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Call Participants

EXECUTIVES

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Miroslav Wicha
Chairman, President & CEO

ANALYSTS

Robert Young
Canaccord Genuity Corp., Research Division

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Presentation

Operator

Ladies and gentlemen, good morning. My name is Abby, and I will be your conference operator today. At this time, I would like to welcome everyone to the Haivision Systems Incorporated Second Quarter 2023 Earnings Conference Call. Today's conference is being recorded. [Operator Instructions]

And I will now turn the conference over to Mirko Wicha, Chairman and CEO. You may begin.

Miroslav Wicha
Chairman, President & CEO

Thank you, Abby, and good afternoon, everyone. Thank you for joining us today to discuss our second quarter results and the first 6 months of our fiscal year 2023. I'm actually joining you from Bank of Thailand this evening as I'm attending our APAC Summit. And that's really the reason why this call is early in the morning Eastern Time as compared to our normal schedule after the market closes. So I apologize everyone for the early start. The good news is that we're actually having an amazing event over here this week with over 100 people attending, which includes 36 of our strategic channel partners throughout the entire APAC region. So a very successful event so far with another day to go. It's also the first summit together with all the Haivision and Aviwest partners in the region and all sharing our combined sales successes. I mean everybody is excited as representing a combined company technologies to tackle the broadcast contribution market as leaders in both the fixed and wireless and coating space. So very, very cool event all week, and we've been glad to see so many new partners as well.

Now as demonstrated by the results we announced earlier today, demand for our products remain strong, and our business fundamentals have never been better. As you've seen in the press release that went out yesterday, the company achieved a record revenue of $35.1 million, which represents a 17.5% growth over Q2 of last year as we continue to deliver top line growth. This is inclusive of the much reduced revenue from the house of worship vertical we have exited from as of April 30th.

The company also achieved a record first 6 months revenue of $69.2 million, which represents 18.8% growth over the last year's first 6 months. And we delivered an adjusted EBITDA of $2.6 million for Q2, which represents a 7.5% operating margin. And for the first 6 months of the year, our adjusted EBITDA was $4.7 million, representing an overall 6.9% operating margin. That's typical for our OpEx to be front loaded, and we expect a much stronger EBITDA and operating margin performance in the second half of the year, especially with our reduced COGS.

Our transition away from the house of worship market, managed services market has actually been very successfully completed. As mentioned in our previous earnings call, we will begin to see the 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 $0.5 million per quarter. This will set up a stronger operational performance, as I mentioned, in the second half of the year and really prepare us for a very exciting fiscal 2024.

We believe that our company 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. The company remains focused on executing its growth strategy, expanding its market presence and delivering innovative solutions to its customers.

In closing, before I hand it to Dan, despite the economic headwinds and continued supply chain challenges, we expect our Q3 to actually be strong and consistent with our strategic plan and feel very comfortable with our 2023 direction, delivering between $134 million to $135 million in revenue with a very good visibility to double-digit adjusted EBITDA performance for the full year. We are very confident in our strategic plan and expect to show growth in both our revenue and profitability in 2023 and are preparing for an even more exciting 2024.

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Our Q3 results will be the first indication of the reduced COGS and OpEx with the synergies derived as a result of our operational realignment we implemented during the past 6 to 9 months. As discussed previously, we are moving quickly towards achieving our longer-term goal of delivering 20% EBITDA performance.

So I'll pass it on to Dan to continue with all the detailed financials, and then he'll be back to me to close it up after the questions.

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Thank you, Mirko. Some of this will be repetitive, but let's get into it. Revenue for the second quarter of fiscal 2023 was indeed $35.1 million, an increase of $5.2 million or 17.5% from the prior year comparative period. As a reminder, we closed the Aviwest transaction in April 2022. So second quarter 2023 results include Aviwest performance for the entire quarter. Whereas in the prior year comparative period, results included a single month of Aviwest performance. This recent quarter was the second best quarter in the history of the company, only surpassed by our fourth quarter last fiscal year. Revenue for the 6 months ended April 30th was $69.2 million, an increase of $11 million or 18.8% from the prior year comparative period. Again, year-to-date results include Aviwest performance for the entire 6 months, whereas in the prior year comparative period, its performance only included Aviwest for a single month. Nevertheless, this year-over-year performance is even more impressive when you take into consideration our exit from the house of worship market.

Recurring revenue, which we define as our cloud solutions and maintenance and support, was about $7.1 million or about 20% of total revenue. We anticipated that our recurring revenue would decrease as a percentage of our total revenue once we exited the house of worship business. The house of worship managed service business represented about 1/3 of our recurring revenue.

On a positive note, the house of worship revenue was heavily dependent on the price of bandwidth and because of the nature of the business, there was a number of more cost-effective solutions to serve that church market, including free offerings. The business had always been putting downward pressure on the growth in cloud revenues and resulting gross margins. On another positive note, we have seen our maintenance and support revenue grow even faster than our overall revenue. Maintenance and support revenue grew 33% quarter-over-quarter and grew 28% on a year-to-date basis. That's largely due to the fact that we've conformed our support offerings across our new properties, and we've increased our attention on these renewals.

For this quarter, gross margins were 68.9%, down from the 69.4% realized in the same period last year. We anticipated margins to slip from historical experience as margins for the Aviwest offering, and for that matter, the Haivision MCS offerings, tended to be operate below our historical margins. However, this quarter's gross margin was an improvement from the 66.6% realized last quarter, and it surpassed what we did for the full year last year as well. Part of the explanation for the improvement in margins is related to overall product mix. The recently acquired businesses lines have different seasonality, heavily weighted to the end of the calendar year, the November, December time frame, or what is consistent with our first quarter. Again, discontinuation of the house of worship business should improve gross margins going forward, as that managed services offering tended to be a below the average performer in terms of gross margins. Even in this quarter where we shut down the business, we incurred about $700,000 in fixed COGS related to that business. We should see the full benefit of this incremental savings in the beginning of our third quarter and beyond. Further, although supply chains appear to be reverting to more normal delivery schedules, we did incur between $300,000 and $400,000 in additional costs related to hard to procure componentry consumed in this quarter. We expect that these types of extra expenses will continue to dissipate as we go forward. Total expenses for this quarter were $25.1 million. That represents an increase of $3.9 million when compared to the same period in the prior year.

Now as we've said in previous calls, our cost structure is heavily weighted towards overall compensation-related expenses. We ended the quarter with 389 employees compared to about 417 employees a year ago. The Aviwest transaction consummated in April is, in fact, impacting year-over-year comparisons. After all, Aviwest added 81 people, 77 of whom are still with us today. Thus, the $3.9 million in year-over-

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year increases is largely explained by compensation-related expenses, adding an incremental $1.7 million, increases in depreciation and amortization expenses related to the acquired assets and intangibles added an incremental $1 million to total expenses. The Canadian dollar exchange rate impacts on U.S. dollar-denominated assets and liabilities added an incremental $600,000 and then increased travel expense added an incremental $500,000 total expenses.

With that said, there are opportunities for additional expense savings that we should realize in the third quarter and beyond. For instance, our largest trade show, NAB, is a second quarter event, and we wouldn't expect to incur similar marketing expenses in the third quarter. And our expenses for professional services are disproportionately focused on the first half of the year. They tend to be aligned with our year-end statutory reporting , our annual shareholder meetings, expenses, accounting services and so on and so forth. So we should not see the same level of professional services in the third quarter or the fourth quarter.

On a year-to-date basis, total expenses were $48.8 million, an increase of $7.8 million when compared to the prior year comparative period. The reasons for the increases are similar to those that we discussed throughout the second quarter. Increases in compensation-related expenses, again, mostly attributed to Aviwest added about $4 million in total expenses, increases in depreciation and amortization expenses related to these acquired assets and intangibles added an incremental $2.1 million. Increased travel expenses added an incremental $1.5 million and the Canadian dollar exchange rate impact on U.S. dollar demand assets and liabilities added an incremental $600,000. When normalized for share-based payments, depreciation of fixed assets and amortization of intangibles, total expenses were only $21.7 million, that's an increase from the $2.9 million last year -- that's an increase of $2.9 million from the prior year, which is only an increase of about 15%, less than what our revenue growth was. The result is that adjusted EBITDA for the quarter was $2.6 million, that's flat compared to the $2.6 million in adjusted EBITDA for the same period in the prior year. However, that adjusted EBITDA margin for this quarter was 7.5%. Albeit lower than our annual expectation, it does represent an improvement from last year's overall performance of 6.4% and an improvement from the 6.2% realized last quarter. We are really just beginning to see the benefits of our restructuring plan. And as I touched on before, there's certainly additional opportunities going forward. Net loss for this quarter was $1.5 million compared to a net loss of $400,000 for the same period in the prior year. As was the case with EBITDA, this quarter's net income was impacted by increased headcount, depreciation and amortization, increases in travel and the exchange rate impact on U.S. dollar-denominated assets and liabilities. On a year-to-date basis, the net loss was $2.9 million compared to a net loss of $300,000 for the prior year comparative period.

With respect to the balance sheet, we ended the quarter with cash balances of $7.3 million. That does represent a decrease of $5.4 million from prior quarter end. However, we also ended the quarter with $10 million outstanding on the credit facility, which is a reduction of $5.2 million from the prior quarter end. Total assets at quarter end were $141.7 million, that is a decrease of $6.9 million from the end of fiscal year 2022. The decrease in assets in the 6-month period include a $7.5 million reduction in trade and other receivables, a $2 million reduction in net intangible assets, that represents $4 million in amortization, offset by the increase in balance sheet items related to exchange rates. These decreases were offset by the $1.5 million increase in cash and the $2 million increase in receivables related to tax credits.

Total liabilities at quarter end were $50.8 million. That's a decrease of $7.2 million from the end of fiscal 2022. This decrease in total liabilities includes a $5 million decrease in trade and other payables, and these trade payables include compensation-related accruals like vacation accruals and commission accruals and so on and so forth. We also had a $1.2 million decrease in the line of credit in that 6-month period. We reduced our term loans by about $600,000, and we decreased our lease liabilities by another $600,000.

With respect to integration plans. For Aviwest, we have completed the move of Aviwest to a common accounting system and our focus in the near term is, again, increasing the flexibility of Aviwest supply chain, coding Aviwest to a common ERP system and bringing Aviwest products to North America. For Haivision MCS, although bit slower than what we had hoped, progress is accelerating. Our current focus has been on fully integrating developing teams and most of the heavy lifting was completed as of this last

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quarter. Our next major focus is integrating production capabilities, and we have additional opportunities beyond that. And as I mentioned before, the pace of integration should increase over the remainder of the year.

In terms of expectations for the remainder of the year, we have completely transitioned out of the house of worship managed services market. And even after losing that revenue, our overall revenues continue to show growth. Thus, our revenue guidance for the full year, which factors in the reduction in the house of worship revenue is still expected to be between $130 million and $135 million, although the top end of the range is increasingly in reach. We also expect to see expansion of our adjusted EBITDA margins as we continue to exploit synergistic opportunities and achieving double-digit adjusted EBITDA margins.

So that concludes my prepared remarks. I'm going to pass the microphone back to Mirko, and then we will open the floor to questions.

Miroslav Wicha
Chairman, President & CEO
Thank you, Dan. I think we'll probably take the questions. Abby?

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Question and Answer

Operator

[Operator Instructions] And we'll take our first question from Robert Young with Canaccord Genuity.

Robert Young
Canaccord Genuity Corp., Research Division

Maybe just a high-level question to kick it off. You gave us some context in the prepared remarks, but if you could just go through some of the -- maybe just the demand across your most important end markets, I mean, government, ISR, commercial and broadcast. Just maybe in relative terms to last quarter, maybe you can give us some sense of the trends in demand that you're seeing?

Miroslav Wicha
Chairman, President & CEO

Sure. Well, thanks, Robert. Good to hear from you. Interestingly enough, I mean, from [Indiscernible] again from Q2, and we're seeing that continue into Q3, and we believe for the rest of the year, we're actually seeing a very strong traction in our government, defense, ISR and enterprise market, which is nice. And when I say enterprise, I'm talking about our video collaboration mission-critical type of stuff. So that's actually -- is very favorable at the moment. And we're actually seeing a very interesting combination right now of our combined Aviwest and Haivision wireless and wired solution in the contribution space of broadcast. So that's actually pretty robust, not at the levels that we saw during the pandemic, of course, because that was pretty dramatic growth that we had, but we're still seeing some pretty good traction. So interestingly enough, we're seeing pretty good feedback from all of our key markets. I was a bit concerned. Obviously, we were all a bit concerned with the debt ceiling nonsense going on in the U.S. That was averted, thank goodness. But we -- as a result, we are seeing a very robust government business as well.

Robert Young
Canaccord Genuity Corp., Research Division

Okay. That's great. Maybe a second question for me would be around the gross margin outlook, again, something you talked about in the monologue, but the -- just trying to get a sense of where that's going to go over the next couple of years. There are some onetime items from house of worship and also supply chain, but that seems to be moderating and then the impact of the recent acquisitions. Do you see a path to get back to the historical margin profile, or should we be looking for something different?

Dan Rabinowitz
CFO, Secretary & EVP of Operations

Sure. Okay. So I'm not exactly sure I would refer to the house of worship anticipated improvements to be a onetime event, but it does represent sort of a forklift lift in what we can expect in the COGS in the near term, midterm. As I kind of alluded to before, we spend about $500,000 and $600,000 in fixed expenses related to that house of worship business, that should be completely dissipated by the third quarter and beyond. Quick math, assuming around the same kind of revenue levels that we're at right now, that could represent about 200 basis points improvement in our overall gross margin from where we have historically been. Let me see -- recent historical EBIT, right? And we do have opportunities as it relates to the supply chain improvements. During the supply chain challenges, we did make significant investments in componentry that we -- that was hard to obtain. And as we consume that inventory. We have been spending perhaps around $300,000 to $500,000 per quarter in incremental costs that are going to be dissipated over some period of time. Now I'd like to say that, that would be an immediate forklift -- lift on our gross profit or gross margins, but really, that's getting -- that's getting eased in. So to give you a sense, in this third quarter, we're expecting those kind of costs to be about half of what they may have been in the second quarter. And hopefully, we'll be fully through the entire inventory of componentry midyear next year. Now that's -- those are the sort of immediate things that are done deal, so to speak.

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On top of that, we are putting both Aviwest and MCS on a common ERP system, that will give us more visibility to the componentry, to the timing, to levels of inventory and what have you, and that will enable our supply chain experts to exploit the opportunities that will be presented to us.

Miroslav Wicha
Chairman, President & CEO

Yes. And I guess I would add to that, Robert, is you mentioned our previous historical gross margins, which obviously before these acquisitions, were pretty significant. I mean we're not going to obviously be at those levels because when we acquired MCS, as you know, that business has a very different profile, right? And after making up 30% to 40% and growing of our business, which is more of an integration model. So we've already been planning for a lower overall gross margin profile. But the good news is that we will be returning with this quarter, we're already in Q3 and of course, for Q4 and next year, you can definitely see us that we'll be in the low 70s for sure, right? I mean we're going to get down to those levels very, very quickly.

Robert Young
Canaccord Genuity Corp., Research Division

Okay. Great. That's all great color. And maybe last question, [Indiscernible] I hand it off, just be -- I appreciate that this isn't something you want to talk about too much, but I was just curious if you could give us an update from your perspective on the unsolicited bidder that you had over the last couple of quarters. Can you just talk about any update from your perspective on what's going on with Evertz, and then I'll pass the line.

Miroslav Wicha
Chairman, President & CEO

Well, I can answer that very quickly, zero update. So I haven't heard anything...

Robert Young
Canaccord Genuity Corp., Research Division

No change?

Miroslav Wicha
Chairman, President & CEO

Yes, no. Dan's favorite word, I would say, quickly, no. No, we haven't really heard anything at all, right, since the last interaction, which has been quite a while ago, so nothing to report.

Dan Rabinowitz
CFO, Secretary & EVP of Operations

I did receive questions by e-mail. Apparently, they're having a difficult time asking questions on the webinar. So the first question that's being asked is seasonality that we can expect in sales in Q3 and Q4. I think in our last earnings call, we kind of mentioned that we were seeing our seasonality revert back to our historical averages, which means that our fourth quarter, which is commensurate with the U.S. government year-end will likely be our largest quarter again this year, just as it was last year. And in fact, if you were to look at the seasonality patterns of last year, you would see that our second and third quarter tend to be about equal, but we tend to think of our third quarter is our weakest quarter and are weaker than our second quarter and our fourth quarter will be stronger than it had been before. I would think that if you looked at our historical for last year, and look at that seasonality, you can expect something similar to this year. And...

Miroslav Wicha
Chairman, President & CEO

I guess -- sorry, Dan, let me just add to that a bit because let's not lose the fact that Q1 and Q2 have been exceptionally strong, right, this year. I mean $35 million in Q1, $35.1 million in Q2 is significantly strong. So Q3, for sure, will be typically low because it is a summer quarter. Obviously, in Europe, but it's

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traditionally lower. So yes, there is going to be some seasonality there. and Q4 is going to be very, very strong. But we have to, again, understand that Q1 and Q2 were pretty strong quarters for us this year, right? So overall, I think we're very confident that we're going to have a very strong year as we mentioned closer to the $134 million, $135 million mark for the rest of the year.

Dan Rabinowitz
CFO, Secretary & EVP of Operations

And I will point out that the house of worship business, which had some revenue in the second quarter will not be part of the third quarter equation.

I thought I had touched on this in our prepared remarks about OpEx being front-loaded. But -- and I gave you 2 examples of front-loaded expenses, one was our marketing expense related to NAV. It was a heavy -- the first half of the year has been heavy in terms of marketing. We've reverted back to our let's go to the trade shows and do it big. We also spend a disproportionate amount of our professional services fees in the first half of the year compared to the second half of the year. But there are other opportunities for us to reduce OpEx in the second half of the year. As an example, our house of worship business does have an OpEx component that's going to disappear in the third and fourth quarter. And as we continue to sort of refine our business model going forward, we'll be seeing additional reductions in the third quarter and the fourth quarter.

Any other questions out there?

Operator

[Operator Instructions] And with no further questions at this time, I will now turn the call back to Mirko for closing remarks.

Miroslav Wicha
Chairman, President & CEO

Yes. Thank you, Abby. I just want to thank all of our shareholders and analysts on the call today and for the continued support of Haivision. Really look forward to speaking with you in September. When we discuss our Q3 results, I truly believe Q3 results will be the beginning of the picture of everything that we've been working on for the last 6 to 9 months. So these are the results, I think that we're all going to be waiting for to be able to give us a really solid guidance, not just the rest of the year, but more to 2024. So very excited for what's happening in 2024 and look forward to speaking with all of you in September. Thank you.

Operator
Ladies and gentlemen, this concludes today's conference call, and we thank you for your participation. You may now disconnect.

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