly due to a one-time gain of 5.2 million related to earnouts payable for our recent acquisitions, SatService and IntraGrain. [Inaudible] structure, now it's based on EBITDA growth from the company's trailing historical performance. The payments are made only once they achieve a minimum of 75% of that growth target. We believe this allows us to stay fiscally prudent while paying for strong growth. We continue to expect positive contributions from these acquisitions in the upcoming year.

Our cash position remains stable at $17 million. This decreased slightly from the previous year due to our two acquisitions as well as working capital requirements as the company continues to increase revenues overall and we delivered larger multi-year customer contracts. Our line of credit stood at 13 million at the end of the year.

I'd like to note that effective, October 1st, 2019, we have adopted IFRS 16 which would impact how we account for our operating leases going forward. These accounting changes would modestly impact our guidance for fiscal year 2020. We expect the impact of capitalizing our leases to be an increase in EBITDA of approximately 2.9 million next year and a decrease in net income of 0.2 million. We provided a full reconciliation of this change in our financial statements and MDNA.

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: Thanks, Patrick. The 2019 fiscal year has been exciting for Calian on many fronts. We finished with record revenues and EBITDA, executed two acquisitions, launched innovative products, strengthened our global presence, retained our key customers and gain new customers across all of our lines of business.

The two acquisitions closed for Advanced Technology to steer[?] support, the segments, customer diversification, and service line evolution objectives. Regina, Saskatchewan-based IntraGrain Technologies enabled our push into the AgTech market leveraging complementary capabilities for the segments. The acquisition of SatService, based in Germany, provides Calian with a foothold in Europe and supports the company's expansion in the European market with turnkey satellite solutions as well as products.

As I've set a profitable revenue growth target of 10% or higher, I was pleased to see Advanced Technologies growth, 11%, Health at 16%, and Information Technology at 22%. Our Learning segments focused on customer retention, re-winning two large contracts this year that added over $200 million to our contracted backlog while still growing at 3% in the year.

Across the four segments, the company continues to invest in innovation. Advanced Technology segment continues to develop its new line of carbon fiber antennas and remote PHY cable technologies, as well as strengthening our communications products and software engineering offerings.

In Q4, the Learning segment launched Calian MaestroEDE. An innovative exercise management software solution designed to fulfill complex training objectives. While these initiatives all require investment, we view them as critical to unlocking innovation and supporting Calian's long-term growth.

Looking forward, we continue to see positive momentum on Calian's growth path as we execute organic and acquisitive growth strategies and leveraging our strong backlog investments innovation and a dedicated employee base, I believe we're well-positioned to continue the execution of our growth plan. At this time, I'd like to inform all of our shareholders and analysts that we'll be holding our ADM and Annual Investor Day, the morning of February 6th 2020 in Toronto and you may contact Calian Investor Relations for more information.

Lastly, the traditional markets in which Calian operates is stable, and management expects organic and revenue growth and earnings growth in most or all of its segments through the successful execution of our growth strategy. However, we must caution that revenue is realized or ultimately dependent on the extent and timing of future contract awards 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 2020 to be in the range of 365 million to 395 million. EBITDA per share, in the range of $4 to $4.30. And adjusted net profit in the range of $2.35 to $2.65 per share.

So, Carrie, I'd like to now open the call to questions.

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 speakerphone, please be sure that your mute function is turned off to allow your signal to reach our equipment. Again, that is star one to ask an audio question. We'll pause for just a moment to allow everyone the opportunity to signal for questions.

Right. Our first question will be from Doug Taylor with Canaccord Genuity.

Doug Taylor: Yes, thank you. Good morning, Kevin, Patrick. I appreciate the added segmentation. Very helpful in helping us see the underlying drivers of your business. So I want to start with a couple of questions on that. I mean, as we work that into our models, is there anything you can provide us either quantitatively or by way of, you know, directionality about how those segments build-up to that annual guidance you provided and perhaps, you know, you could frame that in – with respect to your, kind of, 5% organic growth plus 5% acquisitive growth type target that you have for your business lines?

Patrick Houston: Yes, hi, Doug. Yes, I think next year – you know, we made sure we had a great performance in terms of all of them growing. I think we're still expecting that for next year, but I think the leader in, you know, leading the pack is going to be Advanced Technologies. They've got a strong year. Obviously, we have that big project that we're doing on the ground systems as well as, you know, they have IntraGrain, SatService as growth drivers as well as some of these new products. I think, you know, Advanced technologies will be the most aggressive grower for next year, but we still expect all of the segments to be above this year.

Doug Taylor: Yes, I mean, you mention the large ground systems business. That's – you know, it's obviously - it was kind of lumpy towards the end of this fiscal year. As we enter fiscal '20, can you update us on where we are- with respect to, kind of, the backlog and ramp-up of that new business and, you know, the key contract that you have starting off there?

Patrick Houston: Yes, we still expect a strong year next year probably. You know, an increase of about $20 million over this year's revenue for that project. And then continuing on in the following year, so we'll still have 15 to 20 million that will go into the following year. So it's still a lot of work to go. You know, progress has been good so far and, you know, we're getting into delivery stages now, so I think we're still pretty positive on a strong year.

Doug Taylor: The EBITDA guidance that you provided, you know, just to be crystal clear, that is based on the new accounting standards. So with the benefit of the near $3 million from the leases, correct?

Patrick Houston: That is correct, yes.

Doug Taylor: Okay. So, first of all – I mean, can you help us with the lease benefit. Where do you expect that to fall within the segmentation or is that going to be largely corporate? Any help there would be good.

Patrick Houston: Yes, so the reduction in expenses of 2.9 will be across mostly in the Advanced Technologies group. They have the most expensive facilities, so the facility [inaudible] in each of the segments. So that will be the biggest reduction. And then, you'll see, you know, we'll break up the amortization and expense down below the line.

Doug Taylor: Okay.

Patrick Houston: So the 2.9, probably about 2.5 of it is in Advanced Technologies.

Doug Taylor: That's very helpful. And so – I mean, if I back out the impact of that accounting change, it seems to me that the EBITDA guidance suggests roughly static margins across, you know, corporate-wide. Is that consistent with how you view the individual units? Are you expecting there to be some – you know, some winners and losers with respect to your margin profile of your business this year relative to last year?

Patrick Houston: We're seeing some improvements. I mean, the large grounds system project generally has – the large projects generally have lower margins. That's pulling it down a bit. So I think we are expecting some improvements minus that project. And obviously, if we're able to – you know, a lot of this innovation we're doing is in new products. We're hoping to start phasing in towards the end of the year. So the extent we're able to do that, I think we can continue to improve the margins. But certainly, that is the focus.

Kevin Ford: Yes, it's Kevin. So with regard to our innovation agenda across all of those segments, the goal is to continue to increase margins. And if you look at the announcement, I talked about in our Learning segment with our MaestroEDE product. So we're, you know, as we transitioned from services to products to solutions, the whole spirit of that is, number one, is to make sure our customers are getting, you know, a full solution offering in each of our segments, but as well that we bring more technology in there to drive margins. So, my expectation is we're going to continue to push margins forward. But definitely in the Advanced Technologies group, we expect more, over the longer term as we invest in more products right across IntraGrain, SatService and our legacy side service and our, and our legacy SED division. So, it's definitely a goal, Doug, and I don't think you going to see major jumps, you'll see incremental growth over the next few years here.

Doug Taylor: Fantastic. I'll pass the line. Thank you.

Kevin Ford: Thanks, Doug, appreciate the comments.

Operator: Thank you. Our next question will be from Benoit Poirier with Desjardins Capital Markets.

Benoit Poirier: Hey, good morning, Patrick and Kevin and, congrats for the level of disclosure and the new segmented information. So, very appreciated. Just to come back on the big satellite contract, the ground system contract. Just want to get some color about the ramp-up right now. But you mentioned that there will be about 20 million incremental revenues in fiscal '20. But what would be the – what will be the backlog following fiscal '20? Is there another 15-20 million or the contract will be mostly completed?

Patrick Houston: Yes, I think you got it. In that range, 15 to 20 million depending on the exact timing, but that's likely what would go into the following year to finish it off.

Benoit Poirier: Okay. Okay, perfect. So, but this amount – so if you add up 20 million in fiscal '20, could you remind me what was the contribution in fiscal '19, Patrick, which respect to that satellite contract?

Patrick Houston: Roughly around 20 million, approximate.

Benoit Poirier: Okay, perfect. Okay. So that's very good color. And could you provide now some color about the working cap and free cash flow looking at fiscal '20? If you look at working cap, there was some consumption fiscal '20, about the 8.5 million. But I would just be curious to know a little bit more as you still add more revenues from this contract in fiscal '20.

Patrick Houston: Yes, as working capital we have a couple of things going. One, obviously, this contract has – you know, it's not as flat on working capital, so it's a bit heavier upfront. I think those start to reverse, kind of, in the second half of this year. So we'll probably see a bit of pressure in the first two quarters and then it starts to unwind in the second half, so I think that's one factor. I mean, the overall business is just growing everywhere, so that's just going to lead it back[?] more working capital in terms of accounts receivable. And Capex, we expect next year to be fairly flat to this year. We've got a few investments we're making in IT systems and things like that, but it should be consistent with this year.

Benoit Poirier: Okay, perfect. So would it be fair to say that the working capital consumption should be similar to fiscal '19, 8.5 million? Or would you expect an improvement or a decrease versus last year, Patrick?

Patrick Houston: That's probably a fair estimate. I mean, a lot of it comes down to timing, you know, right around the end of the year. Of course, it could go a couple of million either way, but I think that's a safe planning estimate for now.

Benoit Poirier: Okay. Okay. That's fair. That's pretty good. And I was just curious to know if you saw any impact from the election on your business? Is there something that was either a benefit or some impact on Calian with respect to the election?

Kevin Ford: Yes, from my perspective, Benoit, really, you know, the government is forming even though what we're seeing in some of our key portfolios is for example, in defense, Minister Sajjan[?] is still the minister. ISED, Minister Bains is still there. So, when you look at some of our key drivers from a government business perspective, at least initially, we're seeing stability in the sense that the ministers that were appointed in those departments are basically the ministers we had prior to the election.

So as far as the defense agenda with the Strong, Secure, Engaged, policy that was put out under Mr. Sajjan's watch, I don't expect there's going to be a major variation for that. And in that policy, they had basically committed to, you know, increasing defense spending over a period of years. So I don't – you know, again, I don't expect there's going to be a major shift. We are still very busy in our government segment right now and the federal segment for sure across all of our businesses. So, right now, probably early to tell until we get the budget from the government in February. But right now, at least, I would say, if anything, it looks to be stable coming out of the blocks just by the reality that we're dealing with. What seems to be the same ministers in some of our key departments.

Benoit Poirier: That's very good color, Kevin. And when we look at the EBITDA margin by operating segment, you mentioned some color about fiscal '20, but I was just looking at Health. You were able to improve the margin from 13.3% EBITDA to 16% this year. So just wondering is this 16%, kind of, this sustainable level right now, Patrick, and you'll build on top of that?

Patrick Houston: Yes, I think what we've just did – the Health team's done, you know, really an excellent job, is to expand that business. So we've gone from about one contract to now we're more than 50 contracts. That spans across multiple different customers. We're also bringing in psychological assessments and things like that. Much higher value, more differentiated products. We're very – and when we go into these new customers, we work in their environment, really customize the product to their needs. So that's allowed us to push those margins up. And, you know, we expect them to continue to do that. So we've been really successful and I think this year is just a continuation of that.

Benoit Poirier: Perfect. Okay. And from a modeling standpoint, what should we expect in terms of corporate cost, but also with respect to the intangible or payout earnings in fiscal '20? I'm talking here[?] corporate costs about the 4.9 million and basically the adjustment that needs to be made to derive adjusted EPS. What kind of sustainable numbers we could look for?

Patrick Houston: [Inaudible] of the adjusted EPS, I think the amortization of intangibles this year is about 3.1, probably goes to about 3.8 million next year. Accretion is probably flat. And then obviously we had the gain this year. Right now, we're still at – you know, we had the liability on the books for those two companies. We're still planning on them getting closed better. No, but we'll probably have better reading on that towards the end of next year as we get closer to those [inaudible].

Benoit Poirier: And corporate costs is 4.9 million. Kind of, a sustainable level going forward, Patrick?

Patrick Houston: Yes, I think so. I mean, part of this restructuring is to try to find efficiencies on the corporate side, right? Have[?], like, a shared service model that helps each of these segments grow. So we're starting to implement that now. Obviously, we've been catching up the last couple of years in terms of investments that just needed to be made to scale this company. But I think now we're going into selective investment but looking for efficiencies as much as we can.

Benoit Poirier: So 4.9 likely a good base?

Patrick Houston: Yes. I mean, there's a few investments you need to make, but I don't think it's a drastic increase.

Benoit Poirier: And the last one for me, when we look at the earnouts, you mentioned some color in the annual report with respect to IntraGrain, Secure Tech and SatService, the fact that they were not meeting the EBITDA – the earnout in the first year. Just want to know, does it change the outlook going forward or were they relatively close to hit the targets? How we should add the contribution from those three acquisitions, gentlemen?

Kevin Ford: Yes, so it's Kevin. So from my perspective, we're still very positive on all three acquisitions. You know, if I walked through them – on the Secure Tech, you know, our cyber business continues to grow. And in the fact now that we can offer products as well as services based on the Secure Tech acquisition is only going to be good for us long-term. So, still very positive on Secure Tech on their contributions going forward. And I do believe they have every opportunity to make where we want to see them in year two.

IntraGrain. You know, what we're seeing with IntraGrain is, frankly – you know, when you look at some of the factors that affected IntraGrain this year, the drought in some of the AgTech space, I think we're just seeing the effects of that with regard to, you know, maybe a slowdown in orders but not necessarily something that would indicate that the business is not strong. It's just some realities that we're dealing with that we have to deal with some environmental factors now from an AgTech perspective. And, you know, when there's droughts and things like that, people tend to hold off on buying, so we're just dealing with some of those realities. But if you still look at their contribution to the company, this year's was very strong, both from a margin profile and EBITDA perspective. So, again, very positive. IntraGrain. Very talented team, and I do believe that they're going to continue to support our long-term objectives.

SatService, you know, we'd had a very short window for SatService after we acquired them. You know, a very short earnout period for the first phase. Again, we look at that as being just a timing issue. Their backlog is very strong. I did review a few weeks ago with Germany and I'm very impressed by, you know, the orders that are coming in and the diversity of customers that are coming in, frankly, from accounting perspective.

So again, a brilliant team over there. Very, very dedicated and I'm very confident in their ability to, again, support our long-term objectives. You know, as Patrick said, you know, the one thing we – I think we're doing very well with our M&A playbook is that we're making sure that any company we talk to – everyone has growth objectives, which is fantastic and those are the companies we want to buy. But we also want to make sure that from a value perspective, we're getting the right multiple on trailing and future EBITDA. And the earnouts, we still believe there's a great mechanism to ensure that there's shared risk between the – you know, the buyer and the seller to achieve those targets. And I think it's working. You know, we've had nine acquisitions, our framework's worked, we've paid earnouts in many of our acquisitions, but it also protects to make sure we're not overpaying for perceived EBITDA that may be coming and going forward. So, it just revalidates to me our M&A playbook is working and in all three, no regrets. All three are doing very, very well. Very proud of them. Very proud of the team that's working there. And I'm confident, again, that we'll see a continued growth in each of those acquisitions. So, still very positive in all three and we will continue to look for more M&A opportunities this year for sure.

Benoit Poirier: Okay. And maybe just a quick one, which respect to the ground system contract, could you talk, Kevin, about the opportunity to replace those revenues as it will ramp down in fiscal '21? It's still a good contributor this year. And fiscal 2021 – I would just be curious, the opportunity to replace those revenue going forward?

Kevin Ford: Yes. No, thanks. Great question. I think that's a very fair question because we have had history in Calian of, kind of, moving the cycle on the big programs for the system and then, kind of, taking a step back in our growth objectives as they finish. So, number one, over the next few years, I think we're seeing solid contribution from that project. During that time, we're doing a few things. Number one, you know, I've invested more of any CEO in our innovation agenda in new products, new capabilities, just organically. So I believe those are going to start to increase to start offsetting any major project wind down.

Number two is our acquisitions. You know, we've just acquired two last year. We are looking strongly at acquisitions to support our growth objectives. So, again, I'll be looking for opportunities to make sure we don't take a step back.

And then third, when you look at the other segments that we're dealing with, both in healthcare – you know, our I.T. business was up 22% last year. Healthcare business up 16%. You know, what I'm very confident on – as you know, Benoit, I call Calian a four-piston engine and I believe right now – so if Advanced Technologies is firing in all eight cylinders this year, I think the other ones continue to pick up pace. And they have picked up pace. If you look at I.T. services, for example, in cyber, you know, we are just getting going as a cyber professional services company and you saw that growth, 22% and the 55 million. I think there's huge opportunity for us to continue to grow that segment. So, both, organically and through M&As.

So the plan right now in our strategy is to now take a step back when those projects are done, to backfill them with either new business or backfill them with M&A But, you know, that's our collective challenge and I'm pretty confident the team's up for that challenge.

Benoit Poirier: Okay. Thank you very much for the time. That was great color. Thank you.

Kevin Ford: No, great questions. Thank you, Benoit, I appreciate that.

Operator: Thank you. I'm showing no further questions in the queue at this time.

Kevin Ford: Okay. That's great. And I just want to circle back to a Doug Taylor question. Actually, I didn't think about it. I think Doug asked the question on our guidance and whether or not, you know, what's the basis of that is. I just want to really confirm right now, that guidance is based on what we know today. It doesn't factor in any other acquisitions. It's basically what we're doing today in the company is driving that guidance. So I just want to make sure that's clear as we exit this call.

So, Carrie, thank you for moderating. Everyone, thank you again for joining the call. I hope to see all of you at our AGM in Toronto on February 6th. And an Investor Day, we're going to be bringing some of our leaders in to talk about all the great things that are going on in this company and the innovation. And obviously, Patrick and I are available for any other further questions post this call. So you have a very excited CEO here with regards to what I'm seeing in the company. I think the four segments really will help define the company moving forward for shareholders, or employees, or customers. So I think it's a right time for this at Calian and I look forward to talking about our progress again next quarter in February, on how we're doing against our growth objectives. So with that, Carrie, we can end the call. And again, thanks everyone for your time this morning. Very much appreciated.

Operator: Thank you. Ladies and gentlemen, this concludes today's teleconference. You may now disconnect.