

Haivision Systems Inc.

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Earnings Call

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Call Participants

EXECUTIVES

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Miroslav Wicha
Chairman, President & CEO

ANALYSTS

Nick Corcoran
Acumen Capital Finance Partners Limited, Research Division

Robert Young
Canaccord Genuity Corp., Research Division

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Presentation

Operator

Good day. My name is Emma, and I will be your conference operator today. At this time, I would like to welcome everyone to the Haivision Q1 earnings call. [Operator Instructions] Thank you.

Mirko Wicha, President, CEO and Chairman of Haivision, you may begin your conference.

Miroslav Wicha
Chairman, President & CEO

Thank you, Emma, and good afternoon, everyone. Thank you for joining us today to discuss the first quarter results of our fiscal year 2023.

As demonstrated by the results we announced earlier today, demand for our products remain strong, and our business fundamentals have never been better. The company achieved a record Q1 revenue of $34.1 million, which represents a 20.2% growth over Q1 of last year as we continue to deliver top line growth. And we also delivered an adjusted EBITDA of $2.1 million for Q1, which represented a 6.2% operating margin.

Our transition away from the house of worship managed services market is progressing extremely well, and we expect this to be completed as planned by the end of April. Now we still, however, need to maintain the infrastructure, licensing and the cloud costs to service these clients until the end of April. Although we will begin to see results of this initiative mainly in our reduced COGS and, to a lesser extent, our OpEx during the second half of the fiscal year. And the overall reduction should amount to approximately $500,000 per quarter.

Well, a few key highlights to note. We recently launched our next-generation critical visual collaboration platform called Haivision Command 360 as like we'd like to call it C360, during the ISE Show in Barcelona. It was very well received and the sales teams are already busy in building a sales pipeline, especially within the international marketplace.

We had successful deployment of the Haivision Pro Series transmitters on 5G private networks, the elections in Denmark with TV2, sailing competition in Spain with Telefonica and football in Germany with Media Broadcast and Nokia. TV Technology Magazine selected Haivision Pro Series transmitters, specifically the Pro460, the Best in Market 2022 for innovation, feature set, cost efficiency and performance. And SRT Alliance membership surpassed 600 members as it celebrates its sixth year anniversary, an astounding feat in industry, truly establishing SRT as the industry standard for video streaming.

And our Makito, Haivision Makito X4 was awarded the Best Encoding Hardware for Live Production at the 2022 Streaming Media Readers' Choice Awards.

And our most recent addition, Jean-Marc Racine as our Chief Product Officer, is already making a positive difference on our product vision and strategy. He is making instrumental progress in leading the development and product management teams and really building and help to build innovative products.

Our 2023 plan to increase our revenue and profitability is well on track, and we are pleased with our Q1 results. We continue to have a strong focus on EBITDA and continue to make this one of our top corporate priorities. The entire company is focused on efficiency and execution to make this happen.

And let me quickly comment on the Evertz expression of interest. I'm sure people will be asking some questions. And it's regarding the recent answer to this expression of interest that was made public on March 6. We are not clear whether Evertz's approach can actually be deemed a legitimate offer, as it is nonbinding expression of interest. And more importantly, they are unable to provide a binding transaction structure or price until they, a competitor, completes due diligence. I'm not sure how we could ever get

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to a more committed transaction by giving a competitor access to due diligent materials. So it does get complicated.

Now furthermore, we will be required to enter into exclusive discussions with them. And remember, this is a nonbinding and loosely defined expression of interest. And there are certain expectations that require being asked of myself and other significant Haivision shareholders. But to our knowledge, these discussions haven't happened. Now, I can tell you that speaking as Haivision's largest shareholder, I find the price point of their nonbinding expression of interest unacceptable and would not be interested in voting for any proposal at this level. But again, that's me speaking as a shareholder. But the Board of Directors does have an obligation and fiduciary responsibility, regardless of the expression of interest's shortcomings. And the Board will study this and decide on actions, if any, in due course.

The company remains focused on executing its growth strategy, expanding its market presence and delivering innovative solutions to its customers. And we believe that Haivision has a bright future ahead, and we are committed to maximizing long-term value for all our shareholders. We are confident in our ability to execute on our strategic plan and deliver continued growth and success.

And in closing, despite the economic headwinds and continued supply chain challenges, we expect our Q2 to be strong and consistent with our strategic plan, and we feel very comfortable with our 2023 direction. We'll, of course, continue to review our performance quarterly, while maintaining a strong pulse on the industry and market conditions. Although we are very confident in our direction and expect to show growth in both our revenue and profitability in 2023.

So with that, Dan, please continue with the detailed financials.

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Thank you, Mirko. But let's get into the numbers. Revenue for this first quarter of fiscal 2023 was $34.1 million, an increase of $5.7 million or 20.2% from the same period in the prior year. We did close the AVIWEST transaction in April of 2020. So first quarter 2023 results include AVIWEST performance for the entire quarter.

As discussed on previous calls, historically, there was seasonality in our legacy business, whereby the fourth quarter, which is commensurate with the U.S. government year-end, is traditionally our largest quarter. The recently acquired business lines have a different seasonality heavily weighted to the end of the calendar year, that's November-December time frame. Thus, the revenue decline from prior quarter was absolutely expected.

Recurring revenue, which we define as our cloud solutions and maintenance and support was $7.5 million. These results are ahead of last quarter's performance by $400,000 and ahead of last year's performance by about $1 million. Recurring revenue represented 22.2% of total revenue compared to 23.2% of total revenue in the prior year comparative period. Note that as part of our recent restructuring exercise, we decided to transition out of the house of worship market and expect cloud solution revenue in our second quarter to fall by more than half. Then we expect to be completely out of that business segment by the end of April.

On a positive note, the house of worship revenue is heavily dependent on the price of bandwidth and competitive offerings, including free offerings that are putting downward pressure on cloud revenues and resulting gross margins. With that said, we remain very focused on increasing our maintenance and support revenue as we conform our maintenance and support offering across all entities.

For this quarter, gross margins were 66.6%, down from the 68% realized for the same period last year. As discussed on prior calls, we anticipated margins to slip from historical experience as margins for AVIWEST offerings are below our historical margins. On a positive note, the recently announced price increase has improved the margins on our legacy products. However, the seasonality of our newly acquired product lines resulted in a higher percentage of our first quarter revenues from these newly acquired product lines driving the momentary compression of margins this quarter.

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Further, although we are seeing supply chains revert to normal, we did incur between $300,000 and $400,000 in additional costs related to those hard to procure componentries. Again, the closing of the house of worship business should improve gross margins going forward as that offering tended to be below the average performer in terms of gross margins. Upon the full shutdown, we expect to be able to eliminate approximately $0.5 million in quarterly fixed costs from our cost of sales, and we should see the full benefit of this additional savings in the beginning of our third quarter.

Total expenses for the first quarter was $23.7 million, an increase of $3.9 million when compared to the same period in the prior year. The year-over-year increase is largely related to compensation expenses of $1.9 million, again, largely related to the AVIWEST transaction in April of 2022. Generally speaking, our cost structures have always been heavily weighted towards people costs and the AVIWEST transaction added 81 people, 79 of whom are still with us. We ended the quarter with 401 people compared to 338 employees a year ago.

In addition, increases in depreciation and amortization expenses related to acquired assets and intangibles, added about $1.1 million in additional OpEx. And travel expenses increased by about $600,000 as we return to pre-pandemic normalcy. When we last discussed the annual impact of the recent restructuring, we believe the reorganization would generate $8 million in annual savings. When we normalize our OpEx to exclude the impact of exchange rate variances, OpEx in this recently completed quarter fell $1.9 million when compared to the prior quarter.

We have further opportunities for OpEx savings once we close the house of worship business completely and are optimistic that we've achieved the goal set out for us last quarter. When we normalize for share-based payments, depreciation of fixed assets and amortization of intangibles, total OpEx was $20.6 million, an increase of $3 million from the prior year or an increase of only 17%. Thus, we are seeing operational efficiencies when we compare the increase in OpEx to the year-over-year revenue growth of 20.2%. The result is an adjusted EBITDA for the quarter of $2.1 million, flat compared to the $2.1 million of adjusted EBITDA for the same period in the prior year.

After a disappointing third quarter and a restructuring exercise last quarter, the adjusted EBITDA performance shows the earnings potential of the company on a go-forward basis. The adjusted EBITDA margin for this quarter was 6.2%, albeit lower than our annual expectation and certainly lower than our goal of 20%. Although we believe the recent quarter is more clearly demonstrating our cost structure in the near term, we are really just beginning to see the benefits of our restructuring plan, and there is additional opportunities going forward.

Net loss for the quarter was $1.4 million compared to a net loss of $0.5 million for the same period in the prior year. As was the case with EBITDA, the quarter's net income was impacted by the increased headcount related to AVIWEST, additional depreciation and amortization and an increase in travel and marketing costs post COVID.

With respect to the balance sheet, we ended the quarter with cash balances of $12.7 million and ended the year with $15.2 million outstanding on the credit facility. Thus, one can say the cash increase for the quarter, net of proceeds from the line of credit, was about $2.9 million. Total assets at quarter end were $146.6 million, a decrease of $2 million from the end of fiscal year 2022. The decrease in assets is largely the result of amortization of intangible assets, which decreased by $1.4 million. Just as a note, amortization in this recent quarter was about $2 million.

However, assets were also impacted by movements in exchange rates, particularly intellectual property denominated in euro. The exchange rate for the euro moved from approximately 1.35 to about 1.45 at the end of this recent quarter. Total liabilities at quarter end were $56.9 million, a decrease of $1.4 million from fiscal 2022 year-end. This decrease in total liabilities during the quarter was despite the $4 million increase in the amount outstanding on the line of credit and the $2.1 million increase in deferred liabilities. Deferred liabilities are related to our recurring revenue models.

Payables did decrease by $5.5 million during the quarter. As we settled $1.5 million related to restructuring costs, we paid $1.2 million in commissions and bonuses related to fourth quarter performance. And as a reminder, our fourth quarter was a record revenue quarter for us.

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We've reconciled purchase price payables related to the AVIWEST transaction. And of course, we paid our invoices for inventory purchases related to the fourth quarter and first quarter revenue. With respect to the remaining integration plans, for AVIWEST, our focus continues to be increasing the flexibility of AVIWEST's supply chain, porting AVIWEST to a common accounting system and bringing AVIWEST's products to North America.

For Haivision MCS, the integration has been a bit more complicated and progress has been slower than we hoped. However, our focus has been on fully integrating our development teams. And most of the heavy lifting related to that initiative was completed on March 1. There's still a bit of cleanup there, but most of it is back-office work and does not affect day-to-day product realization efforts. Our next major focus is integrating production capabilities with additional opportunities beyond that. The pace of integration should continue to increase over the remainder of the year.

With respect to the headwinds we've discussed in earlier calls, component pricing and delivery schedule seem to have stabilized. This quarter's expenditures for componentry purchase outside of normal channels continued to be modest. In the recent closed quarter, we incurred approximately $300,000 to $400,000 in incremental cost of sales related to these difficult to procure components, and we maintain that approximately 2/3 of the incremental costs incurred to secure our supply chain have been recognized thus far. So the investments in incremental inventories, board redesigns, identifying alternative sources of supply, in-sourcing certain activities, investing in third-party systems and employing senior supply chain expertise seems to have paid off.

Our supply chains are more resilient and flexible than ever and none of our customers have suffered any delays in shipments. The headwind related to finding qualified people also seems to be easing a bit, albeit with some ongoing challenges. At the last call, we were a bit concerned about the impact of the recently announced reductions in headcount and the hiring freezes on the rest of the organization. We are also concerned that the holiday season might disguise a retention problem that would show itself after the first of the year. However, we have not seen any acceleration or departure -- any acceleration of departures after the holidays. In fact, turnover in this recently completed quarter seems to have reverted back to the pre-pandemic levels.

Yes, we have frozen hiring, except for essential positions, unfortunately, the essential positions that were difficult to hire in the past continue to be challenging going forward.

Beyond supply chains and employment issues, travel and trade shows are back. We saw a $600,000 increase in travel expense when compared to the first quarter of fiscal 2022. Now about half of that incremental increase is related to sales efforts. The other half is related to our professional services and installs, which is a sign that the business continues to grow. The return to trade shows is complete, and we will be exhibiting at a number of the larger international trade shows and a significant number of the regional industry-specific trade shows.

Just as a note, our second quarter will include incremental costs related to our participation at NAB, the world's largest broadcast show.

In terms of expectations for the remainder of the year, despite that many enterprises and government customers may be feeling some pain, and we are transitioning out of the house of worship managed services business, meaning a reduction of last year's revenue in this market, our overall revenues continue to show growth. Thus, our revenue guidance for the full year, which factors in the reduction in house of worship revenue is still expected to be between $130 million and $135 million this year.

We also expect to see expansion of our adjusted EBITDA margin as we continue to exploit synergistic opportunities, and we have visibility to achieving double-digit adjusted EBITDA margins.

That concludes my prepared remarks. I'm passing the microphone back to you, Mirko, and then we will open the floor to questions.

Miroslav Wicha
Chairman, President & CEO
Yes. Thanks, Dan. I guess I think we should just open up for questions. And Emma, if you can help us out.

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Question and Answer

Operator

[Operator Instructions] Your first question today comes from Robert Young with Canaccord.

Robert Young
Canaccord Genuity Corp., Research Division

Maybe just to clarify something you said at the very end there, Dan, about double-digit EBITDA margin. What was the implication there? Was that an expectation in the short run, medium term? I missed whatever you said around that.

Dan Rabinowitz
CFO, Secretary & EVP of Operations

We think we're going to be able to get to that double digits in adjusted EBITDA, going to take us a little bit of time to get there. But by end of the year, we should be seeing that quite solidly.

Robert Young
Canaccord Genuity Corp., Research Division

No, I think last quarter, you had said that double digits was probably too high an expectation for 2023. And so you're a little more positive on that. Is that a good way to read it relative to maybe last quarter?

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Correct. Yes.

Robert Young
Canaccord Genuity Corp., Research Division

And then as -- since talking about guidance; talk about revenue guidance. I mean, the quarter is better than we had modeled by, I think, $5 million or more. And so I'm curious why, why not above the guidance? Are you being conservative? Or is there some seasonality that we should be thinking about?

Dan Rabinowitz
CFO, Secretary & EVP of Operations

I think there's definitely some seasonality that we have to be aware of. We kind of mentioned that the first quarter tends to be down when compared to our fourth quarter. There's a seasonality that we've been the beneficiary of. Fourth quarters are commensurate with the government year-end. So we see -- usually we see a big pop in that quarter. We think the second quarter is going to be quite buoyant as well based on the work that's been done thus far. The summer tends to be a little bit quieter. And then again, we're going to be back into our fourth quarter where we have big expectations.

Robert Young
Canaccord Genuity Corp., Research Division

And then the next question from me would just be around some of the -- Mirko or Dan, I think you had said that there was some headwinds in the government and enterprise end markets. Are you still seeing that same sort of level of headwind? Or is it relenting, getting worse, the same?

Miroslav Wicha
Chairman, President & CEO

Yes. Let me take that one. I think what we -- we're definitely still seeing in the commercial enterprise space that we are seeing some headwinds. But what we're seeing within our solution set that we've been pushing, mainly with the Command 360 sales. Our pipeline is actually pretty robust, and we're seeing

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some great traction, especially since also coming off from the ISE show. So we're very buoyant that in our space, in our solutions, we seem to be pretty buoyant. But we do still see that in general, those types of accounts, whether it's the banks, the pharmaceuticals are still being very cautious. But in our solutions, we feel pretty confident.

Robert Young
Canaccord Genuity Corp., Research Division

And then last question. The comments on the integration, particularly on MCS. I think you said that it was nearing completion. Was that -- is that including the certifications that you needed for U.S. secret? Is that is that all completed? Or do you have an insight there? And then I'll pass the line on.

Miroslav Wicha
Chairman, President & CEO

Yes, let me sort of correct something. I don't think I said that was completed -- we completed the first most impactful element of it. It's a 4-phase approach. So that first element was to -- with the development teams to make sure that they're fully integrated, make sure that the resources are made available to them, to those developers so we can build those products that's efficiently, and that is done. The next step, we'll move into production, then we'll move into another area thereafter. So it's going to take a little bit more time. I would say we had plans for us to take at least 3 or 4 quarters to get done. So that's where we are with respect to the integration there. But the clearance, that's not a milestone event for us. I don't -- I'm not exactly sure what you're trying to get at.

Robert Young
Canaccord Genuity Corp., Research Division

My impression was that there was something that was outstanding there last quarter, maybe I am incorrect?

Miroslav Wicha
Chairman, President & CEO

I don't think so. We're still operating. We still have a good relationship with everyone out there. It's -- that's not on the critical path that I'm aware of.

Operator

Your next question comes from the line of Nick Corcoran with Acumen Capital.

Nick Corcoran
Acumen Capital Finance Partners Limited, Research Division

I think Rob asked most of the questions I had. The only one I have is just going back to the adjusted EBITDA margin, how should we be thinking about the build through the year?

Dan Rabinowitz
CFO, Secretary & EVP of Operations

I'm sorry, I did not -- I was not able to hear that.

Nick Corcoran
Acumen Capital Finance Partners Limited, Research Division

Yes, I'm thinking of the adjusted EBITDA margin through the year, how should we think about the build from Q1 to Q4?

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Well, I think the message we're trying to say is that we've gotten ourselves right sided as expectation. And our business is relatively -- our OpEx is relatively flat in terms of the majority of our expenses, the

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big modification that we might see are the big trade shows or the big marketing efforts that may make our OpEx go up and down. So it really is based on your revenue model with a relatively fixed OpEx with the variability of marketing.

Miroslav Wicha
Chairman, President & CEO

And just to be clear, Q1, Q2 and Q4 are expected to be stronger than Q3 is seasonally in the third quarter.

Nick Corcoran
Acumen Capital Finance Partners Limited, Research Division

It's a summer --

Miroslav Wicha
Chairman, President & CEO

Q3 tends to be not only the 2 summer months, especially international and especially in Europe, but also very low in the government space as well. So kind of get -- it tends to be a very, very -- or the lowest quarter of all 4 quarters, for sure.

Nick Corcoran
Acumen Capital Finance Partners Limited, Research Division

And then maybe going back to the Evertz's expression of interest. Have you formed a special committee to review that offer?

Miroslav Wicha
Chairman, President & CEO

At the moment, it's at the Board level and the Board is taking actions. We just want to get past our earnings call, and that's their next step, and they said that they're going to review it and get back in due course.

Operator

This concludes our Q&A for today. Mirko, I turn the call back over to you for closing remarks.

Miroslav Wicha
Chairman, President & CEO

Thank you, Emma. Well, I just want to thank all our investors and analysts, of course, online for their continued support of Haivision and look forward to speaking with all of you again in June when we discuss our Q2 results. So thank you very much.

Operator
This concludes today's conference call. Thank you for attending. You may now disconnect.

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