Q1 2023 Earnings Call Transcript

Thursday, May 11, 2023

James Lorimer:

Good morning, ladies and gentlemen. Thank you for standing by and welcome to the Data Communications Management Corp. First Quarter 2023 Financial Results Conference Call. My name is James Lorimer, CFO of DCM, and I'm pleased to be hosting today's call. Joining me on the call today is Richard Kellam, our CEO and President.

Following our prepared remarks, we will be moderating a question-and-answer session. As a reminder, this conference call is being recorded live and broadcast live. We'd also like to remind everyone that Richard and I can be available for calls afterwards if anyone has any follow-up questions.

I'd like to 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 within our public disclosure filings on SEDAR.

We have posted a brief video message from Richard along with the summary of our results and key initiatives for the quarter on our website in the form of an infographic. Our presentation today will also be added to our website for your reference, along with the post-view recording and transcript. Our detailed information is also available on our website and SEDAR.

Please follow us on LinkedIn to keep up to date with other business developments, and I'll now turn the call over to Richard.

Richard Kellam:

Thank you, James and good morning and good afternoon, good evening. I see there's some international investors on the call today or shareholders, so good afternoon, good evening to you and good morning to everyone.

Here's what we want to accomplish in the call today. We want to take you through an update on our quarter obviously then talk a little bit about how we are becoming bigger and Better Together with the recent close of our transaction acquiring R.R. Donnelly Canada or Moore

Canada Corp. and then we'll turn it over to any questions that attendees will have for today, okay?

So first off, looking at our 2023 results, I'm going to break this into our theme of bigger and better business and I'll start off with the bigger side. Happy to report that we had a very, very positive quarter in terms of growth, just under 10% at 9.8% versus year ago. And to remind shareholders that was off of 11.1% growth on the quarter last year. So good positive momentum at the start of the year.

A great revenue quarter at $76.1 million up from $69.3 million year ago. That growth of $6.8 million came from a combination of what we call expansion revenues, so growing revenue with existing clients as well as new business development. We brought in several new logos and lots of new logos that we have the opportunity to land and expand as we call, so lots of good kind of positive opportunities moving forward to expand that revenue. So really good solid growth in the quarter, really pleased with the success that our commercial teams are having with our whole client or customer leadership agenda.

Looking at that revenue momentum, you can see on this chart, we look at a three-year kind of time horizon and you can see how we built that over three years. We've actually had six; this is our sixth consecutive quarter of year over year growth. So you can certainly see that we've got positive momentum at our business now and you know if you look at this chart, anybody you know, it's kind of dialed into our call here, you know from a or on the Teams call, you can see that that $76.1 actually is higher than our quarter four and quarter four is generally our strongest quarter so off to a great start in quarter 1, 2023 and great momentum.

Also, pleased to report that our gross profit is growing faster than revenue, which is always positive. That means your gross margin is improving. And as I said to the team, gross margin is our best friend and you can see our gross margin as a percent of revenue is 31.1% and we're up a full $3.3 million in gross profit versus year ago.

So a continued relentless focus on driving a better business and a bigger business and playing in the right margin pools in the category, you know not all margin pools are treated equal and certainly the team has done a fantastic job, at really kind of driving that margin agenda and that 31.1 is actually one of our highest quarters ever so we're certainly very pleased with the progress we're making on that gross margin agenda, OK, so very, very solid.

You can see the growth that we're achieving on gross profit and gross margin quarter on quarter and this chart kind of illustrates the progress we've made over the last three years from $18.8 in 2021 up to $23.6 in 2022. So $4.8 million increase over the course of two years on that quarter.

Now I'm going sort of unpack this. The only, I'd say, I'll call this a positive headwind we experienced in our business was we had to do a mark-to-market adjustment in our long-term RSU and DSU so there was a non-cash impact of $4.5 million in our EBITDA to adjust for that significant appreciation and share value. Why I call this a positive headwind is you know we're certainly all shareholders and we've all benefited from an increase in that share price; at this time in the quarter it was a 63.4% increase in share price and that obviously had an impact on that long term-comp. so it's a positive headwind. It's a non-cash accrual as said, related to that long-term incentive com.

Taking that into consideration and adjusting for that as well as (and James will talk to you in a minute) adjusting for what was very well planned and very well architected acquisition costs, our Adjusted EBITDA was up 30.1% in the quarter. So really, really solid progress. You can see that's $12.3 million and also really, you know positive is as a percent of revenue we're up north of 16%. We gave some guidance that we saw a path to north of 14. You can see we're at the 16.2% of revenue once we adjust for that one-time impact of mark-to-market and of course the acquisition expenses. So great positive momentum on EBITDA as well, obviously driven through or driven by accelerated revenue and improvement in gross margin and then obviously operating pretty tightly from an SG&A perspective as you'll see in a minute. If you look at our Adjusted EBITDA progress over the last three years as well, you can see it's certainly very positive at the 12.3 versus 9.4 a year ago. And James, just want to talk to this chart?

James Lorimer:

Yeah, just another presentation of some of the information that Richard previously described. You can see the performance on a comparable dollar basis compared to last year in the first quarter, breaking out the mark-to-market adjustments and the $6.1 million of acquisition and integration costs which we had planned for (and Richard will talk as we talk a little bit more about the acquisition of Moore Canada in a few minutes), how well prepared we are for closing and how prepared we were literally on day one for closing so we're very well prepared for the integration and we're making great progress on that.

EBITDA as a percentage of revenue. You can see 16.2% when we adjust for the one-time acquisition and integration costs as well as the mark-to-market adjustment. I would also point out that cash flow from operations was very strong in the quarter. We generated $6.3 million of cash from operations compared to $4.7 million last year.

Richard Kellam:

OK, thank you, James. So certainly a lot of progress in terms of building a bigger business. Now I'm going to talk about some of the key metrics around the better business that we have built and continue to build as well.

From an SG&A perspective, SG&A was up slightly over a year ago at 5.2%. But the key metric we look at is how we're operating relative to revenue and if you look at the far right-hand side here, we're 18.7% of revenue versus 19.7% year ago; so this is actually what we call NOG, which is negative overhead growth, and it puts us in the range – we put the five-year plan out there, said that we want to be between 18 and 20% of SG&A and I think at the time we're around 23 or 24, you can see we're 18.7 now on the quarter so we're right kind of in the midpoint of that range. So very happy with the progress we're making in terms of kind of managing our costs and investing where those investments matter. So good progress in terms of managing SG&A and as I said, operating at negative overhead growth as a percentage of revenue.

This chart kind of illustrates that as well. If you look at our headcount, we're pretty much flat at 916; I have said many times pre-acquisition that we had the perfect footprint and now it was the need or the opportunity to grow off of that footprint. We had zero restructuring expenses in 2022 and actually we've had other than the deal costs there's no restructuring either in the first quarter. But if you look at the right-hand side of this chart, what we're proud of is the revenue we're generated per headcount and you see that continues to improve. We're at $306,000 per associate now, up 2% versus year ago and up you know significantly 49, almost 50% since 2017. And this will continue to be a focus of our organization, our entire team as we work the integration process with the acquisition as well. And we'll see these numbers improve considerably.

Also, I've talked to shareholders about the progress we're making on our ESG strategy and ESG initiatives. It's sort of in our Better Business theme we put some targets to street around waste reduction, sustainability, footprint or carbon footprint reduction and renewable energy, lots of work happening on social and governance as well so a lot of momentum over the last couple of years and this momentum continues to accelerate as we move quarter through quarter and maybe just to highlight one area that we're you know very proud of.

We're proud of all this stuff, by the way, but one area that we're particularly proud of is the progress we're making on reforestation. And we have used since we signed onto this program, which was the end of 2021 so we're just kind of a year and a quarter into it, we've actually reforested 812,000 trees and 100% of our clients' paper use is reforested and—I think I mentioned this Cheryl a couple of times before, but maybe just remind them—but we actually flow this credit directly through to our clients so clients can get the benefit of the credit in their ESG efforts or their sustainability efforts and it's proven to be very, very favorable from a client standpoint. And we actually had our first client cross 100,000 trees reforested since the program began and we actually gave a nice little award to that client Friday last week and they were certainly very, very happy, very proud of what they've accomplished and what we've helped them accomplish in terms of reforesting 100% of their paper. So a great program, fully committed to it and great client momentum on this program as well.

Other next area that we're building a Better Business in is digital. We've talked a lot about our digital acceleration and we've got five platforms that we bring to clients: our Flex-enabled platform, which is a workflow optimization platform, and then we've got four others that are more in the kind of pure area space. We just launched our PRSNL video platform and that's off to a good start, we've got a couple of key clients that we're working on some customized and personalized videos for and you can see the chart, some of the other activities of the other platforms. The one we're really going to be putting a lot of energy behind, of course, is the digital asset management solutioning platform called ASMBL.

But if you look at the right-hand side of this chart, early days, we're just kind of starting our digital journey. You can see we had 27% growth on the quarter, $1.5 million in revenue. You know you guys can straight line that to understand what that could look like on the year, but we certainly plan to progress well beyond that straight line. So lots happening from a digital acceleration with our DCM digital team.

I want to remind shareholders that you know, we love print and we love digital and we want to be a—you know strategy is very clear—a digital-first company that does print versus a print-first company that does digital. So they work very synergistically together, but really good progress in terms of building a Better Business and really getting very intentional and delivering success under our DCM digital team.

Just want to talk debt reduction, James?

James Lorimer:

Sure. As everyone knows, debt reduction has been a real primary focus of us of ours over the past several years. At the end of the first quarter, our debt was down to about $22.5 million, down 17% compared to year end, so you know, continued progress there and you know being in that position as we've talked about before really put in us in a great position to be able to make the acquisition that we recently closed on. So we'll talk a little bit more about what our debt looks like you know, in a few slides pro form at the transaction.

Richard Kellam:

OK. Thank you, James.

Alright, now we'll talk a little bit about Moore Canada Corporation. The reason we're calling it Moore Canada Corporation is the legal entity that we acquired; R.R. Donnelly Canada’s legal entity is Moore Canada Corporation. So you'll see us referring to MCC or Moore Canada Corp. and James just want to talk about performance on MCC in the quarter?

James Lorimer:

Sure, MCC continued to have very strong momentum in the quarter. Their revenue was up more than 10%, and their operating income and other metrics were also very positive, you know, really nice to see this momentum going into the deal. I will point out that during the first quarter we were competitors. Now that we're collaborators, we're really excited about the opportunities to grow the combined business. We will be reporting in the second quarter a consolidated picture and the reporting for Moore Canada will be effective April 24 so we'll have basically two months plus a week of their numbers when we report the second quarter and that's expected to be in early August.

Richard Kellam:

Yeah so maybe I'll just kind of amplify this a little bit. In addition to what James said, a great start for the RRD Canadian organization or Moore Canada Corp. in quarter one growing at 10%. You know, we showed you our numbers growing at 10%. And remember, we were competitors in that quarter and now we are collaborators and we kicked off a really accelerated move from competitors to collaborative ways of working sort of immediately upon close. So imagine the opportunities now moving forward, so off to a great start.

So now we'll talk about the new DCM and the better and bigger theme as a better and bigger company here and a little bit about kind of where we are on the post-merger integration process. So this is how we communicate how we are Better Together as two companies and we communicate this both internally and externally to clients. You know 8 key areas, one is around our expanded product offerings. This is a very nice kind of complementary deal that brings more services and more product into our clients. Obviously the superior service we can bring to clients, the incredible execution capabilities we now have together, the speed to market that we can deliver on those new products.

We certainly have exceptional client leadership and especially at the enterprise level, we've talked a lot about our top 250. You're going to be hearing a lot more about our top 400. We now have 400 enterprise clients who represent a significant percent of revenue. Our people, we've got exceptional people across our “Newco”, the new company post the acquisition, we've got some incredible innovation, not just in digital, but also some other product innovation that we're bringing to clients as well and innovation that's kind of horizon 2 and horizon three in the pipeline. And then of course, we've got even more scaled or greater scale to invest.

So 8 key areas why this is a great deal, why we're Better Together and how we communicate this across to our clients. And lots of work happening post-merger on all of these areas and I can tell you that we've come together very, very fast as organization. We were very well prepared for day one thanks to all the work we were doing with Boston Consulting Group to help us get prepared as well as you know how well our teams have kind of leaned into the program or to the acquisition.

You know, we've gone through this with shareholders and investors in the past, but worth kind of repeating, and I'll just kind of unpack this very quickly, the final purchase price was $130.8 million. The original number was $123, so it was just kind of working capital adjustments that took the price up and that was mostly around kind of inventory and payables and receivables. So the way to think about it is $100 million for the business and $30 million for three owned facilities. I'm sure most of our shareholders know that three owned facilities came with the deal.

The pro forma revenues were about $520, I think they're around $525 to be exact, expected synergies we've communicated in the range of $25 to 30. In fact, we've got a very detailed program to deliver the $25 and opportunities to expand up to 30 and maybe even beyond that so we're certainly well prepared and those will be delivered over the next 18 to 24 months.

The transaction was fully funded. We closed on the 24th of April and also important for shareholders to know that those three owned facilities, we've already sold one of them, it's a facility out in Oshawa and the net proceeds are $23 million and that will close soon, certainly before the end of the quarter. And those proceeds will go directly into that $30 million debt facility that we have so immediately into that debt stack so you know happy to get that property sold and that's an important property in our network as well out in Oshawa. So we're leasing that back.

And then of course from a financing standpoint, you know, Bank of Montreal, great lending partners stepped up and with a $90 million expanded revolver, we also got the 30 million term loan facility they what I'm referencing for real estate that again 23 of that thirty will be gone very shortly. And then Fiera Debt, who's been a great partner of ours for a number of years, kind of helped us with the deal, the financing leverage, 3.25 deleveraging very quickly to 2.65 after those sell/leasebacks are completed. OK, so I just want to remind shareholders, as I said, sort of the deal and how it was structured. And I can tell you we're off to a great an incredible start with the new team.

We've also been working on updating our five-year plan because of course shareholders may remember that we put a 5-year plan in place about a year and a half ago. So about four or five months after I joined and obviously we blew through that pretty quickly. So we needed to revise the five-year plan and these are just some key metrics on it and we'll be going through a lot more details with shareholders. But we see a path to north of 5% growth. Remember our last five-year plan, we said between 5 and 10 so we're kind of still holding that range. North of 14% Adjusted EBITDA within that time that five-year horizon will certainly be less than one times debt to EBITDA and we see a real acceleration in our martech growth at north of 60% over that five-year horizon with some of the new platforms that we've stood up and the bets we're making in the market and of course the opportunities we have with existing those 400 enterprise clients now and all that martech businesses is high gross margin.

I will say, I've said earlier, that we're now thinking like a digital company that has print not a printing company that has digital. Now that's not to say print is bad, we love print. We wouldn't have done this acquisition if we didn't love print, but really enabling that print with digital technology or digital solutions allows us to have to deliver even more value, help simplify complexity for clients, deliver more value for clients and then you know obviously, the more we're embedded in clients' digital stacks, the more value we're delivering a client, the higher level of retention. So it's a perfect what we call kind of virtuous circle.

You know the print market is a $10 billion market in Canada alone and depending on what data you look at, is growing from you know from 2, 3% and lots of opportunities for us to expand our presence and business in that market and do that with technology to enable that workflow. OK?

So that's our strategy. Clear five-year plan. Lots of work in behind this, but clear commitment to drive accelerated growth over the next five years with, you know, real positive EBITDA progression as well, OK? So those are the key areas we want to take you through how we did in the quarter, how we're performing from a bigger business, from a better business, a little bit on where we are post closure of the deal and I can tell you we've just hit the treetops for the meeting today, but we are very, very well planned and the teams have come together extremely well. I've done a lot of deals in my time and I'd say this is sort of the best execution that we have orchestrated and I've certainly seen. So a great start and very good momentum in our business overall.

So I want to turn it over to any Q&As now.

James Lorimer:

Thanks, Richard. We'll now take questions from the audience. If you have a question and you're accessing the call directly through Teams, you can use the raise your hand feature and we will queue up questions. Alternatively, you can also use the chat feature in Teams and we will respond to chat questions as well. If you have dialed in, you can press * 5 to raise or lower your hand and pressing * 6 will mute or unmute your microphone and will let you into the call. Please introduce yourself once you're invited into the session. Thanks.

I have a question from phone number ends 0469. Go ahead please.

Chris Thompson:

It's Chris Thompson calling from eResearch. How you guys doing today?

I just wondered moving forward, looking at your G&A going forward are you looking to see that that's gonna be sort of like the new normal with your expenses or is this just a one-time sort of adjustment?

James Lorimer:

Yeah, but from a G&A perspective, you know, on our own, we'd see that run rate being fairly steady, adjusting for that $4.5 million that we talked about earlier of non-cash adjustments. Other than that, our SG&A on a standalone basis should be pretty consistent. We will be reporting consolidated numbers for the combined company in early July, once we file a business acquisition report and at that point that'll have the pro forma numbers for Moore Canada Corporation on a standalone basis.

They currently report under U.S. GAAP and we'll be converting that to IFRS and then we'll be also providing pro forma statements that reconcile as if the two businesses had operated together in 2022 and updated kind of Q1 numbers on a pro forma basis as well.

Chris Thompson:

So will that be you're saying that's July, so that'll be Q3 will be the first time you'll be presenting the combined company? So Q2 will still be separate?

James Lorimer:

No so we'll file what's called a business acquisition report. That'll be filed on SEDAR in early July and then starting in Q2, we will be reporting on a consolidated basis. I think our plan to report Q2 is around August 10 right now and that first quarter would including Moore Canada will have basically two months plus a week of their results in the quarter. So it won’t be a full quarter for them. So we'll do our best to explain what a full quarter would have looked like when we report Q2 OK.

Richard Kellam:

I just want build on your question around SG&A as well. We'reholding firm with our commitment. Our, you know, the plan we put to the street the five-year plan of that range between 18 and 20, you can see we're 18.7 on the quarter and we're committed to that range over the course of the next five years.

Chris Thompson:

OK. And then for the acquisition costs for this quarter, is this sort of the high watermark?

James Lorimer:

Yes, it is. The acquisition cost should come down quite a bit from there. That was, uh, you know, largely due diligence costs and consulting costs kind of in preparation for the integration which were, you know, pretty much peaked in Q1. You saw when we reported Q4, I think we had about $1.8/1.9 million of deal costs that were in Q4. That will come down considerably in Q2.

Chris Thompson:

OK. And just the last question, I mean you covered off the tech growth, it seems to be moving slowly, but you know I mean quarter over quarter, you know, high percentage gains but still a low percentage. Just looking at, you talked last year a little bit about U.S. growth and I know that this acquisition probably put a little bit of a dent in that, but are you still looking at the U.S. market?

Richard Kellam:

Yeah, we're certainly we are still looking at it. The interesting thing on this acquisition, it came with a business called Annan and Bird, which is a large format printer, part of the Donnelly group, part of Moore Canada Corporation and 75% of the revenue's actually done in the U.S., Chris, so this actually accelerates some of our intentionality for the U.S. marketplace as a result.

Chris Thompson:

OK, great. Those are my questions for now. Thanks. Great quarter and I look forward to seeing the changes with the acquisition.

James Lorimer:

Thank you, Chris. Do we have any further Q&A?

We have someone in the chat line here. So we have a question here from one of our longstanding shareholders: "A great quarter1 guys, any update on the ASMBL standalone rollout?".

Richard Kellam:

Yeah, sure. So you know, reminding shareholders that we have, we went to market with ASMBL well about a year or year and a half ago with a white-labelled solution which we've added some features and functions around. We've actually been quite successful early days with that with a few key clients and in fact we just secured a large client with a new ASMBL win a couple of weeks ago. We haven't reported on it yet but we will soon.

While we've gone to market with a white-labelled, we call it sort of a tech-enabled white-labelled solution that we've added value to, we've also been building our own platform and we're now in beta, so we've got beta clients as well and beta users, and then we'll be launching that in August, September will be our go-live date with our kind of fully built-out ASMBL platform. So you'll be hearing a lot more.

We're actually extremely excited about it, so it's a fantastic platform that that the team has built. We've got a clear unique selling proposition in the marketplace. And again you'll be seeing and hearing a lot more about that once we go live, but that is, you know, August, September when we go live with our own kind of fully built-out ASMBL platform.

James Lorimer:

In the chat we have a question from Manny: "Adding back the acquisition cost of $6.1 million and the $4.5 million non-cash charge non-GAAP EPS for the quarter is closer to 17 cents."

Umm, I did a little bit of math on that earlier. I got about 12.5 cents on a basic basis and about 11.6 cents on a diluted basis. That's applying a 25% assumed tax rate on the differences.

So in our tables in the MD&A, we report adjusted net income of $2.1 million. If we're to tax effect that and adjust for the—that adjusted net income includes an adjustment for the $6.1 million of, I'm sorry $4.5 million of mark-to-market adjustments and $6.1 million of the deal costs—so I get to kind of an adjusted net income of about $5.5 million when that's tax effected. So call it 11.5 to 12.5 cents, either basic or fully diluted.

OK. Are there any further questions?

OK, if there's no further, Yeah, I don't see any further questions.

So thanks everyone for attending our call and thank you for your interest. As a reminder, Richard and I can be available after the call if there's any follow-up questions. Certainly hope everyone enjoys the rest of your day.

Richard Kellam:

I'd just like to say thanks to all of our all of I'll call it the new DCM associates, right? All of our associates across the company for delivering such a solid quarter. We're making great progress in our business. Very pleased with the momentum and we certainly plan to continue to deliver the momentum as a now a bigger and even a better company.

Thanks for joining us today and excited to continue to report on progress.

James Lorimer:

Thanks everyone.