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# EDITED TRANSCRIPT

Q3 2023 Calian Group Ltd Earnings Call

EVENT DATE/TIME: AUGUST 11, 2023 / 12:30PM GMT

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**Unidentified Analyst** -

## PRESENTATION

### Operator

Good day, and welcome to the Calian Group Q3 2023 Earnings Conference Call. (Operator Instructions)  
As a reminder, this call is being recorded.

I would now like to turn the call over to Jennifer McCaughey, Director of Investor Relations. You may begin.

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### Jennifer F. McCaughey *Calian Group Ltd. - Director of IR*

Thank you, Michelle, and good morning, everyone. Thank you for joining us for Calian's Q3 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.

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### Kevin Ford *Calian Group Ltd. - President, CEO & Director*

Thank you, Jennifer, and let me start right away with an overview of our Q3 results. After many years of meeting or exceeding expectations and considerable growth, we did not meet our expectations this quarter on some of our key performance indicators. This is unusual for us, and we do not take it lightly.

I would qualify our Q3 results as mixed. We had some positives, and we had some negatives, but we understand where we need to adjust to get back on track, and I'm confident we will do so quickly.

On the positive side, we generated strong revenue growth of 11% as a result of strong organic momentum. Our Health segment rebounded nicely and posted its best quarter since the days of COVID-

19, and our Advanced Tech and Learning segments continue to show momentum from Q2. We also continue to drive gross margin performance above 30% for a fifth consecutive quarter, showing our ability to adapt and deliver consistent performance despite the challenging macro environment. However, adjusted EBITDA and related margin decreased due to various investments we made coming out of our last fiscal year. We have prided ourselves on profitable growth over the last 6 years and restoring the business to double-digit EBITDA margin is our top priority.

We believe it can be done and have already, as of this call, taken steps to deliver on this. We have underwent a complete review of our delivery capacity and overhead cost and initiated cost reductions in targeted areas to rebalance our investment levels. These measures are expected to generate annualized savings, cost savings of approximately \$8 million with the objective of driving a more optimal level of growth and profitability.

Remember that we are trying to build a double-digit growth company. That comes with some level of risk as we need to push more aggressive in terms of investments ahead of demand. As we push forward, there will inevitably be some bumps along the way. The important thing is to make adjustments quickly and move on. Our business is still strong despite the temporary setback. Our customers still want Calian by their side and our expansion initiatives are still just getting go on.

What gives me great confidence is that the top line is there, the organic growth is there, the new contract signings is there, the backlog is there. We see efficiency in certain areas that's not there and that's what we're fixing. Following the end of the quarter, we announced 2 key events. The first being the closing of the Hawaii Pacific Teleport acquisition effective August 1. I welcome that team to the Calian family and believe there will be key contributors in the years to come.

I would just like to take a moment to express our condolences to the families of those who lost loved ones in the wildfires in Hawaii. We're relieved to hear that the new members of the Calian team and their families were unharmed. Our HPT operations are located on the island, Oahu, therefore, it was not directly perfected. We will be donating \$10,000 for the Maui storm which will support wildfire relief and recovery efforts in the affected communities. The second announcement was the expansion of our credit facility to give us aspects of up to \$250 million in liquidity. This is a sign of our commitment to the continued deployment of our capital on our M&A agenda in the years to come.

Before I give you an update on the 4 segments, I'd like to acknowledge our team. Reducing stock is always difficult, but believe it was necessary to do so at this time to put us in a better position to continue to invest and grow in our business in the years to come.

With that, let's begin with IT & Cyber. ITC has had a difficult quarter. Revenues decreased by 6% to \$46 million, the short-term revenue shortfall was primarily due to lower shipments in our product retail business based in the U.S. The nature of this business can be lumpy as it depends on customer spend cycles as well as demand for infrastructure upgrades. We benefited during the quarter -- we benefited during the last few quarters due to pent-up demand in some supply chain related to post-pandemic.

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Recall that we've been working very hard in the last 12 months to address customer backlog, resulting from the ongoing supply chain issues and we were able to do that successfully. With that behind us, we did see a momentary pause in order intake and deliveries midway through the quarter, which affected profitability. The good news is that towards the end of the quarter, we ramped up new signings, and we believe this sets us up for more normalized performance in the coming quarters.

In fact, gross contract signings were \$53 million in Q3, outpacing revenues. This is an indication that bookings continue to be healthy, and this quarterly miss is just a bump in the road. However, this revenue shortfall fall straight to the bottom line. Gross margins fell to 34% from 40% in the same period last year and this gross profit miss, combined with our accelerated investments in sales and delivery capacity resulted in our EBITDA dropping by more than 50% to \$3.4 million.

Part of our restructuring plan implemented subsequent to the quarter end, laying to realign our sales and marketing delivery capacity with a run rate level of business. Looking forward, macro conditions are neutral with a hint of conservatism from customers due to recession fears. Realistically, we will not be able to make up the shortfall in the fourth quarter, especially since we're already expecting a lower Q4 than last year, given significant deliveries in the final weeks of the quarter last year, but we do expect to return to more (inaudible) level of EBITDA in the coming quarters.

Turning to our Health segment. In the third quarter, our Health segment rebounded and posted its highest revenue since the third quarter of 2021 in the peak of the pandemic. Revenue increased 23% to \$49 million, primarily driven by existing customers, increasing the requirements for health care services as well as new programs being launched across Canada. We have now built a run rate business of approximately \$200 million in recurring revenues. Similarly gross margins and EBITDA margins increased to 27% and 18%, respectively, as our recent investments in recruiting and various outreach initiatives have helped us address customer needs across our portfolio.

Our ability to fulfill contracts at higher utilization levels and lower turnover were key in achieving higher gross margins. In the quarter, we signed new contracts value to \$27 million. Amongst these new signings was our first software-as-a-service customer under the Nexi solution. For the fourth quarter, we expect continued momentum in the business, and we see continued strong demand signals for our existing customers for a pharmaceutical CRO services that have gained increased traction.

Turning to our Advanced Technology segment. In the third quarter, we continued our momentum from Q2. Revenue increased 14% to \$45 million, primarily driven by stronger telecom product sales with existing customers and increased demand for GNSS products. In fact, GNSS products generated double-digit growth again at 22% this quarter and our book-to-bill ratio so far exceeds 2x. This growth comes from new large-scale customers as well as increased demand from existing customers as they include our products into more of their offerings.

During the quarter, we continue to make progress on orders and projects that were delayed to supply

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chain issues. We continue to see delays in certain products, but the delays have started to ease. We are optimistic that we can make further progress in the fourth quarter as we chip away the other product backlog. Gross margins improved from 29% to 35% due to a better mix of higher-margin business. The contribution of more Calian products will continue to drive higher gross margins in the longer term. This gross profit margin improvement flow to EBITDA line with EBITDA margins increasing from 14% to 16%.

In the quarter, we signed new contracts valued at \$50 million, outpacing our revenues. Key wins included upwards of \$15 million for G&A (inaudible) tenants as well as some significant deals for defense and space products. We were also selected by the Canadian Space Agency to receive \$0.5 million in funding to further develop RF over IP technology. RF over IP is the ability to digitize and transport RF signals over an IP network without data loss. This technology will be a key enabler for the introduction of Virtualized Satellite Ground Systems.

For the fourth quarter, we expect to continue on this momentum given the continued easing of supply chain restrictions, delivery of ground system projects recently won and strong demand for our GNSS products. Turning to our Learning segment. In the third quarter, top line continued its year-over-year revenue growth momentum displayed in the last few years. Revenue increased 20% to \$27 million driven by recent investments in technology and geographical diversification as we take advantage of strong demand in the military training market due to geopolitical issues and renewed focus on readiness.

Gross margins temporarily decreased to 25% as the cost of our delivery increased in advance of the contractual rate increases with customers. Predetermined increased tangibles are set to take place in Q1 '24. Similarly, EBITDA margins went down to 14% as we invest to support growth in new countries in Europe. The Learning segment is a perfect example where we don't want to hit the exit button in investments. The issue is that the demand signals from military training in Canada and Europe continues to be high, the procurement process is a challenge to keep up. Global Defense takes time. Our strong position with our legacy contracts allowed us to continue to grow revenues, while we wait for procurement activities to catch up.

We made the conscious decision to continue to invest in our assets to position Calian in the market because we see significant global opportunity down the road. For example, we are seeing positive growth signs in our SimFront software assets and are investing in R&D to get more features and functionality to be able to address a wider customer set in the future. In the quarter, we continued the expansion of our training globally with projects in Poland, Germany, the Netherlands, Australia and Switzerland. This is a strong indication of our pedigree and ability to be a global training partner in defense. We also diversified inside of defense and signed contracts with academic clients, including University of Guelph and Sault College.

For the fourth quarter, we anticipate continuing on the same momentum. As a result, we believe we are on track to break the \$100 million revenue mark in learning for the first time ever. This continued growth is giving us more confidence to continue to invest to make sure we are well positioned to capitalize on the macro environment where military training has become mission critical.

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Now I'd like to turn the call over to Patrick to discuss cash flow, balance sheet and our guidance. Patrick?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

Thank you, Kevin, and good morning. In the third quarter, we generated \$3 million of cash flow from operations compared to \$20 million for the same period last year. The main variance this quarter is explained by a temporary increase in working capital. More specifically, working capital was negative \$12 million in Q3, which puts us at negative \$6 million on a year-to-date basis. We expect to return to positive working capital in Q4 and depending on the timing of some larger collections, we could end the year with working capital increase in the double-digit range.

Operating free cash flow was \$11 million this quarter and represented 78% conversion from adjusted EBITDA. In the third quarter, besides funding working capital, we used our cash to pay dividends and invest in CapEx. We do expect over \$50 million in cash flow on our M&A agenda in the fourth quarter. The first of these being the closing of the acquisition of Hawaii Pacific Teleport on August 1 for about \$38 million as I would schedule earn-out payments related to the acquisitions of Boutique Emissions Security as well as Alio Health for approximately \$17 million.

Recall that these amounts are recorded in full on our balance sheet at the end of this quarter. We continue to have a robust pipeline of acquisitions and are looking to continue our strategy of capital deployment going into FY '24. We maintained our dividend rate at \$0.28 per share. We continue to see the dividend as an important part of our balanced capital deployment strategy. We will reevaluate the size of the dividend in future quarters. We've had \$3 million in CapEx in the quarter and continue to manage our spend within our target of \$7 million to \$8 million for this year.

At June 30, 2023, our \$80 million credit facility was unused and we had \$41 million of cash on hand. As a result, we ended the quarter with a net cash position once again. So to the end of the quarter, on July 24, we extended and expanded our credit facility to a committed amount of \$180 million with an accordion taking it up to \$250 million. This new 3-year term will give us the access to additional liquidity to fuel our growth strategy.

Our cash on hand combined with the new expanded credit facility provides us with \$221 million of net liquidity at the end of the quarter. Given our strong cash flow generating ability and liquidity position, we are operating from a position of strength as we continue to execute both our organic growth plans and our M&A strategy. Let's take a look at our guidance for FY '23.

In light of our third quarter results, we are updating our FY '23 guidance. Note that this guidance has been updated to include the impact of the acquisition of Hawaii Pacific Teleport starting on August 1. The benefits from the restructuring plan for the final month of the quarter excludes the onetime restructuring charge of approximately \$2 million to be recorded in our fourth quarter. We have not made any changes to our revenue guidance. We expect revenues in the range of \$630 million to \$680 million. At the midpoint, this reflects revenue growth of approximately 30%.

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At the end of Q3, our trailing 12-month revenue was \$643 million. Turning to EBITDA, we expect EBITDA in the range of \$60 million to \$65 million, down from our previous range of \$70 million to \$75 million. With one quarter left to go, this range may seem a bit wide. Although we have a strong backlog for Q4 of \$151 million, the range reflects the timing of deliveries of products in our Advanced Tech and ITCS segment. The objective of our cost reduction measures is to restore EBITDA in line with recent performance levels as we enter FY '24.

And finally, we expect adjusted net income in the range of \$36 million to \$40 million. 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 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.

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**Kevin Ford *Calian Group Ltd. - President, CEO & Director***

Thank you, Patrick. To sum up, our top line organic growth was a positive with our efficiency in doing so in certain areas with lower expectations. We have acted quickly and decisively to adjust our business and believe we will be back in the double-digit EBITDA range in the short term. This should be seen as a minor setback and not the start of a trend.

We will still end fiscal '23 for the sixth consecutive year of record revenues and gross profit. The cost reduction measures we have taken will restore EBITDA levels in line with recent performance levels as we enter FY '24, and our trend of over 20 years of profitable execution remains. When I look ahead, I'm very enthusiastic about the future. Since January, I've been traveling across Canada, the U.S. and Europe, visiting our customers. What I found is that our solutions continue to resonate with our customers and what we do for them remains mission-critical. Customers do choose Calian and they cannot fail.

Looking to FY '24, we see the opportunity for another record year. While we only provide official FY '24 guidance next quarter, there are a few factors that I'd like to highlight that I believe will positively impact the year. Expected cost savings of \$8 million from the restructuring plan is to restore our EBITDA margins; the full year impact from the acquisition of Hawaii Pacific Teleport which is characterized by high margins and recurring revenue streams; continued organic growth momentum driven by a solid demand in our 4 operating segments; a robust backlog of \$1.1 billion and strong contract signings of \$568 million in the last 12 months; and a strong pipeline of acquisitions, supported by a pristine balance sheet and available liquidity north of \$200 million.

Finally, I want to thank our team. First, we said goodbye to some of our team members. I'd like to thank them for their hard work and dedication as they make Calian a better place to work. For employees who continue with Calian, I know we can count on you to deliver our mission to help the world communicate,

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innovate, learn and lead safe and healthy lives. At the end of the day, we are very confident that our Q3 miss was a bump in the road, and over the next quarters, we'll unwind, and we will be back to double-digit EBITDA margins and continue our growth momentum on our journey to \$1 billion.

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

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Maxim Matushansky with RBC.

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### Maxim Matushansky *RBC Capital Markets, Research Division - Analyst*

I just wanted to touch on the cost reductions. Can you maybe just give a bit more color in terms of how this came about? Why now? And maybe what parts of the business will be impacted the most?

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### Kevin Ford *Calian Group Ltd. - President, CEO & Director*

Yes. Thanks, Maxim. I think quite a few questions there. I think from the why now and how it came about, we obviously monitor monthly, quarterly -- in real-time, those times, the performance of the company. And I'll take the hit with regard to an agreement of investments at the beginning of last year that I thought were going to put us in a position to continue our growth momentum in certain areas. And some of those are not coming to fruition. There's some macro conditions we're dealing with. So why now is, I felt that I don't see some areas, the macro conditions changing dramatically, and I thought it wasn't prudent to make those changes now and do so quickly and do so decisively so that our staff, our team, our customers know this is a blip, and it is something we're moving on from.

So right now, it was the right time. I felt it does position us to continue the growth momentum and a profitable growth momentum. And frankly, at this time, I think it was prudent to do so to ensure we align our capacity to the performance areas that we see growth opportunities. So that's the why now. Yes, please go continue with your other questions.

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### Maxim Matushansky *RBC Capital Markets, Research Division - Analyst*

And just in terms of maybe what parts of the business, this will impact maybe if there's any particular segment?

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### Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary*

Yes. We try to be -- when we look at the performance, certainly, some of the segments were performing quite well and some of the divisions within them and other ones, the efficiency wasn't where we wanted. So we tried to target the reductions in those areas. So I think there was reductions in all the segments, but we try to be targeted so that it wouldn't impact the revenue as much given that there are in areas where we thought the capacity was too high or the efficiency wasn't there.



**Maxim Matushansky RBC Capital Markets, Research Division - Analyst**

Okay. And then just on the lower product resale shipments, is that -- is there any portion of that, that lost to competitors or maybe customers deciding not to upgrade or refresh the technology for a while? Or do you have confidence that that's all just timing issues?

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**Patrick Houston Calian Group Ltd. - CFO & Corporate Secretary**

Yes, I think it was more timing than not given that we saw some of the signings come back on, you saw the signings in the quarter were so good and they came in towards the end of the quarter. So I think when we reviewed it with the team, I think it was more timing than loss to any particular person. Certainly, our bar business is very diversified. We're in 7 or 8 different verticals with a lot of customers. So we're diversified there. We did see a bit of a slowdown, but it picked back up. So I think it's more of timing than anything more long term.

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**Maxim Matushansky RBC Capital Markets, Research Division - Analyst**

And just final one from me. Just in terms of the profit margins in that ITCS business that they seem to be significantly lower than at least in the past few quarters. Is that all from the lower product resales? Is there something else impacting margins? Was that the investments that you're referring to earlier?

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**Patrick Houston Calian Group Ltd. - CFO & Corporate Secretary**

No, it was really almost entirely on that. Our recurring revenues were stable, similar to prior quarters. And then our on-demand business is also stable. So it's really of our business and given we've got some fixed costs there when we didn't have the gross margin from that, it slowed down to the EBITDA, which is why you saw the lower profit margins and some of the reductions we made obviously kind of reduced some of the capacity there, and we're expecting to see better demand in the coming quarters. So I think it will normalize, as Kevin said, back to kind of performance we've seen in the last couple of quarters.

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**Operator**

Our next question comes from Doug Taylor with Canaccord Genuity.

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**Douglas Taylor Canaccord Genuity Corp., Research Division - Director**

You speak to reducing the cost to optimize the balance of growth and profitability. I think the cost side pretty well articulated and understood here. Maybe I could get you to expand upon what you think the related growth impact is that you're trying to offset on the other side of that and maybe put that in the context of your 5% organic plus 5% acquisitive growth model that you've established at various points in recent years?

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**Kevin Ford Calian Group Ltd. - President, CEO & Director**

Thanks, Doug. So I think it's important to recognize that the fundamentals haven't changed as far as our philosophy or approach. The [5 in 5] is still very much intact. You see the organic growth momentum that we've had right now across 3 of the 4 segments, it's actually in double digits. So very strong. It also demonstrates the value of the diversity, frankly, with regard to one segment hitting some headwinds, but the others -- and frankly, I think the performance was slightly overshadowed in the context of the

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overall EBITDA performance.

But again, 3 segments, double-digit organic growth. M&A, we just finished up with Hawaii Pacific Teleport, a very busy M&A pipeline right now as well. And then, again, seeing the progress in areas such as Health and Advanced Technologies and Learning, I'm confident, Doug, that the fundamentals of what we've put in place and what I've been talking to market since I've taken over, obviously, haven't changed that at all and I was -- I really want to reiterate that. This is a bump, this is not a trend, and this is not something that takes us off our game in any way. We continue, we've made the adjustments and we move forward.

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**Douglas Taylor *Canaccord Genuity Corp., Research Division - Director***

Okay. So let's -- I mean, let's talk about the M&A pipeline. You, at certain points, I think hinted at the prospects of additional meaningful M&A beyond HPT by the end of this fiscal year? I mean, looking at the date here and in light of some of your comments, are you signaling much change at all in that outlook or potentially a change in your focus areas as in which sectors might be most attractive in light of some of the challenges facing ITCS for example?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

Yes. I mean, we're pretty active, Doug, on the M&A side. We've got multiple processes going. So we're optimistic on a few of them that we can guess where we want to be. Realistically, I don't think those close before September 30. But to the extent we're able to follow through on some of the ones that are very active right now, they would be likely in Q1 or early in Q1. So we're optimistic there. We've got the liquidity in place. We're spending a lot of time on the M&A. And then I think our priority hasn't really changed. We're -- we've got strong strategic initiatives in each of the 4 segments, and we're trying to find M&A that fits that. So I think it's continuing on there, and we're optimistic about keeping pace on capital deployment here going into FY '24.

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**Douglas Taylor *Canaccord Genuity Corp., Research Division - Director***

Perhaps one last one then from me. You mentioned your intention to review your dividend again at some point in the near term. It's something I think you've talked about increasingly, perhaps I can get you to potentially expand on what you think an appropriate framework might be for how you balance that dividend against your need for capital for M&A in the current interest rate and debt environment and all that. Could you just expand a little on your thoughts there?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

Yes, absolutely. We've always said to try to get the payout down to kind of 30% of our free cash flow. We're kind of in that range now, which is why we've kind of guidance to where we wanted to be. It took us a couple of years as we just grew the business. So we're kind of in that range now. To your point, we've been prioritizing the deployment of capital on M&A because the return has been good, and we've been getting really good results there. So that's been our top priority. So I think going into next year, we keep watching it as long as the M&A targets are there. We likely hold a dividend, but we're always looking and to the extent that, that 30% starts to reduce as we continue to grow, then I think we look at

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it more seriously. So I think that's our short-term outlook on the dividend.

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**Operator**

Our next question comes from Benoit Poirier with Desjardins.

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**Benoit Poirier Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst**

With respect to the shortfall in EBITDA, you're calling almost a \$10 million reduction in fiscal year '23. But on the back of the restructure, you plan that will bring about \$8 million of benefits, how should we be thinking about the EBITDA for fiscal year '24?

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**Patrick Houston Calian Group Ltd. - CFO & Corporate Secretary**

Yes. If you remember, last quarter, we said we thought we'd be at the bottom of the range on the guidance. And if you take the midpoint of our new guidance that we spoke to this morning, we're \$7 million to \$8 million off and that's why we feel with the reductions we've made it kind of puts us back to where we thought we would be, which I think is what we wanted going into FY '24. And then it's really looking to the elements Kevin pointed, the M&A we disclosed, the organic growth in the pipeline which puts us back to the growth position going into next year. So I think that was the purpose of the restructuring and the size and that's why kind of realigned our business.

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**Benoit Poirier Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst**

Okay. That's great color. And when you're looking at your backlog, it was down 8% sequentially. It looks like booking was softer for Health and Learning. Could you provide some color about the -- what you're seeing out there in terms of booking activity, bidding pipeline and any slowdown in demand?

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**Patrick Houston Calian Group Ltd. - CFO & Corporate Secretary**

Yes. Health actually the demand has been going up. Obviously, a lot of our core contracts don't come up for renewal a lot. So we've been using those and the customers have been using them to a greater extent. But we do see a pretty strong pipeline, so we're expecting strong signings here going into next year in Health and on Learning, Kevin?

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**Kevin Ford Calian Group Ltd. - President, CEO & Director**

Yes, I think so. And I think actually, just a comment on Health, we're seeing, Benoit, very high demand on our core health services contract with defense, probably higher level -- price levels we've seen in a while. So I think that's also contributing to the backlog remaining on Health quicker than normal. On the learning side, really, what we're seeing is, again, with my travels now between NATO and Europe, Canada is strong demand right now on our current contracts for sure and then lots of procurement activity. But as I mentioned in the past, it's just timing.

The government procurement cycles are complex and they take time. So we're still confident there's quite a few opportunities for us. We have a good pipeline of opportunities. So it's just the ability for the

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customer to get it to the street. And as we know, the customer is under significant stress right now with regard to the productions and capacity, the lack of capacity in the military as well as the operational tempo.

So we're trying to work with them as best we can to optimize our current contract vehicles and then obviously, we'll be ready to respond for these new procurements as they come out, and we expect that's going to be online over the next 2, 3 quarters.

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**Benoit Poirier *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst***

Okay. Okay. That's great color, Kevin and Patrick. If we look at the net cash, it ended at \$41 million and looking at Q4, there is the upfront payment for HPT with the share issuance. And if I'm right, there are still \$15 million of earn-outs for that (inaudible). So I'm just wondering if my calculation for cash outflow is okay in Q4?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

We've got HPT as well as the 2 earn-outs that outflows a little over \$15 million. I think we're going to have some positive working capital impact. We -- the collections have been stronger here starting in the quarter, and our AP payments were a bit higher in Q3. So I think we'll see some positives there. So likely have some debt at the end of Q4 just because we need some cash on hand to run the business, but we'll certainly start to -- already between the free cash flow as well as positive working capital in Q4, we should start clawing back some of the payments we've made on the M&A.

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**Benoit Poirier *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst***

Okay. And in terms of working capital reversal, do you still feel comfortable about an overall \$20 million positive working cap reversal for the full year, Patrick?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

I think we might miss that a bit. Right now, we're negative 6 on a year-to-date basis. I think Q4 will be positive. So depending on some of the collections, we could get over \$10 million by the end of Q4, but I think it will be dependent on the timing right towards the end of the quarter on collections.

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**Benoit Poirier *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst***

Okay. Would you say \$10 million for the year or \$10 million positive just for Q4?

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**Kevin Ford *Calian Group Ltd. - President, CEO & Director***

For the year.

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**Benoit Poirier *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst***

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Okay. Perfect. That's great color. And any color about the -- more comments about the buyback these days given the valuation multiples?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

Yes, it's a good question. It's always something that we look at. But right now, our main priority is just continue to deploy the capital on any agenda. We're seeing good momentum there. So I think that's our top priority, and we're just going to focus on that. Obviously, if any was changed drastically on the shares or we continue to see misalignment between the growth we're driving in the stock price, I think we'll look at it more seriously. But right now, we're more focused on our operational plans.

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**Operator**

Our next question comes from (inaudible) with Industrial Alliance.

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**Unidentified Analyst -**

On the IT side, I just wonder, did the weakness in the quarter both on the top line and the margin performance kind of surprised you? Or could you start to see that like last quarter in Q2 when you guys were settling like probably to lower ends of the guidance range? Then do you feel like this weakness is due to the macro environment or part of it is also due to the leadership transition in IT?

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**Kevin Ford *Calian Group Ltd. - President, CEO & Director***

Yes. Thanks, (inaudible). Maybe I'll start with your last question first is, I don't, in any way, believe this is related to the transition team we have in place with the IT group. They are strong, I'm meeting with them there -- as of yesterday, we continue to look at every opportunity in pipeline and they have reassured me this is a blip. And as we saw, there are strong signings in the end of the quarter that we expect to pick up. So I believe it's a blip and it doesn't in any way (inaudible) I don't worry about that transition team. They're very strong, they're committed, and I'm confident that they're going to turn this around.

And with regards to the beginning of the quarter, we started to see some slowdown clearly in the resale elements and worked with the team proactively in capacity, looking where the opportunities were, and we saw in the last month of the quarter, a turnaround. So I just want to reiterate that this isn't something we just wait for the end of the quarter and hope results happen. We're monitoring this all the time. So we were actually working with the middle quarter looking at the opportunity funnel and saw a strong pickup again in the last month of the quarter, obviously, not enough to reflect in the full quarter.

So we're confident to work, I've total confidence in that team. And macro -- well, there's macro (inaudible) on that. I don't believe that it's going to negatively affect us longer term here. So our IP business will be back in line. It's also important to recognize that our Cyber business was very strong. It continues to be very strong, and the recurring revenues continue to be very strong. So it does reflect more on our resale than our Cyber. Cyber is very strong. Our government business continues to see new wins. So it's really a piece of our IT business. I don't want the whole IT business characterized, but somehow it's having some issues here. I expect this will come back in the quarter.

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**Unidentified Analyst -**

That's great color, Kevin. Then I guess what I'm thinking about Q4 for this business line, last year, you had a very large quarter. Can you maybe remind us how to think about seasonality in IT and Cyber?

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**Patrick Houston Calian Group Ltd. - CFO & Corporate Secretary**

Yes. I think there's less seasonality more than just -- it's a bit lumpy. Like you saw last year, obviously, when we were unwinding some backlog because of the supply chain issues, we were on the positive side of the lumpiness. I think this quarter, we're on the other end. I think the performance you saw kind of in Q1 and Q2 were kind of more normalized levels and I think that's what we're trying to get back to here in the coming quarters.

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**Unidentified Analyst -**

Okay. Then I just wonder on the cost savings initiative, I sort of I guess, from your prepared remarks, I thought the implied method was that what targets ITC, but it seems like it targets like more than one area. I just wonder how it impacts your delivery capacity at all?

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**Kevin Ford Calian Group Ltd. - President, CEO & Director**

Yes, great question. And it's important for people to realize that when we looked at this, this wasn't in any way a blanket reduction. This was target reduction, working with each of my senior leadership team members to find areas. Either way, we had additional capacity or it just wasn't aligned to market reality. So it was targeted. It was not just IT, it was across our business in certain areas in corporate support services. We're learning health care IT. The whole business, we looked at with regard to where we needed to make those tough decisions. So it no way -- the important thing is areas that we have seen great demand and good growth, they were basically left untouched, and we wanted to make sure that in this process, we did not impact our ability to meet our customer requirements or our ability to meet our growth objectives. So it was very surgical. It was -- it's never fun to go through those, but it was necessary. It's done, and we move forward.

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**Unidentified Analyst -**

Then maybe one last one. On Health, I appreciate your comments on the growth visibility going forward. So I understand the investments you are making. But just wondering on the gross margin side, a nice jump in the quarter. Are these levels sustainable? Or how do we think about that going forward?

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**Patrick Houston Calian Group Ltd. - CFO & Corporate Secretary**

Yes, we're seeing big demand. We had some new contracts come online in the second half year. So I think that's helped the margin. I think we'll see a little bit of it come back off and normalize a bit, but I think we are seeing as some of these new contracts come on, we're able to generate a bit higher margins than we had in our legacy business. So not a huge increase, but I think we're slowly trying to get better there. And I think as we cross this kind of \$200 million run rate business in Health, which is a new level for us, I think we're seeing better efficiencies as we go. So I think Derek has been doing a good job about looking at the business and building a more efficient health segment.

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**Kevin Ford *Calian Group Ltd. - President, CEO & Director***

Yes. And I just want to jump in on that, because I want to go with what Patrick said. Derek's been here just almost 6 months now and really been impressed by his ability to take a look at what we have in the truck. We've reorganized some of the health care digital assets, we're sitting in (inaudible) his watch. We now have a health care digital team. We're seeing lots of progress there. As I mentioned in my results summary, we've got our first Nexi sale. So very, very optimistic. He's got a great vision and the team is aligned to that vision. So I think we're going to continue to see good things from our Health business.

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**Operator**

(Operator Instructions) Our next question is a follow-up from Benoit Poirier with Desjardins.

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**Benoit Poirier *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst***

Yes. In the press release, there are some mentions around the timing of deliveries of products for Advanced Tech and the IT segment. So could you maybe provide more color about those covenants? And is there any relation to issues at the Viasat?

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**Patrick Houston *Calian Group Ltd. - CFO & Corporate Secretary***

No, I know that why it really just -- we've got -- we had some good planning. We saw (inaudible) to get in Q3, we need to turn those around and deliver into Q4. So it's really going to come down to the timing in the last month and how much of that we've been (inaudible). I think that's why they'll certainly have higher margin and impact on EBITDA. So that's why we're going to -- bigger going to that. The good thing is the business is there, we've got the order, we're looking to turn around...

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**Benoit Poirier *Desjardins Securities Inc., Research Division - VP and Industrials, Transportation, Aerospace, Industrial Products & Special Situation Analyst***

Okay. And last one from me. Kevin, could you give us an update on the President search for ITCS. And what you're looking for in terms of key attributes for the new President?

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**Kevin Ford *Calian Group Ltd. - President, CEO & Director***

Yes. Thanks, Benoit. So we're -- we've been a couple of months into this. Frankly, over -- almost over 100 applicants. It was -- so we've worked down to the last few. We're finalizing interviews now with those candidates. And my goal is still to have a new President in place in time for beginning of our new fiscal year and sooner if I can, but we're not going to rush the process. We want to make sure we get it right. Key attributes clearly are continuing to look at our IT and Cyber business, how we position that in the marketplace with regard to increased cyber demands in the cloud, cloud migration, the ability to continue to generate and increase our recurring revenue streams with our team, the global expansion that we see, obviously, North America focused initially, but obviously going to Europe.

So I look for somebody that can bring positive energy, track record on transforming and continue the transformation of our IT business and somebody that can work across Calian with our cross-business unit

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updates with regard to cross-sell opportunities. So we're getting there, and I think we'll be close soon to announcing who that will be.

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**Operator**

There are no further questions at this time. I'd like to turn the call back over to Kevin Ford for any closing remarks.

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**Kevin Ford *Calian Group Ltd. - President, CEO & Director***

Thank you, Michelle. I think it's important for me to restate my confidence that this is a blip, my confidence that we're on track for another record year as we head -- as we start looking ahead to '24, summarize the \$8 million restructuring done. It's not something we're planning on doing, it's done. We do have (inaudible) on the team and excited about that. We do have the organic growth momentum. You saw that in the quarter. We have the backlog still of over \$1 billion, over \$568 million in signings.

And now with our M&A pipeline strong and our balance sheet, I do want the market to understand, I believe this is a blip and in no way a trend. Our team is committed to working through this. It's been a very busy couple of weeks, as you can imagine. And I've seen nothing but everyone putting their shoulder into this to make sure that we rightsize on this EBITDA margin.

So with that, I want to thank you all for the questions and attending today and look forward to providing an update on our next quarterly call. And with that, Michelle, we can close the call.

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**Operator**

Thank you for your participation. This does conclude the program, and you may now disconnect. Everyone, have a great day.

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