# Fiscal 2022 and Q4 2022 Earnings Call Transcript

## Wednesday, March 22, 2023

### James Lorimer:

Good morning, ladies and gentlemen. Thank you for standing by and welcome to the Data Communications Management Corp Fiscal 22 Financial Results Conference Call. My name is James Lorimer and I'm pleased to be hosting today's call. Joining me is Richard Kellam, our President and Chief Executive Officer.

Following our prepared remarks, we will be moderating a Q&A session. As a reminder, this call is being broadcast live and recorded. We'd also like to remind everyone that Richard and I are available after the call for any follow-up questions that you might have. Before we begin, I'll remind everyone that we will be referring to forward-looking information on today's call. This information is subject to certain risks and uncertainties as outlined in the forward-looking information disclosure in our press release and more fully disclosed within our public disclosure filings on SEDAR.

We have posted a brief video message from Richard along with a summary of our results and our key initiatives in the year on our website in the form of an infographic. Our detailed information is also available on our website and SEDAR.

I'll now turn the call over to Richard.

### Richard Kellam:

OK, good morning and good afternoon and good evening for any shareholders that are joining us from international time zones. Here's what we want to accomplish today. We want to take you through our results for Q4 2022 and then we'll look at our total year of 2022 and how we're building and have been building a better and a bigger business. I'll then briefly talk about the announced acquisition of RRD and where we are there and then we'll turn it over for any Q&A.

So starting off with Q4 2022 results. We had an exceptional quarter in terms of revenue growth. Our revenue was up exactly 20% over year ago at $73 million, so it was up a full $12.2 million versus prior year. So a very good solid quarter. If you look at momentum across the quarters, you can see it was our second strongest quarter on the year. Our highest quarter was quarter two, but you can also see in this chart that we had positive growth in every quarter on the year from 11% in quarter one through to 20% in quarter four. So we're very pleased with the momentum that we delivered through each quarter and especially exiting 2022 with quarter 4 results of 20% growth.

Looking at gross profit: our overall gross profit grew 33% on the quarter, so again gross profit growing faster than revenue, which is super positive; $23.6 million in overall gross profit. That was up by $5.8 million versus a year ago. And we're also a very happy to report that our gross margin was 32.2%. So certainly one of the highest gross margin quarters we've delivered. And getting very close to that five-year range that we provided to shareholders of 35 to 40%. So certainly heading in a very positive direction.

Looking at gross profit momentum through the year, as I said, 33% growth in gross profit in the quarter and you can see positive momentum every quarter starting off in quarter one at 8% growth, 29 in quarter two, 16 in quarter three and again exceptional growth in quarter four at 33%. So very pleased with how we've exited the year in overall business shape from a gross profit perspective.

Our net income was also outstanding in the quarter at 3.7 million, up 5.5 million versus quarter four last year, which then kind of ladders down or leads down to EBITDA and our EBITDA was very strong up close to 90 percent—89.9%—versus last year; 9.5 million in EBITDA. So up $4.5 million over year ago and also that's a clean EBITDA, it's the fourth quarter in a row—and I'll talk about this in a minute—where we've actually had no restructuring as we committed to shareholders, no restructuring in 2022. So that's a clean EBITDA, hence the positive net income.

And then if we look at that clean EBITDA momentum, you can see anybody looking at the chart here, we've had positive EBITDA quarter by quarter, 29% in quarter one, 47% growth in quarter two, 25% growth in quarter three. And again, that 90% growth in quarter four. So our best quarter of the year and that sets us up very positively as we exit 2022.

Over to James for a little bit more detail.

## James Lorimer:

Here's a little bit more detail on our financials, just laying out some of the numbers that Richard mentioned. As you can see and Richard mentioned, gross margin was certainly strong compared to last year. SG&A was actually lower than last year's fourth quarter. Last year we did have $2.3 million of restructuring expenses. This year we did have $1.9 million of acquisition costs and that's really due diligence and a one-time cost related to our review of the R.R. Donnelley Canada acquisition.

Hope that this is the last time we'll talk about CEWS Adjusted EBITDA, but last year we had about $100,000 of wage subsidy benefit. So you can see kind of clean CEWS Adjusted EBITDA here of 15.5% of revenue, which we're very pleased with. And again, you know, tracking towards our five-year targets, that's a very good number for us.

## Richard Kellam:

Yeah. So very positive momentum in the Adjusted EBITDA line as well. Thank you, James.

So having a look at year end, so that was a positive quarter on every kind of line item in our P&L. And looking at our year-end results and you know we talked a lot about this theme of building a better and bigger business. I'm first going to talk to you about what we're doing to build a better business and then we'll move into bigger.

So on the better side, looking at this chart, our head count is down to 910 associates. That's a 1.3% decrease over a year ago and a 35.5% decrease since 2017. I did reference and I did mention to shareholders that we have the perfect footprint right now and it's about driving revenue through that footprint, hence the no restructuring expense. And if you look at the right-hand side of this chart, you can see how we're driving revenue through that footprint and through that associate base, we've actually crossed $300,000 per associate in 2022. We actually didn’t think we’d get there until the end of 2023. What with the exceptional revenue growth we've crossed that milestone much quicker than anticipated. So super positive, up 18% over year ago and revenue per associate up close to 47% over the last five or six years, so great momentum in terms of driving productivity improvements.

Also happy to report that our customer engagement, we run a Voice of the Customer once a year. So it's the second time we've done it using a company called Apex Scoring System and our voice of the customer, so what customers are telling us about how we're working with them are overall level of engagement has improved considerably.

Some key metrics here on being meaningful, responsive, predictable, forward-thinking and dependable up significantly and in the Apex scoring system, we are considered engagement experts and on our way to being engagement masters. So we're very pleased with the response we're getting from our clients in terms of how engaged they are with our level of client leadership. So again building a better business and building that client leadership model from engagement experts to engagement masters.

We also do a biannual survey using Gallup to understand the engagement of our associates, those 910 associates. Also very happy to report that we've had solid improvement in overall engagement with our engagement mean up 8% and overall percentile ranking up 18%. So associate engagement is certainly critically important for us and we're seeing those improvements from the voice of our associates.

Also pleased to report that we've worked hard on building a solid growth muscle as an organization and we've actually won 35 new logos this year and we've got just north of $35 million in new business that we've brought into the organization in 2022 across a multiple number of verticals. And all of that revenue that we've generated from new business development is what we call tech-enabled, so it's enabled with some type of technology. It may end up as a physical printed product, but it's enabled by technology, which obviously makes that client model much more higher-level retention and obviously you know a higher value as well. So very pleased with the new business development that the entire commercial team has delivered this year and the entire organization; more than commercial team involved in new business development. It's all of us and so very pleased with the progress there.

Also, you know on the theme of building a better business, we really put some key targets in place a couple of years ago to deliver environmental, social and governance momentum. And on the environmental side, we're actively participating in what's called SGP, which is sustainable green printing partnership. A lot of metrics around that in terms of waste and carbon emissions so we're tracking all that information and we've actually made some solid progress there.

We've also aligned with science-based targets which give us sort of a glide path to reduce CO2 emissions by 42% over the next seven years. And I think the one thing we're most proud of; we're proud of everything, but we're super proud of our PrintReleaf association where we reforest 100% of our clients' paper use. And that is accounted to 702,000 trees being reforested since we started working with PrintReleaf at the end of 2021 and through 2022, but offsetting 58 million pounds of paper, so very pleased with that reforestation effort and certainly clients are very pleased with that as well. But a lot of work happening on ESG and again some very good momentum across our organization and we're very committed to this moving forward.

Also, we've made good progress on our DCM digital journey, especially around standing up a solution or portfolio for the future. Of course, our shareholders know that we've got this fantastic DCMFlex platform that we continue to drive client penetration on and that's a platform that optimizes and manages workflow. The centre of this chart, we've got our digital asset management solution which we've been actively in market with and we've got our own, you know, platform coming to market in the next couple of months to drive some good client penetration. We just introduced a personalized video capability, we call it PRSNL, sort of an end-to-end solution and we're driving penetration with clients on that right now.

We're in the process of introducing a marketing campaign, omnichannel workflow PAT platform called "Marketing Flow", MTGFlow; we actually stood this up for a large electronic retailer a year ago and now we're scaling that into more clients. And we've also got a platform we call OPTICHANL and that's a campaign collateral allocation and distribution platform. And we've stood that up with a large FI about a year ago or a year and a half ago. And we're now commercializing that to more clients so driving penetration with this whole OPTICHANL platform. So some really good progress in terms of getting the foundation and building the solution portfolio in 2022 for our DCM digital group.

And then finally, debt reduction down quite significantly. You can see our high in 2019 was close to $80 million. We've had a 26% reduction in debt in 2022 versus 2021 down to $27 million and a 65, almost a 66% reduction from our high of 2019. Another important point is that this is the lowest debt we've had since we IPO'd in 2004. So real good progress in terms of you know, paying down debt and you know managing our cash flow and paying down debt quickly.

And as I said earlier, we've had zero restructuring expense. We obviously had zero in the quarter. We've had zero on the year. I said that our right sizing is complete. We've got the perfect footprint to grow off of and you can see the numbers. We've certainly driven growth through that footprint in 2022.

So that was a little bit on building a better business. Now I'm going to talk to you about the results on the bigger business side of 2022.

So revenue, exceptional growth at 16.3% versus last year, revenue approaching $274 million, up $38.5 million versus prior year. So very, very good revenue growth on the year.

Gross profit growing faster than revenue at 21.1%, we like to see that because that means our percent is growing, our gross margin is growing and you can see on the right-hand side of this chart; our gross margin is up to 30.8%, about a point and a half up over a year ago and our total gross profit is $84.2 million and that is up close to $15 million versus prior year or so. Good momentum on revenue, great momentum on gross profit.

Net income, a similar kind of story, through quarter four, if you look at this on the year net income $14 million up $12.4 million versus prior year. And that's a real number on the chart, 792% increase in net income over year ago. And again, you know, all that due to the productivity improvements that we've made, the improvement of gross margin, the 0 restructuring obviously flows directly into net income, so a good solid net income year as we committed.

And then rolling down or flowing down to EBITDA, EBITDA very pleased to report up 45.3% on the year at 36.4 million, that's 11.4 million up over prior year and that's 13.3% of revenue, up

2.7% versus last year. And this is a clean EBITDA number. We'll talk about you know what that final number looks like when we look at some of the costs that we've incurred for due diligence on this acquisition, but very pleased with the EBITDA progress that we've delivered in 2022.

So over to James with little deeper dive here.

## James Lorimer:

Yes, I just did another little look at our summary financial information, most of which Richard has already gone through. You know, gross margin 30.8% up from 29.5% last year; SG&A was a little bit ahead of where we were last year, but you know with 16.3% growth on the top line, we're very pleased with that. Restructuring expenses as we've talked about and acquisition costs of $1.9 million just in the fourth quarter. So if you look at kind of adjusted income from operations, which is more of a kind of a P&L line than EBITDA, we're $25.2 million.

We're almost $12 million ahead of where we were last year and adjusted net income $15.4 million compared to $7.7 million last year, really kind of doubling what we did last year.

You know, looking at Adjusted EBITDA and cash conversion, we realized this is important to many shareholders. You know, while our cash from operations was down a bit from last year, last year you'll recall we had significant working capital improvements as we really, you know, reduced our accounts receivable outstanding, crunched our payables. This year we did have a little bit of inventory build and so that cut into a little bit our working capital, but it certainly supported our high levels of revenue growth and it also differentiated us in the market, made sure that we had adequate inventory in order to meet the demand that we had from our clients.

With a little bit less CapEx this year, our free cash flow conversion rate was 93.5% compared to 88% last year. So really driving kind of more free cash flow to the bottom line, which allows us to service our debt, pay taxes etc. And really I think that the big point here is that these high levels of free cash flow conversion allowed us to pay down $12.6 million of fixed-rate term debt last year and it's really put us in a position where we're very well positioned to make the acquisition of R.R. Donnelley Canada and finance that fully with debt. So we're really comfortable with where our debt levels are and fortunately the aggressive debt pay downs that we've made over the last few years have really possessed positioned us well for this acquisition.

### Richard Kellam:

OK. Thank you, James. So 2022, as I said, an outstanding year building a better and a bigger business and clearly, you know, very proud of the results the entire team has delivered.

I'm now going to talk a little bit about where we are on the announced acquisition of R.R. Donnelley. And just a little reminder on the transaction highlights, we entered into a definitive agreement about three weeks ago and announced that three weeks ago.

It is a cash purchase price of $123 million subject to working capital and other adjustments and to remind shareholders R.R. Donnelley Canada has total revenues of approximately 250 million.

The closing is expected to be sometime in Q2 2023 and is subject to the Competition Bureau, which is in progress right now; financing is through 100% cash consideration. So 100% financed through a Canadian Chartered Bank and Fiera private debt.

Now important for shareholders to understand that of that $123 million, there's $30 million in there that is associated with real estate, OK. So think of it as the business of $93 million and real estate for $30 million; we actually have a bridge loan for the real estate because we're going to sell and lease that back very quickly post transaction and that will take our leverage from 3.25 down to a very manageable leverage level of 2.65 to 2.7. You know, following those sale and lease backs, OK, so think of it as a $93 million deal, $30 million on top of that for real estate, it's about 4.5 times multiple. So you know very pleased with this transaction.

Some of the benefits combining two companies with complementary operating models, really best-in-class products, strong innovation and very strong client leadership at Donnelley, you know they've got a fantastic team, lots of opportunities to leverage some of the moves that we're making here at DCM on digital and our digital leadership and bringing that into the Donnelley organization.

Obviously you know, creating some meaningful benefits to clients and customers, you know being better together and there's some attractive financial benefits due to some value creation opportunities as well. So that's just a quick summary of the transaction and just a summary of our presentation today.

So we started this phase of our journey almost exactly two years ago. So I've been here almost exactly 2 years to the day and we started this two-year journey of building a better and bigger business and really driving momentum in our business so I trust that all of our shareholders can see the productivity improvements that we've made, the efficiencies that we're driving in our business, the significant improvement in both associate engagement and client engagement, the moves that we've made on our ESG efforts and the significant reduction in debt. So we've done a very nice job as a collective team over the last couple of years to build a better business, clarify strategy and deliver results.

And then on the bigger side, again, we've had five quarters now of positive revenue growth, north of 16% growth in 2022. You can see the gross margins improved quarter on quarter over the last two years. Our profitability has certainly improved considerably. As I said, we've got the perfect footprint right now to grow off of. We've thought really the team has done a phenomenal job building a sustainable growth muscle.

And we'll see that deliver dividends over time as well as we continue to grow and continue to pioneer new clients, new customers and new verticals. And again, I think we're very well positioned for digital acceleration given the portfolio that we've established over the last year and our digital leadership team. So clearly we've got, you know, fantastic momentum as we exit 2022 and we're, you know, very pleased. We're kind of two years into a multi-year journey as we say here, and we're certainly excited about the next phase of the journey as we continue to build a better and a bigger business to now do that together with R.R. Donnelley once we close the transaction so very excited about the future and I do want to thank all of our associates for delivering this exceptional year in 2022 and most importantly delivering on a very successful journey over the last couple of years. And as I said we're certainly excited about the future.

So we'll turn it over for Q&A now. James, do you want to give the instructions of Q&A?

## James Lorimer:

Sure. Thanks, Richard. If you have a question and you're accessing the call directly through Teams, you can use the raise your hand feature in Teams and we will tee up questions. Alternatively, you can also use the chat feature in Teams and we will respond to questions there as well. If you have dialed in using old-fashioned phone version, you may press star 5 to raise or lower your hand and pressing Star 6 will mute or unmute your microphone. Please introduce yourself once you're introduced to the session.

## Chris Thompson:

Hello.

## Richard Kellam:

Hi there.

## Chris Thompson:

Sorry, can you hear me now?

## Richard Kellam:

Yep, Yep, we got you.

## Chris Thompson:

Yeah. Hi, it's Chris Thompson from eResearch.

Just a couple of questions, one about the gross margins in Q4 were you know higher than the gross margins for the rest of the year, is that sort of the gross margins you think you'll be building on for the rest of 2023?

## James Lorimer:

Yeah, I'd say Q4 was probably a little bit higher than our expectations. You know, we finished the year around 30.8. I think if you look back historically, Chris, we've been pretty good at building margins about a full percentage point a year. And so I'd say, you know that kind of growth is probably a little bit more normal through the balance of the year and over the next kind of four to five years through our five-year plan.

## Richard Kellam:

Yeah, and Chris? You know, I think you're aware of this. We experience a lot of kind of raw material headwinds and supply chain disruption in 2022. You know hence our working capital had to increase quite significantly just to have raw materials on the floor to meet clients' needs. So some of the movements and gross margin are due to pricing when we receive materials, how we price it as well. OK, so that you know will eventually kind of normalize over time.

## James Lorimer:

But certainly with the strong levels of revenue in the quarter, that helped with all our operational efficiencies and certainly you know contribution margin was very high, yeah.

### Chris Thompson:

Great. And your acquisition costs for the next couple of quarters, are they going to be similar to what you booked in Q4 or was that sort of the high watermark?

### James Lorimer:

Yeah, they'll be similar in Q1, probably a little bit higher, Chris, in Q1; a lot of the acquisition costs were really kind of November, December of last year as we ramped up our diligence. And then, you know, when we announced the transaction about three weeks ago, you know a lot of costs through kind of January, February and March related to that. So yeah, I would expect Q1 will be higher than you saw in Q4.

### Chris Thompson:

OK. And my final question just has to go along the lines with the Silicon Valley Bank. So the banking issues these days, do you see any of that impacting either any of your clients and/or the acquisition moving forward?

### James Lorimer:

With regards to clients, as you know, 90 plus percent of our business is with 250 odd clients, most of those are kind of large enterprise clients. We don't do a lot of work with, you know, kind of more venture-funded type clients; that’s not our typical client base so we don't see any real client exposure there.

From our own funding and acquisition lines from our funding partners, we don't expect any issues there either and likewise R.R. Donnelley Canada has a kind of similar profile, different mixing clients but similar profile to ours and we don't expect that they'd be impacted to any significance.

### Chris Thompson:

Thanks. Those are my questions. Great quarter and look forward to seeing Q1 when it comes up.

### James Lorimer:

Thanks Chris.

Scott, do you want to go ahead please?

## Scott:

Great. Thanks. Great quarter. Good job, excellent work. I have a couple of questions. One, we are now at the tail end of Q1. Can you comment on how Fiscal ‘23 has started out? And then secondly, can you talk a bit about the strategy to drive digital penetration and where you are as a percentage of your print revenues being now tech-enabled and with that can you come in on what the margins are on the tech-enabled revenues versus the print revenues?

## James Lorimer:

So, where we are in the quarter, Scott, we're tracking positively. You know, we had very strong momentum in the fourth quarter as everyone's seen; that momentum has continued through the first quarter and we are, you know, continuing to pass through price increases where we were maybe restricted from contracts in doing so last year. So, so we are getting some kind of continued effect from that. So we think we think that should show a pretty good comparable first quarter this year compared to last year.

## Richard Kellam:

OK. Yeah. Your question on our tech-enabled workflow or tech-enabled penetration, about 35% of our revenue starts with a technology solution that may end up in a printed product or it could end up in distributed in a kind of email. But it starts with technology, so the technology is embedded into our clients’ digital stack if you will. And obviously we get value for that; the margins are higher because obviously there's more value we're bringing. I'm not going to—from a competitive standpoint I’m not going to tell you about the difference in margin but they’re certainly better margin and importantly when we are bringing that technology or that solution to a client to help streamline or enable their workflow then there's a much higher level of retention and loyalty. It's hard to kind of lift and shift that work elsewhere if we're deep in their digital stack. So our strategy, we made it clear on our five-year plan. We want to take that tech-enabled workflow from 35% up to 75% over time over the 5-year glide path. And so that's kind of one part of our digital strategy.

The other part, the question you didn't ask, but I'll answer it anyway, which is some of the (other than DCMFlex) other solutions that I shared in the presentation today, the PRSNL solution, the ASMBL solution, the marketing workflow solution and the OPTICHANL solution, those are all pure SAAS plays and we just kind of started that journey in 2022 and you'll see that accelerate in 2023 onward.

### Scott:

Yeah, that's helpful. And related to that, are you receiving any revenues from those solutions that you just highlighted today? And then maybe if you could comment as we exit ‘23, what are you thinking in terms of those revenue streams being as a percentage of revenues?

### Richard Kellam:

Yeah. Do you want to talk about revenue we're getting from our digital solutions today?

### James Lorimer:

Yeah. So, in our statements, we break out what we call subscription fees and program management fees and other kind of recurring revenue. It's in the range of about $5.5, million last year. We are seeing growth in the subscription fees, you know kind of software and like pure kind of SAAS or services, still a reasonably small number for us, Scott, probably in the million and a half range in aggregate. But we do see that accelerating through the balance of the year and you know certainly continuing to accelerate in 24 and 25 past that.

### Scott:

Very good. Thanks for the comments.

### James Lorimer:

OK. Thanks Scott. We have a question in the chat regarding our financials on SEDAR, a question regarding inventory levels, which have been climbing through last year. Our statements in information should be filed on SEDAR first thing this morning, so it should be available there.

In terms of inventory levels, we did see a little bit of a reduction at the end of the year. We had some big jobs that consumed a lot of inventory at the balance of the year, hence some of the higher revenue that you saw. We are starting to see a little bit of a moderation in the raw material market at least from an availability perspective.

Pricing, we still see some pricing pressure expected through the balance of the year, but we are, you know, kind of confident in the inventory levels that we have. They did come down a little bit and we certainly expect them to come down through the balance of this year.

**Richard Kellam:**

At one point in the year, just for clarity, to meet clients' workflow needs, in other words, to have raw materials, you know, on the floor to meet those needs, we were up as high as three months of inventory at some of our facilities and we're seeing that come down significantly, and we're expecting that will continue to decrease as we go through 2023. Demand in the market is still there, but supply has improved considerably and so you know that will kind of normalize over time. We're expecting to see some normalization through the end of 2023.

**James Lorimer:**

OK. yeah. Question from Raymond Williams. Hi, Raymond. "Will you be providing the RRD synergies and savings as soon as the deal closes?"

Yes, we will provide some more insights into opportunities once the deal closes and once we get through the next quarter or two. We do have kind of a number of areas that we think there's opportunities. We certainly see some operational synergies, we see some procurement synergies and I think importantly, we also see some revenue synergies where there's significant opportunities for cross-selling some of the products and services that we have that they don't and vice versa. So we're really excited about the opportunity of putting the two businesses together.

**Richard Kellam:**

OK. No further questions from anybody?

Alright, thank you for everybody listening today; I really appreciate it and thank you to all of our associates. As I said earlier for delivering outstanding 2022. We're very excited about 2023 about continuing to deliver a better and a bigger business and really delivering a better and bigger business after we have the successful acquisition of RRD Canada which we're very, very excited about. So thank you everybody and look forward to reporting on our Q1 results I guess in the next month or so, right? Next couple of months so.

Thank you.