FINAL TRANSCRIPT

Optiva Inc.

Fiscal 2018 First Quarter Earnings Conference Call

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CORPORATE PARTICIPANTS

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CONFERENCE CALL PARTICIPANTS

Robert Young
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PRESENTATION

Operator

Good morning, everyone. Welcome to the Fiscal 2018 First Quarter Earnings Conference Call for Redknee Solutions Inc., which is now doing business as Optiva Inc. At this time, all participants are in a listen-only mode.

Following the presentation, we will conduct a question-and-answer session. Instructions will be provided at that time for you to queue up for a question.

Before beginning its formal remarks, Optiva would like to remind listeners that today's discussion may contain forward-looking statements that reflect current views with respect to future events. Any such statements are subject to risks and uncertainties that could cause actual results to differ materially from those predicted in these forward-looking statements. Optiva does not undertake to update any forward-looking statements except as required.

I'd like to remind everyone that this call is being recorded today, Thursday, February 8, 2018.

I would now like to go ahead and turn the call over Danielle Royston, Chief Executive Officer of Optiva Inc. Please go ahead.

Danielle Royston — Chief Executive Officer, Optiva Inc.

Thank you. Good morning, and welcome to our 2018 Q1 earnings conference call. I am Danielle Royston, CEO of Optiva, and I am joined today by our Interim CFO, Anin Basu.

I have three points that I'd like to communicate today on our call. With our funding from our rights offering, we have commenced our restructuring activities to support our strategic plan. We have completed our first full measurement period for customer success, and it's coming in at 27 percent.

While we remain steadfastly focused on customer success, we have begun activities to support the new Redknee, or should I say Optiva.

So with that, I'm going to turn the call over to Anin. Anin?

Anin Basu — Interim Chief Financial Officer, Optiva Inc.

Thank you, Danielle, and good morning, everyone. Please note that our complete financial statements, MD&A, and earnings release for the quarter are available on SEDAR and on our website, and I encourage you to review them at your convenience.

As you can see from the release of the statements, our revenue for Q1 2018 has come in at $34.4 million with a net loss of $64 million. As many of you are quite familiar with the financial reports, I'm not going to go over the numbers on today's call. I would be happy to answer any specific questions during our Q@A portion of this call.

Today, I want to spend my time discussing our restructuring and other provisions, the related party contracts, and the catch-up payment on the preferred shares dividend.

On restructuring, as we communicated in December, we have kicked off our activities in this area. In our first quarter, we have recorded a restructuring charge of $47 million. While most of the expense is related to severance costs to outgoing employees, it does include costs related to exiting offices and lab facilities globally.

Our restructuring liability at December 31, 2017, is $54 million and includes provisions from past restructuring of $7 million. Most of our restructuring liability is stable within 12 months. We paid approximately $11 million in the first quarter.

Also, in our first quarter, we've identified certain contracts where we expect our total contract costs to exceed the revenue we will earn from these contracts by $5.4 million. These contracts were signed in 2016, and the product being delivered is the first generation of a new solution. We are confident that despite the additional costs, we will be able to deliver the solution and keep our commitments to our customers.

Now I wanted to give you an update on our contracts with two related parties, Crossover and DevFactory. Total costs incurred in this quarter with Crossover amounted to $6 million. As for DevFactory, this quarter we incurred a cost of $6.8 million. We believe both of these investments contribute to our goal of having great products, great people, and enable us to be a leader that help us to achieve our targets on customer success.

And finally, a comment on the preferred share dividend. The Series A preferred shares issued in January 2017 had a dividend rate of 10 percent per annum, payable quarterly. However, if we do not pay the dividend quarterly, the unpaid dividend is compounded monthly at a rate of 10 percent. To date, we have not made any dividend payments. The liability for unpaid dividends has amounted to 7.6 million through December 31, 2017.

So we had a decision to make. Should we keep accruing the dividend or pay it out. We decided to pay it out for two reasons. First and foremost, we are trying to create a culture of profitability that includes a focus on return on equity and managing our cost of capital. These are things we already did not do well these last few years. Paying out the dividend instead of accruing it at a compounding rate seems to be a prudent decision.

Second, given our cash balances, we can afford it. Therefore, we will issue a catch-up payment for the accumulative dividend of 7.6 million and pay this in February.

That about covers it for my portion. And with that, I'd like to pass the call back to Danielle.

Danielle Royston

Thank you, Anin. Q1 was a very busy quarter for our company. In September, we received our funding from our rights offerings, which we badly needed to fund our strategic plan.

As Anin has mentioned, we took action last quarter and kicked off the bulk of the restructuring activity. We expect this work to continue through the remainder of the calendar year, as we gradually work the plan. Operationalizing the restructuring is an easy thing to do. At this point, it is more just a matter of execution, and while it will take time, it will get done.

On almost every earnings call, I've mentioned the concept of customer success. If you recall, it is our differentiated program that works with each customer to align our work to our customers' most strategic goal, creating plans to deliver against those goals, then ask our customers, did we achieve the goal. And by aligning our employees' incentive compensation to these results, we really put teeth into the program so that our entire company, top to bottom, is focused on our customer success.

We have finished our first full measurement period, June through December, and after talking to just over half of the revenue, we are coming in with about 27 percent of the revenue reported to us that yes, they feel that our teams and our results are aligned to their success, and we are helping them achieve their goals.

While this is about 7 percentage points higher than when I first reported it back in May, as I said before, this is a very long and arduous process where you literally have to fit each customer one by one.

For example, we have two customers that I recently visited within the past month. Both of these customers wake up trying to decide, is the new Optiva going to deliver? Or should I switch to another vendor? And we are in there fighting every day.

Anin mentioned the $5.4 million provision we are taking this quarter as we are facing the harsh reality of the delivery status of these two customers. These projects are both significantly delayed. We are having to spend millions more than we will ever make on these accounts to fix the installation to get them back on track.

So we are spending every day looking at the status of each account from the quality of our relationships to the value we provide, to delivery, reviewing every single staff member to make sure we are doing absolutely everything we can to accelerate customer success, build a great team, and deliver.

In other exciting news, we rebranded our company to our new identity, Optiva, which we announced on January 16th. Now this is more than a new name and a new coat of paint on the website. We chose to rebrand our company to really signal to the markets that we are a completely different company: one focused on customer success, a company that wins its business insight and value to our customers with our expertise, that has great technological innovation and market-leading products, offered at the lowest total cost of ownership.

In December, we announced our work with Google Cloud Spanner, an innovation that improved the scalability and performance of the Optiva charging engine by 10x.

Historically, Redknee has used an on-premise Oracle system to generate 50,000 transactions per second. We partnered with Google to create a system that could do 10x that, 500,000 transactions per second. We have been demonstrating the system to our largest customers and proving to them that Optiva is making the investment and moving the products back into a leadership position.

Our customers are not only excited about the performance improvement, they are excited to have other better-priced data-based choices to finally move away from expensive Oracle.

Finally, our big event of the year is coming up, Mobile World Congress in Barcelona, at the end of the month. We will be showcasing the Optiva charging engine with spanner. So if you're at the event, you can see for yourself the 10x improvement.

We are excited to partner with the Google cloud team we will be hosting in our booth, talking about our new innovations and showing our newest products, the Optiva revenue management suite, which will be available on Google cloud.

Aimed at Tier 2 and Tier 3 communications service providers, this end-to-end suite will be offered on premise and in Google cloud. For customers selecting the Google cloud route, we are excited to offer 80 percent total cost of ownership savings over our on-premise solutions. We want to position ourselves as a partner to our customers, and we believe our lowest TCO message will resonate very strongly.

I am super excited about the new Optiva and where we are headed. We are not out of the woods yet, but with real focus and execution, I feel we are on a great path.

At this point, we're ready to open up the call for Q& A.

Q&A

Operator

At this time, if you would like to ask a question, please press *, then the number 1 on your telephone keypad. Again, that is *, 1 on your telephone keypad.

Again, if you would like to ask a question, please press *, 1 on your telephone keypad.

And your first question comes from the line of Robert Young with Canaccord Genuity. Your line is now open.

Robert Young — Canaccord Genuity

Hi. Good morning. Maybe I'll just ask about Cloud Spanner just because that's where you finished. I guess the first thing, 500,000 transactions per second. Where is the need for that volume of transactions? Is that related to Internet of Things and broader applications? Is that why the customers are excited?

And then second, seems like this was skunkworks last quarter, and now it feels more like a productized offering moving a lot more quickly than I think I would have expected. So why did that happen? Why did you choose to put the effort there?

And then last piece there would be why can't a competitor do this if it's based on Google? Or is there something that the old Redknee IP does to supplement that to make it a more differentiated offering.

And then I've got a couple more, but maybe I'll just leave it there for a second.

Danielle Royston

All right. I will not be able to remember all your questions. Keep your list and then we can keep going.

But okay. To your first question about the 500,000 transactions per second. So the Optiva charging engine is really aimed towards Tier 1 communication service providers. These are our customers that have more than 5 million subscribers as their customers and really aimed towards the people who are getting into the tens of millions and maybe even hundreds of millions.

And so what ends up happening is to add scalability or performance to the product, you tend to have multiple installations of the same stack. Right? So we have a large customer base in India, and they have 20-plus installations of our systems. And when you start to add additional 10x performance, maybe you don't need 20. Maybe you need 10; maybe you need five. And so it brings down their total cost of ownership, and it really starts to make them think about how they configure their offering and their services to their customers. So it's really aimed at Tier 1 providers and not so much to Tier 2 and Tier 3 who tend to be in the sub 5 million, sub 1 million subscribers.

Does that make sense?

Robert Young

Yeah. Makes a lot of sense. Second question was around last quarter it seemed like this was skunkworks, a pilot, and now it seems like it's more productized tighter with Google. How did you move so quickly on it? Or why did you choose to move so quickly?

Danielle Royston

Wouldn't say it's like fully productized. We kind of keep evolving that pilot. We're in an active pilot right now with the customer, and so we're getting a lot of feedback about things that we need to tune. We're starting to run real data through the system, and so it's sort of pilot-plus I think at this point. We are going to be demonstrating it at Global World Congress. People will be able to walk up and see the system live running. So you can kind of see the old system running against Oracle and then the new system running against Spanner. And I met with Google this week, and they told me they're going to send a database architect for Spanner, so we'll be able to answer super technical questions about the solution. So we're really excited about that.

Robert Young

Okay. And then what about Redknee's prior IP makes this a differentiated product against someone who could use Google's backend to do the same thing?

Danielle Royston

Yeah. I mean, really to date—I mean we still have that IP in the engine. Right? The application layer if you will. And whenever we deploy today, which is primarily on-premise, we have the Oracle database running underneath it and, of course, all the compute power.

Today we don't really control so much of the lower stack, and we feel that, again, with technological innovation and being in control of the compute, the database, and the application layer, we can performance tune better than our customers can do certainly on-premise, and that's really driving that lowest TCO message.

And then our IP is in that Astelit, its application layer. And so that continues, and we'll continue to invest in that and make that great, so.

Robert Young

Okay.

Danielle Royston

We have the IP that we have today, we're putting it on Google cloud. We're controlling the database and the compute power, and we feel that we have insights that the average customer doesn't have in terms of how to make that whole stack really efficient.

Robert Young

Okay. And maybe just a couple other questions. On the top-line outlook that you were talking about before stressed that the low-end to 100 million maybe 120 million notional. If I look at the quarter, just look at the software and services report and I annualize that, I'm at 128 million. And so do you expect it to continue to decline from here? It looks as though there's been a rebound this quarter. Which way should we be thinking? Should we be thinking of a quarter of growth from here? Or is this the bottom? Or do you expect further decline?

Danielle Royston

Yeah. I believe we have a message in the MD&A on this. But what we saw this quarter, we got an order that we expected in Q2 that closed in Q1. My message from last quarter has not changed. We do expect 2018 to be another down year. And so I don't know that I would take my run rate and multiply it by four. I think we just got some early revenue.

We are a month into the next quarter. The next time I talk to you guys it'll be May; we'll have a little bit more information. But at this point, I'm still sticking to my storyline here of it's a down year. It could be below 120, and we've created a plan around restructuring that if the revenue falls even below 100 million it still works.

Robert Young

Okay. And now that you've had more time with customers, are there any new churn notifications that you've received? Or do you have a good handle on whether there's going to be any churn in the near term? And then I'll pass the line.

Danielle Royston

Yeah. Fortunately, no. We do have some customers that we have our eye on. That works both ways. Right? We have some customers that have been in swaps for multiple years. I'm new to this industry, so I'm learning about just how long it takes to move off of these kinds of platforms. I don't think Optiva is particularly unique in it takes a long time to move off our platform. I think it takes a long time to move off any platform in this space.

So in terms of new churn notifications, not that I recall. But there's a couple of people where we know—obviously, we took a provisionist quarter. We feel that those are two particularly crisis accounts, but they haven't given me a notice. We felt it was prudent to, like I said in the talk earlier, face the harsh reality that these two customers could churn.

And on the flip side, because it's taking so long to move off, we are seeing some extensions that we didn't really plan on. We thought that they were further along on their swap-out projects. And so we're getting extension of revenue here and there.

And so again, we remain super conservative. I visit more and more customers and slowly try to learn what they're doing and make sure we're providing value, and I really think the customer success message has caused them to take pause and think wait; maybe this is a vendor that we want to grow into more of a partnership and advisory relationship. And aiding (phon) is all really great news for us.

Robert Young

Okay. So it seems better than the message you were sharing on that last quarter. In context of that $100 million bottom end, is that less risk there than you saw last quarter? And then I really will pass the line.

Danielle Royston

Okay. That's okay. We could go to lunch and just chat. But no. I love how you guys want me to be super positive and I totally want—when the time comes and things are great, I will totally be like that.

My outlook has not changed. I still remain that it could be below 120. Create the plan under 100. Visit customers. Make sure that we're aligned. Make sure we have a really great team on the ground working. We have a lot of change going on inside our company as we standardize on a single operating platform. We have tools changes and things like that. So I'm not that quick. I wish I was. Again, it's going to take a while, and I want to continue to temper your expectations.

Robert Young

Okay. Thanks for that. I'll pass the line.

Danielle Royston

Yeah.

Operator

Again, if you would like to ask a question, please press *, 1 on your telephone keypad.

Your next question comes from the line of Paul Treiber with RBC Capital Markets. Your line is now open.

Paul Treiber — RBC Capital Markets

Thanks very much, and good morning. Just looking at Crossover and DevFactory, as you mentioned, the spending increased quite significantly quarter over quarter. Should we expect the spending at those two entities to continue at these levels? Or do you think that there's a further increase over the next several quarters?

Danielle Royston

Okay. So really the spending increased I think more on DevFactory than it did on Crossover. And again, with that accelerated contract that we got in Q1, we had a little bit of extra revenue that we didn't expect. DevFactory had extra capacity on some of the projects that we had running, and so we decided to go ahead and accelerate that work into Q1.

DevFactory and Crossover are totally crushing it. They are amazing. They are providing, on the Crossover side, amazing resources for us that are ramping very quickly and having quick impacts throughout the Company; not just on the customer side, but also internally in different functions. And so yeah. Whenever there's churn or turnover within our company, it's nice to be able to turn to our partner like Crossover and be able to very quickly identify top talent and pull them into our company, get them trained, and make them productive very, very quickly. So that's going to continue. But like I said, the Crossover pace I think was pretty much on par with where we thought it was going to end up.

And like I said with DevFactory, we had this extra revenue, they had extra capacity, things were going really well. Currently, we're really focused on improving the quality of our product. And so we were able to accelerate some work there.

I do expect it to increase. Again, we're going to manage very conservatively. Like I said, we want to approach cash flow breakeven towards the end of the year, and we want to maintain a minimum working cash balance at our company. And so every quarter, we'll look at how we're doing on restructuring plans. We'll look at how we're doing on our cost-cutting activities. We'll look at how we're doing on revenue. And I think that DevFactory will ebb and flow according to our ability to make investments in our roadmap, in improvements in our product, in internal projects to improve our overall processes. And so it really is this lever, if you will, that we are just really trying to change this company to be managed towards profitability.

Paul Treiber

Thanks, that's helpful. Just in regards with the restructuring, like the departure of 520 employees, how are you managing the knowledge that may have been built up in those employees and trying to transfer that insight over to the contractors at Crossover and DevFactory? Particularly given just the speed of the restructuring to date?

Danielle Royston

Yeah. So if you recall from previous earnings calls, I had mentioned that we were doing everything that we could around restructuring and creating a plan, even though we didn't have our funding. And the rights offering piece took longer than even I expected, right?

So we knew we wanted the restructuring I think back in February. We knew approximately the size. It was going to be 50 million to $60 million in total cost. We didn't have the cash. And so we were trimming our bonsai tree wherever we could, but then we were making significant plans.

We got our Crossover short-term agreement signed in June or July, something in that time frame. And so from that point forward, we started to do some cross-training. And so we had some—actually we experimented here at what was then Redknee in terms of how to quickly ramp contractors, and we used this concept that's familiar in—actually Farhan Thawar, our Board member, uses this exclusively at his company. The concept of pair programming.

And so the idea here is you have two people working on the same computer, looking at the same screen. The more experienced person is the navigator, and they're just like talking through what they would do in a particular code snippet. And then the newbie, the person that's learning, is the driver. They're the ones with the hand on the keyboard. And we have found that not only does this concept work with technical people, it works in support; it works in services.

And so we've really borne out this concept across the Company. We've shared our learnings with ESW. They're adopting it as part of their playbook because we've really seen how much we've been able to accelerate the learning when the newbie is driving and that.

And usually, you switch roles. Right? The newbie's sitting in the chair watching the expert? It can be frustrating for the navigator because if someone's going slow, and you're just like—it's like watching someone type. And that can be frustrating. But we really get good feedback. The navigator can give feedback on the driver of yeah, this person is learning really fast; or I have some red flag warnings. The drivers report successful sessions; it's not a waste of time. And so initially things go a little bit slower internally, but then you ramp up people so much faster.

And so we've been doing that approach since about July. Certainly, in our German workforce and entities, but then just throughout the Company, we've really been able to accelerate learning. And so while we didn't have all our restructuring money, we started planning about six months ago.

And so we have different levels of results throughout the Company. Some functions a little bit better at it than others. But for the most part, it's really been able to accelerate, so that when we got our funding in September, we just needed to freshen up the list; double check it; make sure we were all good to go with the pair program activity, and then pull the trigger in Q1.

Paul Treiber

And turning to sales and marketing, sales and marketing is down quite significantly, and actually down to pre-NSN levels. Just what drove the decrease there? And then do you have—can you elaborate on that? Do you have a new process in place for sales and marketing that allows you to be perhaps more efficient than what you previously were?

Danielle Royston

Yeah. Again, this is part of the ESW playbook that I'm super familiar with in terms of insights on lower level routine work around, for example, how you do renewals processing.

At Redknee and a lot of enterprise software companies, a lot of the times that renewal process is in the hands of the account manager or the relationship owner. And so that person's doing everything from calculating what the new pricing will be, figuring out the document and negotiating the redline, negotiating the discounting, and the making sure the POs get into finance and invoiced, and all that stuff.

And so one process that we brought to Redknee is a streamlined approach where we have a dedicated team that does all the operational side of that piece. They prepare the quotes always at least 90 days in advance. They know what contract to use because we have standard templates available. They know how to apply the pricing, and then they get it to the customer on time. And then when it comes in, they process it very quickly.

And so you don't need as many salespeople. And the salespeople tend to be the more expensive resources. When you have these lower cost resources just doing all the processing for you, and it really has been able to accelerate conversations with customers. And now I'm using my expensive resources, my salespeople, with stuff they're really good at, which is negotiating, building that relationship, and closing the deal. And so that's a big piece that's coming out of that sales and marketing number.

I think we had a lot of inefficient spend just in general in our marketing group. We've been able to take that team from eight to like one. I think we have effectively less than one full-time person on marketing. We've outsourced this to some experts. And so I pull in—for example, I have a team around the MWC event planning, and so I just need them—we've been working with them since November, November through February. And then they go away, and they just—there's not that much work the rest of the year. And so when it's time you start planning for MWC, we'll pull them in. And so it's a lot more efficient spending in areas like marketing and areas like sales. And so it's not perfect yet. I think it still could be more efficient.

It's really hard to pry the process from the salespeople. They don't trust the new people. They think they're going to get the numbers wrong or screw it up. But once you start to get them used to the fact that the process actually does work and saves them time, then they usually report, within a few months, they love the new process.

Paul Treiber

Okay. And just one last one from me. On deferred revenue, it also dipped down. Is that just timing? Or are you seeing a trend toward shorter duration contracts or just a lower level of deferred revenue in general?

Anin Basu

So, Paul, it's Anin. December through to March is our renewal season. And that's when most of the POs and the invoices are received for renewal for the next year. So the dip is normally caught up by the end of our second quarter. But generally, we are seeing, as Danielle mentioned, that there is an overall trend in declining revenues. So while overall there is a declining trend, we do expect that the deferred revenue numbers should go up at the end of Q2.

Paul Treiber

Okay. Thank you. I'll pass the line.

Operator

And we have no further questions, which brings us to our conclusion.

Thank you for your participation, and you may now disconnect.

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