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Zacks Small-Cap Research

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VIQ Solutions (VQS-NASDAQ)

VQS: Near-Term Headwinds Mask Longer-Term Positive Outlook

Economic uncertainty has caused some of VIQ's customers to shift from upfront spending on tech to monthly billing instead. This shift has the benefit of accelerating the company's planned transition toward subscription-based annual recurring revenue (ARR) but, in the short-term, led to a 3Q22 shortfall. Also, the large Queensland, Australia contract has proved more difficult to ramp than initially expected. Once it ramps fully and VIQ has fully integrated Auscript, VIQ expects that gross margins will normalize at 50+% levels.

Current Price (11/10/22)	$0.31
Valuation	**$10.00**

OUTLOOK

2022 YTD bookings are $7.1M, up from $4.4M at the end of 2Q22; VIQ continues to expand its client base and expects to accelerate growth and increase its global market penetration over time. VIQ's focus in 2022 is on consolidating operations and likely will not include a large M&A transaction, small strategic tuck-n acquisitions that strengthen a key target vertical – such as the recent acquisition of the Carbon™ technology – would not surprise us.

SUMMARY DATA

52-Week High	**$2.72**
52-Week Low	**$0.30**
One-Year Return (%)	**-87.2**
Beta	**N/A**
Average Daily Volume (sh)	**70,389**
Shares Outstanding (mil)	**34**
Market Capitalization ($mil)	**$11**
Short Interest Ratio (days)	**N/A**
Institutional Ownership (%)	**10%**
Insider Ownership (%)	**24%**
Annual Cash Dividend	**$0.00**
Dividend Yield (%)	**0.00**
5-Yr. Historical Growth Rates	
Sales (%)	**N/A**
Earnings Per Share (%)	**N/A**
Dividend (%)	**N/A**
P/E using TTM EPS	**N/A**
P/E using 2022 Estimate	**N/A**
P/E using 2023 Estimate	**N/A**
Zacks Rank	**N/A**

Risk Level	**High**
Type of Stock	**N/A**
Industry	**Technology Services**

ZACKS ESTIMATES

Revenue
(in millions of $)

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	6.4	6.2	6.5	6.1	25.1
2020	7.5A	8.3A	8.2A	7.8A	31.7 A
2021	8.3A	8.2A	7.1A	7.5A	31.0 A
2022	11.5A	12.4A	11.8A	10.7E	46.4 E

Per Share Data

	Q1 (Mar)	Q2 (Jun)	Q3 (Sep)	Q4 (Dec)	Year (Dec)
2019	-0.12	-0.17	0.04	-0.25	-0.49
2020	-0.37A	-0.05A	-0.02A	- 0.18A	-0.62A
2021	-0.07A	-0.42A	-0.15A	-0.12A	-0.74A
2022	-0.07A	-0.11A	-0.04A	-0.02E	-0.25E

Quarters might not sum due to rounding & share counts

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KEY POINTS

Reiterated 2022 goals & financial guidance …

- VIQ has been impacted by general economic uncertainty, which has caused some of its customers to shift from large upfront spending on technology to monthly billing arrangements instead. This shift has the benefit of acc4elerating the company's planned transition toward subscription-based annual recurring revenue (ARR) model but, in the short-term, led to a shortfall from revenue expectations in 3Q22.

- In addition, the large contract with the Queensland court system in Australia has proved more difficult to ramp than initially intended for several factors, including the general labor shortage that resulted in a shortage of trained and experienced personnel. Once the contract ramps fully and the company has completely integrated Auscript, VIQ expects that gross margins will normalize above the 50% level.

- The company revised its revenue expectations down reflecting several factors, including FX headwinds, the timing and execution of new contracts, slowing conversion of new bookings to revenue and ongoing labor shortages in some markets.

- Year-to-date 2022 bookings are $7.1 million, up from $4.4 million at the end of 2Q22. VIQ continues to expand its client base and expects to accelerate growth and increase its global market penetration over time. However, compared to earlier quarters, the company's 3Q22 conversion of bookings to revenue slowed – partially reflecting the difficulty of hiring trained personnel.

- Longer-term, the company expects the transition to a monthly recurring revenue model to lead to improved revenue and margins over time and help smooth out lumpiness in monthly and annual revenue flows.

3Q22 HIGHLIGHTS

Shift to recurring revenue accelerating; long-term positive, but near-term revenue shortfall

VIQ Solutions (VQS-NASDAQ and VQS-TSX) reported 3Q22 results yesterday that were below expectations. The company noted that it has been impacted by general economic uncertainty, which has caused some of its customers to shift from large upfront spending on technology to monthly billing arrangements instead. For example, one customer (a court) had committed to a $700,000 licensing deal earlier in 2022 but subsequently lost funding for the project. VIQ modified the agreement, transitioning from an upfront payment to a monthly 4-year contract.
This shift has the benefit of acc4elerating the company's planned transition toward subscription-based annual recurring revenue (ARR) model but, in the short-term, led to a shortfall from revenue expectations in 3Q22. Conversely, the company expects this transition to lead to improved revenue and margins over time and help smooth out lumpiness in monthly and annual revenue flows.

In addition, the large contract with the Queensland court system in Australia has proved more difficult to ramp than initially intended for several factors, including the general labor shortage that resulted in a shortage of trained and experienced personnel. Once the contract ramps fully and the company has completely integrated Auscript, VIQ expects that gross margins will normalize above the 50% level. The contract is to provide courtroom monitoring and transcription services to about half the Queensland, Australia court cases.

Margin expansion expected over time

Revenue came in at $11.8 million in 3Q22 compared to $7.1 million in 3Q21. This represents a 66% year-over-year increase – primarily reflecting the acquisition of Auscript and TTA, which VIQ acquired in 2021, offset partially by FX headwinds. Nevertheless, 3Q22 revenue fell short from our $13.3 million forecast. Gross profit of $5.6 million equated to a gross margin of 47.3%, compared to $3.6 million and 51.4% in 3Q21. Adjusting for the exclusion of COVID-19 wage subsidies in both periods, the gross margin for Technology Services would be 44.6% compared to 43.9% in 3Q21. The company reported a net loss of $1.3 million, or ($0.04) per share compared to a net loss of $3.9 million, or ($0.15) per share in 3Q21.

Reflecting the 3Q22 challenges, VIQ revised full year 2022 guidance. The company now expects revenue to be in the range of $46 million to $47 million and adjusted EBITDA to be in the range of negative $2.3 million to $2.8 million. This compares to prior VIQ expectations of generating at least $50 million in revenue in 2022 and gross margins ranging from 47% to 55%. We have revised our 2022 forecast to reflect the updated guidance.

The company revised its revenue expectations down reflecting several factors, including FX headwinds, the timing and execution of new contracts, slowing conversion of new bookings to revenue and ongoing labor shortages in some markets. Year-to-date 2022 bookings are $7.1 million, up from $4.4 million at the end of 2Q22. VIQ continues to expand its client base and expects to accelerate growth and increase its global market penetration over time. However, compared to earlier quarters, the company's 3Q22 conversion of bookings to revenue slowed – partially reflecting the difficulty of hiring trained personnel. The company recognized about 10% of booked revenue in the period as 3Q22 revenue. Longer term, VIQ expects the ongoing roll-out of *FirstDraft* and other high margin products to accelerate revenue growth and margin improvements. The company expects to approach positive adjusted EBITDA in 2023. At the end of 3Q22, the company had cash of $3.9 million to advances its initiatives and for operations.

With focus on consolidating operations, do not anticipate M&A measures near-term…

VIQ has historically leveraged strategic M&A to complement and enhance organic growth. Following the two key acquisitions in 2021, the company expects to consolidate its new units and overall organization in 2022 and therefore expects its operational focus in 2022 to be on execution of its organic growth initiatives and integration of recent acquisitions and new clients into the AI-enabled system. The company will make small strategic tuck-in acquisitions that make sense.

… except potential smaller tuck-in acquisitions

For instance, towards the goal of advancing its growth strategy and expanding its suite of product and service offerings, VIQ's recent acquisition of the Carbon™ technology platform is expected to improve the company's ability to service real-time needs of journalists and global media clients. We believe the Media, Corporate & Government vertical illustrates the growth potential facing VIQ, as various industries move towards digital data delivery and archiving. The company entered the Media vertical within the past two years with the 2020 acquisition of ASC Services LLC and it has subsequently become a key focus vertical for VIQ that is expected to continue growing.

The above-noted Carbon tuck-in purchase follows the company's recent strategic partnership with software development company LegalCraft, as VIQ seeks to strengthen its position and offerings in its key verticals. LegalCraft is expected to help the company consolidate and grow its strategic market position in the legal sector. LegalCraft focuses on technology innovations for the legal sector particularly via its flagship product Lexel, makes VIQ the first LegalCraft strategic partner to offer Lexel in the U.S. Lexel enables law professionals to collaborate securely to prepare cases for trial. Although the company does not intend to proactively seek prospective M&A candidates, if VQS finds additional attractive tuck-in opportunities, we would not be surprised to see a smaller transaction.

Strengthening key verticals

The Legal (Courts) vertical continues to represent the company's largest one through 1H22 (contributing 64% of 2Q22 total revenue). The Criminal Justice (including Law Enforcement) vertical represented 12%, Insurance was 12% and the Media, Corporate and Government vertical added another 12%. Although VIQ's 2022 focus is on consolidating operations and will likely not include a large M&A transaction, the company has indicated that it will make small strategic tuck-n acquisitions that make sense.

VALUATION

Based on our 2022 revenue forecast, VIQ shares trade at a significant discount to peers in the cloud-based technology space. Peers trade at an average multiple of about 6x to 8x. We also point to Nuance Communications, a large player in the technology/ communications solutions space that helped consolidate the medical transcription market through a series of M&A transactions and organic measures much as VIQ is now doing in its core silos.

As a publically traded company, Nuance shares commanded an even higher than industry average multiple of forward revenue basis, according to consensus data. Moreover, Microsoft acquired Nuance at a valuation that implied a roughly 23% premium to where they had been trading prior to the announced offer. We believe this underscores the importance of the sector and also implies a higher valuation for VIQ shares over time.

We expect the multiple gap on VQS shares to narrow further compared to peers, as the company continues to make strides in its organic and acquisition-driven growth strategy. We anticipate multiple expansion. Our valuation of $10 equates to only just over about 5x our 2022E estimated revenue. This multiple is below the group average and our revenue forecast does not take into consideration additional possible M&A tuck-in transactions, as noted.

RECENT NEWS

- VIQ announced 3Q22 results on November 10, 2022.
- VIQ appointed two new board members on March 24, 2022 and another board appointment on April 5, 2022.
- VIQ announced that it was awarded a new U.S. patent on February 08, 2022.
- VIQ announced a strategic partnership with LegalCraft on February 01, 2022.
- On January 04, 2022, VIQ appointed a new managing director to strengthen its U.K. market presence.
- VIQ closed on the Auscript transaction on December 13, 2021.
- VIQ launched NetScribe™ across the U.K. and Canada on October 26, 2021.
- VQS shares began trading on the Nasdaq on August 12, 2021.

RISKS

We believe risks include those outlined below, among others.

- The impact of COVID-19 on VIQ's business could increase if the number of cases escalate and last longer than originally anticipated.
- VIQ might not gain market share or wallet share as quickly as it expects.
- The company might not continue migrating customers to the SaaS model as quickly as management anticipates.
- The company could incur unanticipated costs associated with its growth strategy and for marketing to promote its platform.
- Additional M&A transactions that the company anticipates might take longer than expected to close or might not close at all.
- Competition could increase.
- The company's cash burn rate could be higher than management expects and / or it might not reach positive cash generation as quickly.
- VIQ might need to raise capital to support growth initiatives.

PROJECTED INCOME STATEMENT

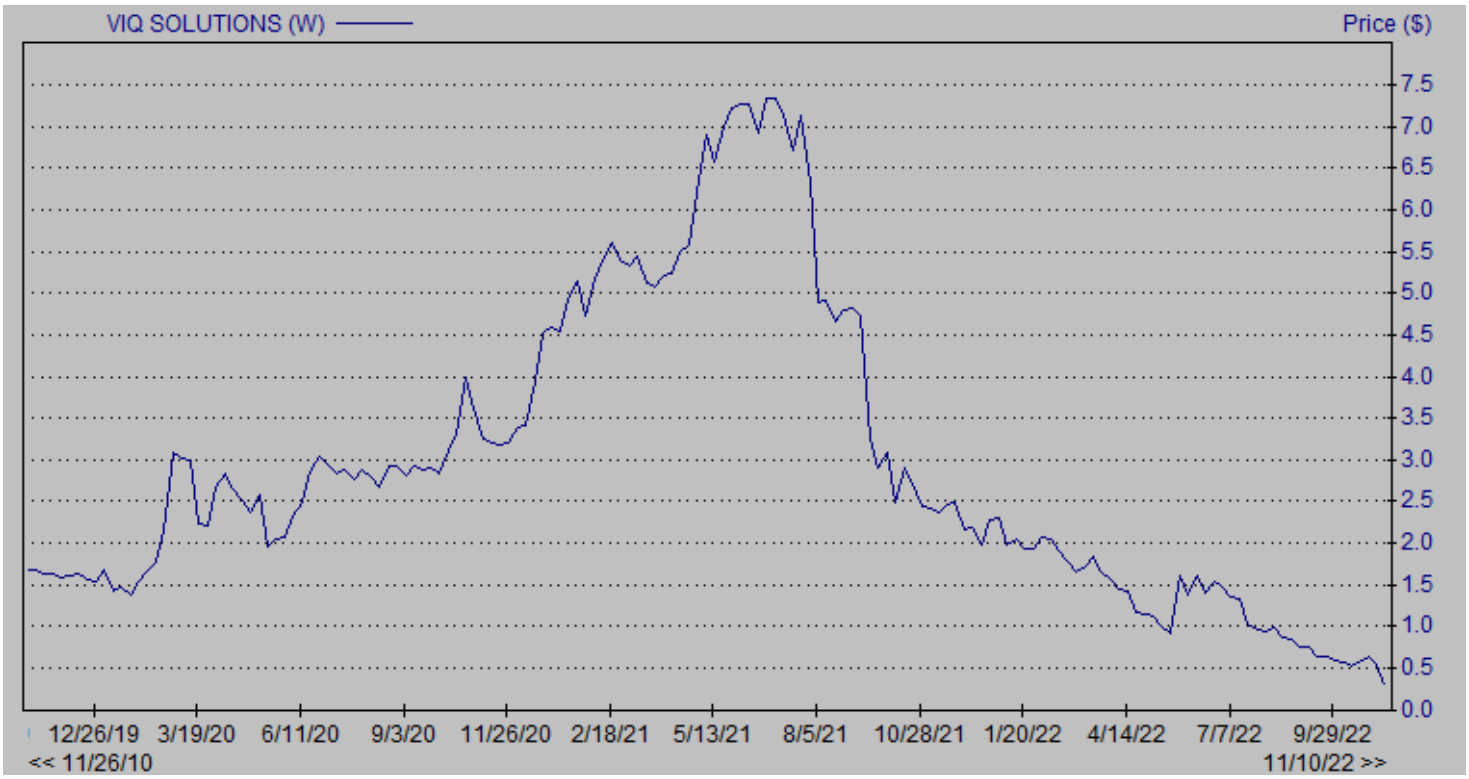
VIQ Solutions Inc. Income Statement & Projections ($)

	2018	2019	2020	Mar-21A	Jun-21A	Sep-21A	Dec-21A	2021A	Mar-22A	Jun-22A	Sep-22A	Dec-22E	2022E
Revenue	$11,462,804	$25,096,308	$31,749,693	$8,254,222	$8,191,812	$7,086,357	$7,514,421	$31,046,812	$11,524,981	$12,351,655	$11,785,713	$10,724,999	$46,387,348
Cost of sales	7,874,219	14,276,321	15,599,437	4,236,387	4,210,733	3,444,259	4,232,474	16,123,853	6,035,932	6,257,453	6,208,528	5,630,624	24,132,537
Gross profit	3,588,585	10,819,987	16,150,256	4,017,835	3,981,079	3,642,098	3,281,947	14,922,959	5,489,049	6,094,202	5,577,185	5,094,374	22,254,810
Gross margin	31.3%	43.1%	50.9%	48.7%	48.6%	51.4%	43.7%	48.1%	47.6%	49.3%	47.3%	47.5%	48.0%
Selling & administrative expenses	5,533,724	8,954,512	11,034,902	3,539,110	3,953,046	6,516,449	5,111,108	19,119,713	6,136,309	6,532,440	5,960,010	6,073,731	24,702,490
Research & development expenses	458,675	994,640	1,074,178	239,663	260,010	317,546	274,889	1,092,108	199,085	278,357	164,849	193,172	835,463
Stock-based compensation	(31,461)	195,113	725,316	85,995	6,687,792	859,119	862,283	8,495,189	952,196	540,580	681,193	800,000	2,973,969
FX & other	198,180	217,040	(132,306)	(95,994)	153,400	(445,978)	(859,948)	(1,248,520)	(623,940)	(7,489)	(288,578)	(642,846)	(1,562,853)
Depreciation & amortization	648,873	3,502,429	5,259,243	1,248,363	1,188,115	1,034,951	1,170,172	4,641,601	1,159,344	1,219,637	1,272,637	1,279,000	4,930,618
Total operating expenses	6,994,435	12,295,345	17,961,333	5,017,137	12,242,363	8,282,087	6,558,504	32,100,091	7,822,994	8,563,525	7,790,111	7,703,057	31,879,687
Operating income	(3,405,850)	(1,475,358)	(1,811,077)	(999,302)	(8,261,284)	(4,639,989)	(3,276,557)	(17,177,132)	(2,333,945)	(2,469,323)	(2,212,926)	(2,608,683)	(9,624,877)
Interest expense	(96,484)	(1,549,904)	(4,934,517)	(331,419)	(335,594)	(329,598)	(334,489)	(1,331,100)	(339,713)	(241,128)	(234,892)	(340,223)	(1,155,956)
Other	(2,552,729)	(1,399,781)	(5,343,744)	(599,037)	(597,177)	(353,062)	1,322,486	(226,790)	615,045	(35,583)	1,094,007	1,098,383	2,771,852
Total operating inc / (expenses)	(2,649,213)	(2,949,685)	(10,278,261)	(930,456)	(932,771)	(682,660)	987,997	(1,557,890)	275,332	(276,711)	859,115	758,160	1,615,896
Pretax income	(6,055,063)	(4,425,043)	(12,089,338)	(1,929,758)	(9,194,055)	(3,957,329)	(3,653,880)	(18,735,022)	(2,058,613)	(2,746,034)	(1,353,811)	(1,850,522)	(8,008,980)
Tax	(11,571)	(99,155)	944,032	262,969	(1,304,607)	97,824	87	(943,727)	(48,696)	37,699	(23,871)	(200,000)	(234,868)
Net inc/ (loss)	(6,066,634)	(4,524,198)	(11,145,306)	(1,666,789)	(10,498,662)	(3,859,505)	(3,653,793)	(19,678,749)	(2,009,917)	(2,783,733)	(1,329,940)	(1,650,522)	(7,774,112)
FX	(95,899)	(262,811)	56,152		101,642	(432,533)	484,323	153,432	412,798	(489,803)	(823,213)	100,000	(800,218)
Per share data:													
Comprehensive loss	(6,162,533)	(4,787,009)	(11,089,154)	(1,666,789)	(10,397,020)	(4,292,038)	(3,169,470)	(19,525,317)	(1,597,119)	(3,273,536)	(2,153,153)	(1,550,522)	(8,574,330)
LPS	($0.04)	($0.49)	($0.62)	($0.07)	($0.42)	($0.15)	($0.12)	($0.74)	($0.07)	($0.11)	($0.04)	($0.02)	($0.25)
Avg shares out	161,816,064	9,251,546	18,080,533	24,467,151	25,029,019	26,359,517	29,938,689	26,448,594	29,881,717	28,653,056	32,749,800	32,754,800	31,009,843

Source: Company reports, Zacks estimates Quarterly LPS/EPS might not sum to annual reflecting differences in share count.

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