

Transcript of  
Calian Group Ltd.  
First Quarter 2023 Conference Call  
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**Participants**

Jennifer McCaughey - Director of Investor Relations, Calian Group Ltd.  
Kevin Ford - Chief Executive Officer, Calian Group Ltd.  
Patrick Houston - Chief Financial Officer and Corporate Secretary, Calian Group Ltd.

**Analysts**

Doug Taylor - Canaccord Genuity Group Inc.  
Maxim Matushansky - RBC Capital Markets  
Michael Kypreos - Desjardins Capital Markets  
Reni Sharma - BMO Capital Markets

**Presentation**

**Operator**

Greetings. Welcome to the Calian First Quarter 2023 Conference Call. At this time, all participants are in a listen-only mode. A question-and-answer session will follow the formal presentation. [Operator Instructions] Please note that this conference is being recorded.

I will now turn the conference over to your host, Jennifer McCaughey, Calian's Director of Investor Relations. You may begin.

**Jennifer McCaughey - Director of Investor Relations, Calian Group Ltd.**

Thank you, Kelly, and good morning, everyone. Thank you for joining us for Calian's Q1 2023 conference call. Presenting this morning are Kevin Ford, Chief Executive Officer; and Patrick Houston, Chief Financial Officer.

As noted on Slide 2, please be advised 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. As a reminder, all amounts are expressed in Canadian dollars, except as otherwise specified.

With that, let me turn the call over to Kevin.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Thank you, Jennifer, and good morning. Let me start with an overview of our Q1 results. We continued our momentum of double-digit growth in the quarter. Q1 revenues reached \$148 million, up 14% compared to the same period last year, and represents a record level of revenues for the first quarter.

This impressive growth was driven by a strong performance of our recent acquisitions, coupled with our ITCS and Learning segments, which both posted double-digit organic growth. This growth was partially offset by delays in new business in our Health and Advanced Tech segments, as well as the temporary impact of part shortages preventing us from fulfilling orders in our Advanced Tech and ITCS segments.

Supply chain issues resulted in a revenue impact of approximately \$10 million and gross margin of \$3 million in the quarter. We believe we will recapture this in the balance of fiscal year 2023 as components can become available.

Our gross profit reached \$45 million, up 30% compared to the same period last year and also represents a record level for the first quarter. Gross margin surpassed the 30% mark for a third consecutive quarter, increased 4 basis points from the first quarter last year, despite the fact that we're dealing with challenging macro environment, inflationary pressures and ongoing supply chain issues.

Similarly, EBITDA reached \$14 million, up 2% year-over-year. It also represents a record level for our first quarter. However, our margin was down slightly as we continue to invest for future growth. These solid results translated into strong cash flow from operations, as Patrick will discuss in a moment and demonstrate once more the power of our diverse operating model.

I'd also like to highlight our continued push to win new customers and extend our relationship with existing clients. This quarter, we recorded \$126 million in new contract signings with approximately \$45 million from contract renewals and extensions, and \$81 million from new customers.

We exited the quarter with a robust backlog of \$1.3 billion, of which \$340 million is planned to be realized in fiscal year 2023. With these new contract signings, a healthy backlog and improvements in the supply chain environment, we are confident in our ability to post our 6th consecutive record year, and as such, have reiterated our full year guidance.

For now, let me provide an update of our results by business segment. Let's begin with the IT and Cyber Group. In the first quarter, ITCS doubled its revenues to \$46 million, driven primarily by our expansion in the U.S. market with the acquisition of Computex in March 2022. This growth was compounded by double-digit organic growth in our overall cyber practice as we continue to win new customers in Canada for our cybersecurity offerings. This growth was partially offset by lower product sales as a result of significant deliveries in the final weeks of the fourth quarter, and part shortages resulting in orders of about \$5 million not being delivered.

Gross margins increased significantly from 26% in the first quarter last year to 37% due to acquisitive revenue at higher margins, coupled with the expansion of our cybersecurity offerings in Canada. Similarly, EBITDA nearly doubled to \$7 million or a margin of 15%.

In the quarter, we invested in Field Effect Software, a simulation-based cybersecurity training platform used to grow individual skills, rehearse incident response and train teams. We see the investment in Field Effect as a way to enhance our solution set and begin to address the

cybersecurity skills gap for a growing customer base, including governments and defense agencies.

In addition, in the quarter, iSecurity achieved Service Organization Control Type 2 compliance, a gold standard of industry recognition, and we were awarded a cybersecurity contract with the Ontario Health. For the balance of the year, we expect this momentum to continue. We believe product sales will increase as we continue to see robust demand and address the remainder of the consumer backlog due to supply chain shortages.

Turning to our Health segment. In the first quarter, revenue declined 5% due to a slower pace of awards for new business and ongoing lower COVID-related business, which accounted for about 3% of this decline compared to the same quarter a year ago.

In order to deal with the evolving health care landscape and the shortage of specific skill sets, we are investing in multiple initiatives to recruit new professionals to realize unfulfilled demand on existing customer contracts and to drive new business. Furthermore, our existing contract vehicles and services continue to track more to normal run rates. Gross margins and EBITDA margins decreased to 24% and 16%, respectively.

In the quarter, we achieved our strongest revenue performance for our Contract Research Organization division with strong signings in our pharmaceutical business of \$25 million; we see good momentum in this segment for our business. Total signings in the quarter were \$34 million. This is a good indicator of renewed momentum on the new business front. These contracts will start in the coming quarters as capacity is brought on and what continues to be a difficult environment in obtaining health care capacity.

Our 3-pronged approach of health care professional services, pharmaceutical industry solutions and in-store health clinics will provide multiple growth avenues, while we continue to develop our health technologies.

Last week, we announced the appointment of Derek Clark as the new President of the Health segment. He will take over the leadership of Calian Health from Gordon McDonald, who is retiring at the end of March after a long and successful career in health and health services.

Derek Clark is a strong leader with a deep understanding of the multifaceted health segment. He has a passion for teaching, mentoring and coaching leaders the quality that we value here at Calian. His experience leading teams through the commercialization journey, change management and acquisitions will benefit the entire Calian Health team, and I'm delighted to welcome him at such an exciting time in our growth. I'd also like to thank Gordon for his years of service to Calian, leading the Calian Health team through the important transitions that have brought us to this point.

Turning to our Advanced Technologies segment. In the first quarter, revenue decreased 17% to \$34 million due to delays in the award of new ground system projects, large-scale projects rolling off and ongoing supply chain issues, which resulted in parts delay that slowed our ability to deliver products.

In fact, this temporary part shortage impacted the realization of customer backlog of about \$5 million in the quarter. We expect these orders to be fulfilled in the remainder of fiscal year 2023 as parts are forecasted to arrive in the coming months.

These factors were partially offset by a strong performance of our GNSS antenna business, which was up 38% compared to the same quarter last year. We continue to experience momentum in this business, driven by current customers where antennas are designed into their product increasing demand as well as new customer wins. We have continued to invest in incremental manufacturing and delivery capacity to meet strong demand.

Although, our revenue was down, gross margins improved significantly from 26% to 35% due to a better mix of higher-margin business. The shift into our own products and software solutions over the last several years is showing its impact this quarter. These verticals deliver high gross margins than traditional ground-based antenna business and are becoming a larger proportion of our revenue mix.

In the quarter, we announced the Natural Resources Canada Center for Mapping and Earth Observation once again entrusted us to provide 3 high-performance antennas for Inuvik and Gatineau value to \$12 million, a solid win for us. As a leader in ground station design and implementation, our technology and our know-how will improve them to a significant additional capacity, enabling to support their Earth Observation customers. Recall that this contract comes on the heels of the NASA contract signed in August and is a testament to our brand of excellence in the space exploration market.

Although, we have had a slow start in fiscal 2023, we expect a return to organic growth in the second half of the year, with new contract wins of \$42 million, the supply chain coming back in line and strong demand in our software engineering for satellite communication customers, as well as demand for precision location services for our GNSS products, we are well positioned to drive revenue in the coming quarters.

Turning to our Learning segment. In the first quarter, revenues increased 16% to \$26 million, driven entirely by organic growth. It was generated by increased demand and ongoing projects along with new programs that have implemented for long standing customers. Our ability to bring proven solutions in short order is key in this rapidly changing environment and is valued by existing customers. We have continued to expand to new nations in Europe based on work with NATO, and we are seeing robust activity in Europe as nations look to evolve their military training practices.

While gross profit was up to \$7 million, gross margin was down slightly to 25%. This is a result of adjustments to rates in our contractual staff before customer contractual increases kick in. Similarly, EBITDA margin was down to 16%.

Our expansion outside Canada has continued. We delivered 2 large NATO exercises in Europe, delivered seminars to military students from 13 Latin American countries and continued development of features of our command and control software in cooperation with NATO.

For the balance of the year, we see continued demand for our services and technology in the military training space in Canada and in Europe. We will continue to invest to make sure we are well positioned to continue to capitalize on the macro environment where military training has become mission-critical. This should put us on track to break the \$100 million revenue mark for the first time in our Learning segment.

With that, I will now turn it over to Patrick to discuss cash flow, balance sheet and our guidance. Over to you, Patrick.

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

Thank you, Kevin. In the first quarter, we generated \$25 million of cash flow from operations. The strong performance was driven by a combination of strong operating free cash flows and strong working capital performance.

Operating free cash flow was \$12 million this quarter, an impressive increase of 24% compared to Q1 last year. It represents an 85% conversion from our adjusted EBITDA. Our conversion to cash flow has consistently improved as we have gained greater scale and been able to implement further operating efficiency and lower CapEx.

Our working capital performance was also a highlight as we recaptured \$12 million in the quarter. This was a result of a combination of initiatives, including collection of long-term projects, as well as more focused cash management. The strong conversion and focus on managing working capital in the longer term means that our already strong liquidity position will strengthen in the coming periods, allowing us to continue to invest in our M&A agenda.

We continue to have a disciplined approach to capital deployment with a view of getting maximum return for the amounts invested. In the first quarter, we paid earn-outs totaling \$3 million based on the performance of our M&A files. We expect to have further payments in the balance of FY 2023 on the acquisitions of Dapasoft, Tallysman and Alio as their earn out periods come to an end. These amounts are recorded on our balance sheet at the end of the quarter. They do have a robust pipeline of acquisitions and are looking to continue our track record of deploying capital every year.

As Kevin mentioned earlier, we made an equity investment of US\$2 million in Field Effect Software in partnership with other financing groups. We use equity investments for geographical expansion and entry into new markets, which necessitate greater partnership and ecosystem to bring best-in-class technology to our customers. You'll see more investments of this kind in the coming years as we broaden our reach.

We maintained our dividend rate at \$0.28 per share this quarter. We continue to see the dividend as an important part of our balanced capital deployment strategy, and we'll reevaluate the size of the dividend in future quarters. Our CapEx levels came down this quarter to less than \$1 million.

We ended the first quarter in a net cash position once again. As of December 31, we had \$58 million of cash on hand, up \$15 million from the fourth quarter. This cash combined with our

committed credit facility provides us with \$131 million of net liquidity, and we're able to further expand its liquidity with our current lending syndicate if need be. Given our strong cash flow generating ability, solid balance sheet and a robust pipeline of acquisitions, we're well positioned to deploy this capital and drive long-term value.

Let's take a look at our guidance for FY 2023. We're reiterating our full year guidance this morning. As a reminder, we expect revenues in the range of \$630 million to \$680 million. At the midpoint, this reflects revenue growth of 13% over our record last year. After Q1, our last 12-month revenue sits at just over \$600 million.

Our guidance assumes a return to positive organic growth was an even split between organic and acquisitive growth. We expect adjusted EBITDA in the range of \$70 million to \$75 million. At the midpoint, it reflects adjusted EBITDA growth of 10%. After Q1, our 12-month EBITDA sits at \$66 million. And finally, we expect adjusted net income in the range of \$46 million to \$50 million.

We see continued momentum throughout the first of the year with approximately 55% of our revenue to be realized in the second half of this year as new business comes online fully and we recaptured \$10 million of customer backlog due to supply chain shortages.

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, any impacts due to COVID-19 and potential recessionary pressures.

Our guidance does not incorporate any additional M&A activity and should we close any new opportunities, 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 to conclude our prepared remarks.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Thank you, Patrick. In conclusion, coming off a record Q4 with strong deliveries at the end of the year, we managed to achieve record Q1 results once more. It represented the highest ever first quarter for revenues, gross profit and EBITDA, a performance worthy of mentioned given the current operating environment.

The ITCS and Learning segments generated double-digit organic growth, a testament to strong demand for those services. While Advanced Tech and Health had a slow start to the year, we believe their performance will improve in the second half due to timing of new business wins, recent new contract signings and the easing of supply chain issues.

In addition, our recent acquisitions, namely Computex, SimFront, iSecurity and Tallysman are performing very well and are driving significant value for shareholders. We currently have a strong pipeline of acquisitions and are working hard to close a few this year to continue to scale, drive growth and ultimately reach our \$1 billion revenue objective. For all these reasons, we



have reiterated our guidance, which implies another record year of double-digit growth for Calian.

Finally, I want to thank our staff for their commitment and dedication. They make all the difference. I also want to thank our customers for their loyalty, our suppliers for their collaboration and our shareholders for their continued support.

And with that, I'd like to now open the call to questions.

**Operator**

At this time, we will be conducting a question-and-answer session. [Operator Instructions] Our first question is coming from Doug Taylor with Canaccord Genuity. Please pose your question. Your line is live.

**Q:** Yeah, thank you. Good morning. I'd like to ask about the last statement you made about the expectations of a better second half due to in part to new business wins, new contract signings. We've heard a great deal of chatter about slippage from some of the peers and the broader tech industry. I guess my question is around your confidence interval you have with a statement like that. Are these contracts all now in hand? Have they since begun post-quarter? Or are these deals that you still expect to close in the coming months that contribute to that?

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Yeah. Thanks, Doug, and good morning. The one thing that gives us some confidence – a few things. Number one is our backlog. We have over \$340 million in backlog right now from the context of deals one closed that we expect to realize this year. So we have the backlog element. Strong signings, as you said in the context of new business that we've reported. And we are seeing, as we look at the supply chain issues we've been facing, we are seeing some relief. We are certainly seeing now orders where we can predict when we can deliver.

So based on the backlog, the pace of our new business signings, supply chain issues and some tailwinds in certain elements of our business, we're quite confident in our ability to deliver another record year as per our guidance.

**Q:** Okay. And then maybe as a follow-up to that, and getting to the midpoint of your guidance for this year, I think implies a bit more of an uptick in your margins versus continuing on the same revenue trajectory you delivered here in Q1. Is that driven by an assumption of better cost absorption as you layer these new contracts on? Is there more of just a seasonal pattern? I believe Q1 has been a little bit lower in terms of margin historically. Can you help us bridge that to your guidance there?

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

Sure. Good morning, Doug. Yeah, I think what we've been – you'll see in Q1, we've been investing, obviously, to support the higher uptick in revenue in the second half. I think a lot of our revenue sources now are driving higher margins, higher product margins. So in one way, as long as we – as Kevin mentioned, we have the backlog and we closed the new orders, they'll scale up a lot more from a margin perspective. So we're really trying to build the organization

here to be able to deliver those types of performances in the second half. And right now, we're confident that we can deliver that.

**Q:** Okay. So front end loading the costs ahead of the growth, I get that. Last quick one, Patrick, you briefly mentioned working capital. I mean you had a pretty good recapture of some investments you've made there. I think you said you expect to capture more. Can you maybe just lay out how much excess working capital you've invested that you still think you would be able to convert here versus what you consider a normal working capital posture?

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

Yeah, if you remember at Q4, I mentioned that we thought we could probably be around \$20 million positive working capital this year just from a recapture minus investing to keep growing. Certainly, I think after Q1, we're probably ahead of where we thought we would be from just the speed of getting that to that \$20 million, but it was still a strong performance. I still think that's a reasonable number for this year.

**Q:** Thank you very much. Look forward to the Investor event this afternoon.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Great. Thanks, Doug.

**Operator**

Your next question is coming from Maxim Matushansky with RBC Capital Markets. Please pose your question. Your line is live.

**Q:** Yeah. Good morning. I just wanted to start in your prepared remarks; you mentioned the majority of the orders were from new customers, if I understood that correctly. Was that primarily from strength in any one segment like ITCS for the new customers? Or was it more broad-based?

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

I think we saw strong signings in both Health and AT. So I think both of them had some new signing mix, there wasn't one particular one. But you make a great point. We were – are thrilled to see \$80 million from new customers that's not an easy task to do to go in and win net new customers like that. So, certainly, we're pretty thrilled about the performance overall this quarter.

**Q:** Got it. And for the Learning segment, I mean that was particularly strong this quarter. Was that a one-time impact? Or is that an ongoing contract that should expect to see kind of a higher run rate at least for the near future? How should we think about that?

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Yeah. Good morning, Maxim. It's Kevin. So the exciting part of our Learning business right now, you saw the double-digit organic growth is the continued demand for training, especially in the military environment is strong and both in our customers here in Canada, as well as now, as I mentioned, NATO in Europe. So we really don't see the pace slowing down. We believe right



now, we're in an area that is in demand, more military training, as well as our brand is getting stronger in Europe with regard to the ability to conduct these exercises.

So I don't think that's a onetime thing. I think that's general tailwinds we're seeing in our Learning business, and we're expecting, as I mentioned, a record year for our Learning business this year, which should push over \$100 million for the first time ever.

**Q:** Great. And last one for me, just on the Health segment. You talked about a slower pace of awards for new business. Is this in any particular area like the pharmaceutical solutions or healthcare services? Or is it more kind of just broader, slower pace? I'm more curious to whether there's any difference between the government and commercial customers?

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Yeah. I think for us right now, the legacy Health services business with regard to our medical network that we deploy, that's where we're seeing a few headwinds just in capacity and as I said, recovery from COVID. Where we're seeing positive uptake is in our pharma business right now, pharmaceuticals, both in our patient support program and contract research, strong signings in the quarter and continued growth.

So while we see some headwinds on the clinician services side, we are definitely seeing growth opportunities with our pharma business. So we expect those to come back online this year. And hopefully, with clinician services in the rest of the year, we'll start to see that capacity come back so that we can actually fulfill, frankly, numerous contracts that we're just dealing with the capacity shortages right now.

**Q:** Okay, thanks. I'll pass the line.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Thanks, Maxim.

**Operator**

Your next question is coming from Michael Kypreos with Desjardins Capital Markets. Please pose your question. Your line is live.

**Q:** Thank you and good morning. Maybe just quickly on the Canadian government. You recently saw it announced and approved commercial space launches, given private companies the ability to launch satellites. I was wondering how does this exactly impact the Advanced Technologies segment or your customers, or maybe just the Canadian space sector in general, there seems to be a lot more openness today than just a couple of years ago.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Yeah, great question. It's an exciting time for space globally and also in Canada. I sit on the Board of the recently launched Space Canada Association that is really there mandating to provide that visibility and all the incredibly good space exploration, innovation that's happening here in Canada.

So for me right now, it's positive in that the investment in space, both again in Canada and globally continues to be strong, whether it's space exploration, whether it's communication satellites. So the launch on the East Coast, that company, I know the owners, that's going to be an exciting time when we see the first launch of a spacecraft from a Canadian soil. So I think it's a great time for space.

And from my viewpoint, it only is good news when we see innovations actually becoming realities here in Canada and the funding increasing that we're seeing in the space segment. So that's all positive for the space segment and for our business as well.

**Q:** Thank you. And maybe just quickly on M&A. In terms of the 4 segments, with the interest rates going up, have you seen one segment in particular, where there's been more valuation compression? Is it more maybe attractive targets than the others? Or it's the same across all four?

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

Yeah. I think, we're seeing good in 3 of them. And in Health, we were expecting things to start coming back based on the valuation modifications last year that were pretty drastic. I think that's been slower than we thought, but I still think it's going to happen here this year in terms of more health targets coming on the market. The other 3 segments, we're seeing good deal flow from a pipeline perspective. So I don't think anything has changed from our perspective.

**Q:** Perfect. I'll pass it over the line. Thank you.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Thank you.

**Operator**

Your next question is coming from Reni Sharma with BMO. Please pose your question. Your line is live.

**Q:** Hi. Good morning. Can you hear me?

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Yes, good morning, Reni.

**Q:** Hi. So my question, actually, I was wondering if maybe you could comment about the seasonality in the ITCS business through the rest of the year and how that's expected to evolve given the delays that occurred in last quarter and the supply chain constraints that you're currently facing?

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Yeah. I wouldn't say we have traditional seasonality in that business, but we do have – obviously, we still do hardware delivery, and we've been working through the supply chain realities here. Things have been getting better, which has given us – we're excited about that. Obviously, our customers are excited. But you saw, obviously, we had large deliveries last year.

At the end of Q4, we were able to pull in some material. In this quarter, we're actually short again.

So, I think, you're going to see some of that until we get back to a kind of a normal lead time environment. So, I think, it's just more timing than anything, but we're still seeing strong demand across hardware, our services and our consulting. So, I think, it's strong across all the aspects of ITCS right now.

**Q:** Thank you. And should we be expecting any impact to gross margin based on that?

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

I think you might see 1 or 2 points up or down depending again on the mix that quarter between our services and our hardware delivery. But over time, I think they would stay stable to the levels that you're seeing right now.

**Q:** Okay. Thank you for taking my question. And that's good color.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Thank you, Reni.

**Operator**

[Operator Instructions] We have reached the end of our question-and-answer session, and I will now turn the call back over to CEO, Kevin Ford, for any closing remarks.

**Kevin Ford - Chief Executive Officer, Calian Group Ltd.**

Thank you, Kelly, for facilitating today's call. And before closing this call, I'd like to remind you that we are hosting our Investor Day in Toronto at 12:30. For those of you who'd like to join us at the Globe and Mail Centre. On that note, thank you to each of you for attending, and we look forward to providing an update on our next quarterly call. And with that, Kelly, we can close the call.

**Operator**

Certainly. This does conclude today's conference. You may disconnect your phone lines at this time. Thank you for your participation.