Q3 2023 Earnings Call Transcript

Thursday, November 9, 2023

James Lorimer:

Good morning, ladies and gentlemen. Thank you for standing by and welcome to the Data Communications Management Corp second quarter 2023 Financial Results Conference Call. I'm James Lorimer, the CFO of DCM and I'm pleased to be hosting today's call. Joining me on the call today is Richard Kellam, our President and CEO. Following our prepared remarks, we will be moderating a Q&A session.

As a reminder, this conference is being broadcast live and recorded. We'd also like to remind everyone that Richard and I can be available after the call for any follow-up questions you might have.

Before we begin, I'd like to remind everyone that we will be referring to forward-looking information as well as non-IFRS measures 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 from last night and more fully within our public disclosure filings on SEDAR.

We have posted a brief video message from Richard along with a summary of our results and key initiatives for the quarter on our website and the form of an infographic. This presentation will also be added to our website for your reference, along with a post-view recording and transcripts. Detailed information is also available on our website and SEDAR. Please also follow us on LinkedIn to keep up to date with other business developments.

And now let’s turn the call over to Richard.

Richard Kellam:

Thank you, James, and good morning, good afternoon, good evening for anybody joining us in other time zones. We had a very exciting third quarter. I’m looking forward to unpacking that quarter with shareholders today.

Here's we want to do from an objective standpoint: we're going to first start off with an update on our merger integration and then we'll talk about our consolidated results on Q3 and year to date. And then we'll turn it over for any Q&A.

So first with the with the merger integration: it's progressing very, very well and ahead of target and pretty much on schedule. We talked to shareholders many times about our focus areas, those being operational, organizational, procurement and revenue. And originally we put a target to the street of $25 to $30 million. We're happy today—very happy—to be revising that target to between $30 and $35 million in annual savings. So we're certainly off to an incredible start, [having] identified a lot of opportunities across these four areas which I'll talk about in a minute.

And I will say, and you'll see it later in the in the deck that, to date, we have generated $17.5 million in annualized synergies that will flow through in 2024. So about 53% of that midpoint target of $30 to $35. We'll talk about that in a little bit more detail when we get into the deck.

So [we're]off to a very good start.

Here are some details across each of the areas starting with the operational initiatives. We will be consolidating and optimizing our operational facilities from 14 plants to 10. That consolidation is already announced across our network and will increase our average revenue per plant to north of 45%, so a 45% increase.

The first plant that we are consolidating is Edmonton and we moved very quickly on that into our Calgary facility and that's all happening in December of this year. Three other consolidations are going to happen over the course of the next 18 to 24 months. Obviously we need to ensure that we're protecting client experience.

And of that $17.5 million, 18% of it is coming from operational initiatives. So roughly $3.75 million of that $17.5 million we've already secured to date. Obviously, much more will flow through as we consolidate the other three facilities over time, over the next 18 to 24 months. So great progress from an operational perspective.

Moving on to organization. [I'm] happy to report that our sales or we call it our commercial team is now fully integrated. So now one team that's responsible for client leadership, we've optimized or spans and layers across all functions. We've completed payroll integration from four payroll systems to one. So fantastic effort from our HR team to deliver that payroll integration process. We're in the process of benefit alignment. The annualized impact on organizational initiatives is roughly $9 million. It will flow through in 2024, so 51% of that

$17.5 million 2024 savings are coming from the organizational initiatives that we have already implemented and executed. So great progress from our teams here.

On the on the procurement side, again, you know a great momentum. We've optimized our vendor base. We've leveraged our scale. We've centralized purchasing and outsourcing. We've delivered or will deliver $4.7 million in annualized savings in 2024 and that's 27% of that $17.5 million.

And then on the revenue side, [with] the growth initiatives that we're delivering, our priority focus has really been on commercial momentum or growth right from the day we closed this deal. We have very, very strong collaboration and cross selling across the business and we've already delivered some sizable new business wins across retail, healthcare, QSR, manufacturing and transportation— just over $18 million in new business wins since we closed the transaction, so very proud of the progress we're making from a commercial leadership perspective.

Okay, so our integration initiatives are very much on track. And as I said, fantastic plans to deliver the $30 to $35 million of which $17.5 million is already initiated and will flow through in 2024. All the other [thing]s are going to happen obviously over the course of the next 18 to 24 months, as we've communicated several times to shareholders. So great progress and great team that's working to deliver these initiatives.

Now I'll move on to talk about the quarter and I'm going to start off with what we're doing to build a better business. I'm going to start off with SG&A: you're going to see it that our SG&A as a percentage of revenue is down by just over one point at 20.4%. Obviously the total SG&A is up in in value—obviously—because of the acquisition, but the percentage is down. So, so very good, very good progress there and you'll see on the next slide when we talk about year to date, our year to date SG&A as a percent of revenue is 19.5%, so [it's] well in the range that we put to shareholders of 18 to 20 [percent] and we certainly see opportunities to continue to progress to the low end of that range.

Okay, so really good progress on continuing to build a better business. We'll build a bigger business at the same time. And then just a quick look at restructuring expenses: our restructuring expenses on the quarter are $7 million and that reflects a lot of the announcements that we made in terms of consolidating organizations and operations.

And we obviously book those expenses—the people expenses—once we make the announcement. The cash expenses actually happen later. So those are those are reflected in the quarter: $9.7 million in restructuring year to date and exactly what we expected—sort of a 1-to-1 payout. Acquisition expenses were a lot lighter on the quarter at $200,000. So most of the expenses that we incurred, you know, on the deal costs have been complete and they're behind us.

And then as already mentioned in the upfront section, $17.5 million in annual savings to date from integration initiatives are, you know, already well identified and those will flow through as we enter in well as we exit out of this year, [and] importantly, as we enter into 2024.

[I’m] also happy to report headcount productivity improvements. We've shown this chart to shareholders many times. If we look at the right-hand side of the chart, you can see that our revenue per employee is now north of $300,000, [at] $306,000 per employee, up 2% over the last year and about 36% over the last five or six years, so very good improvement and progress there. And as we deliver, as we continue to deliver our synergies in operational organization, you'll see that revenue per employee continued to increase as well.
So very good momentum there in terms of productivity improvements.

[I’m] also happy to report that we are and have been very active in our ESG efforts and one that we are and have been proud of is our environmental reforestation efforts. And since we started this program, which is a little less than two years ago, we have we have reforested 100% of our paper use. So [it was] 90 million pounds of paper that we've used in our workflow for clients and we've reforested 100% of that. That's equivalent of just under 1.1 million trees. We celebrated the cross of 1,000,000 trees in September and this has been an incredible program for us. You know, we're very committed to deliver a sustainable environment and it's a great program. And those credits flow through to our clients as well.

And on our on our DCM digital journey, we have not taken our eye off the ball here at all. In fact, we are all in on our digital efforts with our DCM Flex platform, with our digital asset management solutioning, some of the work we're doing on personalized video, our marketing campaign optimization and then our Optichanl platform.

This is the first time we're actually reporting the consolidated DCM digital revenues and those revenues include software revenues and marketing services—or sorry—digital services revenues, managed services revenues. You can see on the chart here, we're actually up over 255% over year ago and we're just under $10 million year to date in those software revenues and managed services revenues. So great progress on our DCM digital journey as well and [there’s] a lot of exciting stuff that we're working on as we enter into 2024.

James, [do] you want to talk about debt reduction?

James Lorimer:

Sure. We continue to focus on debt reduction. At the end of the third quarter, our total credit facilities sat at about $118 million. These, you know, are down a little over 18% since we closed the acquisition, which as everyone, I think, will appreciate was fully financed with debt. [On the] slide here, we talk about kind of net debt and at the end of the quarter, we had a $22.5 million cash balance. So we ended up with net debt at about $95.5 million.

We've been very active through initiatives to complete the sale and leaseback of our Oshawa plant which was which was announced last quarter and through the equity private placement we did back in May to pay down debt.

We're also pleased to announce that we have entered into agreements to sell both our Fergus and our Trenton facilities, which are the two remaining owned facilities that we acquired as part of the MCC acquisition.

Collectively, those two sales will generate about $15 million in net proceeds and shareholders will recall when we first did the acquisition, we had allocated about $30 million for the real estate. Once everything is said and done, and these transactions close, well actually have generated about $38 million. So that term loan that was associated with the credit facility will be fully paid down by the end of this year with the sale of our Fergus facility, which is expected to be completed before the end of 2023. And then we'll have some excess cash to apply to our credit facilities when the Trenton facility closes and that's expected early in 2024.

Richard Kellam:

Thank you, James.
So [those were] our integration efforts, the, the work that we're doing to build a better business and now we're going to move to the next chapter, which is what we're doing to build a bigger business and some of those bigger business results.

I will talk about Q3 and we'll look at that year to date results as well. Q3 revenue is up 93.6%, so obviously solid growth in revenue. Underlying growth on DCM legacy and acquired growth as well and you can see the numbers $122 million on the quarter up $63 million versus Q3 2022. We look at our year to date results: year to date up 58.3%, I remind shareholders the acquisition happened the 24th of April.

So we now have all the acquired growth incorporated into our into this quarter, the first full quarter, uh and just over $317 million in revenue generated year to date. Our underlying

business performance, if we strip all the kind of noise out from the acquisition is exactly on target.
The five year target we put to the street right around 5% or just over 5%. Well, a growth across our acquired business and current business, if you will, DCM legacy MCC legacy. So very, very much on track to the numbers we put to the street. So very, very pleased, very proud of the revenue growth we're delivering.

One of the, you know, one of the more difficult things to do when you do a transaction of this size is maintain revenue flow or client leadership in the marketplace and our team has done an understanding job to maintain that momentum, which puts us in a very good place as we move into our final quarter and into next year. If we look at revenue momentum by quarter, we've delivered eight consecutive quarters of year over year growth.

Now moving on to gross profit. Our gross profit was up 52.4% at just over 30 million and our gross margin came in at 24.7% and that is down versus year ago. But I want to explain: this is very clear and we made it very clear to shareholders that the acquired company, the MCC acquired company had roughly a 20% margin and DCM legacy roughly a 30% margin.
So when you blend those margins, obviously you're going to get a decrease in margin for a period of time as we work the journey back to north of 30[%].

And that's exactly what happened in the quarter. Exactly what was expected. But I'm going to give shareholders a little bit more granularity on the next chart, just to look at the difference in margin by quarter. Okay.

So James, you just go to the next one.

If we look at the chart on the left here, this is all pre-acquisition. The dark blue line is the gross margin percentage for legacy DCM and you can see it pretty flat, obviously growing, but pretty flat across all the quarters. And that's really due to how the legacy DCM workflows and how the operations are kind of optimized, if you will.

If you look at the MCC legacy business, all legacy pre-acquisition, you can see that the quarters are a little lumpy from a gross margin flow and a lot of that's due to the transactional business that that MCC legacy has had in their workflow. So very strong, sort of, quarter one and quarter two and then it drops in quarter three and quarter four.

So all of that is obviously taken into consideration when we look at our slight margin, our combined margin, if you will, for the quarter and what I will tell shareholders is we—and we've said this many times—we've got a very active plan to get our, our new combined margin, if you will, north of 30%.

So is a very clear plan that will come through what we call strategic revenue management, it'll come through mix and it'll come through all the operational efficiencies that we've already announced, those consolidation of facilities. So this is very much what we expected very much what we planned.

But just wanted to give a little bit more detail to put it into context. So year to date gross profit, same story. You can look at the far right, our combined gross margin here today is 27.1% versus 30.2% a year ago. And, as I said, we've got a lot of detailed plans to get this back north of 30[%] and back into that range of north of 35[%] that we put to the street a couple of years ago.

Going on to the next slide, if we look at gross profit momentum, we've actually had nine, so 8 consecutive quarters of revenue growth, nine consecutive quarters of gross profit momentum. Gross profit is, as I said to James, our best friend, and we continue to be relentlessly focused on driving gross profit momentum.

And over to James to talk about adjusted EBITDA.

James Lorimer:

Yeah. Adjusted EBITDA is a result of the revenue and gross profit performance that Richard described. Adjusted EBITDA was up a little over 28% this quarter compared to last year, a coming in at $11.8 million. As a percentage of revenue, that worked out to 9.6% compared to 14.5% last year. And just as we have a clear plan in place to return our gross profit margins to 90% along with the targets to increase our revenue by 5% a year or more, we believe that 14% adjusted EBITDA margin is certainly achievable over the next few years. So that's a that's a major initiative for us.

You can see on a year to date basis adjusted EBITDA was up 35% and I'll just remind everyone the this was the first full quarter that we had results for MCC included. In the second quarter, we had about two months plus a year. Sorry, two months plus a week. So as in this quarter, going forward, we'll have the combined results of both businesses.

Likewise, you can see how our adjusted EBITDA has performed over the last almost three years now and, you know, given continued strength, we certainly don't believe that that should continue in the in the fourth quarter this year.

We’ve included a brief summary of our financial results here, comparing this year to last year; really just a different presentation of some of the adjustments that Richard talked about.

So I won't go into detail on those other than to highlight that you know we certainly guided the street that our restructuring expenses were going to track pretty much a dollar for dollar with the synergy targets that we have and we're seeing that play out over the next 18 to 24 months still. And also, as Richard mentioned, the acquisition integration costs have tailed off and those kind of nonrecurring costs should be should really not continue going forward.

On a year to date basis, you can see where we've landed from a restructuring side and acquisition costs and also from an adjusted EBITDA perspective.

Richard Kellam:

Thank you, James. So look, we had a good quarter, lots, lots of work, you know, [and I'm] really proud of the team. Incredible, incredible efforts and a big lift on all the integration work that's happening, [and] continued focus on building that better business while we build a bigger business at the same time.

The market is good. We're playing our strength into the market and we're seeing the results. Happy to continue to report that we are on track on our five-year strategic financial objectives of north of 5% organic growth are getting EBITDA north of 14%. You saw our aggressive debt repayment.

So we'll be in that less than one times EBITDA range over the course of five year—in fact, well less than five—and then continue to focus on our DCM digital journey and we see a path to well over north of 60% growth in our martech stack and margins of north of 80%. So good progress on the quarter and we continue to commit to our five-year financial objectives here.

So now, with that [done], James, we turn over to Q&A.

James Lorimer:

Yeah, sure. We'd like to take questions with the audience. If you have a question and are accessing the call directly through teams, you can either use the raise your hand feature in teams and we'll we will queue up questions. Or, alternatively, you can also use the chat feature and we will respond to chat questions as well.

If you have dialed in through the telephone access code, 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 are introduced to the session.

Right. We have a question from Noel Atkinson. Noel, would you like to go ahead?

Noel Atkinson:

Can you hear me now?

James Lorimer:

Yeah. There we go.

Noel Atkinson:

Good morning, Richard, James. Thanks for taking our questions.

Nice to see the merger synergy target going up. That's great. Just firstly on the synergy outlook. For 2024 talking about that $17.5 million: Is that an annualized number so that at the end of 2024 you know you're at that $17.5 million a year run rate or is that the actual savings that will flow into the income statement through 2024?

James Lorimer:

Yeah, we see that, Noel, as being a number that will hit the income statement on a full-year basis in in 2024.

Noel Atkinson:

OK, great. And there's no revenue synergies in that number, right?

Richard Kellam:

No, we don't have any revenue synergies in the number at all. And I mean the best way to think about revenue synergies [is] every $10 million in growth if we're at 14% EBITDA, does 1.4 million in EBITDA, right?

So we haven't modeled in that 30 to 35. We have not modeled any gross synergies into that 30 to 35 number. So just hard synergy is what we factored in the 30/35.

So yes, it's a great question, Noel. Gross synergies are an opportunity.

Noel Atkinson:

And then Q4: so how should we be thinking about sort of the cost savings flowing into the income statement and in Q4 of this year in the in the current quarter. Do you see material cost savings from what you reported in Q3 to what you would be able to achieve in Q4?

James Lorimer:

Noel, it's James. Yeah, we should start to see particularly some of the organizational savings that we that we introduced a lot of those were completed in September so we'll start to see the benefit of those in the in the fourth quarter. Some of the operational savings will be kind of modest in the fourth quarter. You know, a good chunk of that is coming from our Edmonton plant closure and that's going to be completed in [the] of middle of December. So we won't see a lot of those benefits this year, but you know we should start the year off in January with the full positive impact of that and then and then likewise with the procurement savings you know a lot of those are in place right now. There're some things like, you know, early pay discounts that we've negotiated with our suppliers given our higher purchasing amount; those will probably be phased in and should hit the ground, you know, on a kind of 100% running [capacity]probably beginning in January, but we will get a little bit of those procurement savings in the in the fourth quarter.

Noel Atkinson:

And then just a couple more quick ones, if you don't mind. Richard, the 5% pro forma year over year revenue growth of the business that you mentioned in your remarks, is that Q3 or is that sort of nine months year to date?

Richard Kellam:

That’s year to date.

Noel Atkinson:

Okay. Thanks.

And then I noticed in the filings that you mentioned you're getting some good traction on the digital side, and that you're still expecting some solid growth over the medium term in that business, but when I look at the Q3 numbers [I saw] that you're tech-enabled subscriptions and fees more than doubled quarter over quarter in Q3.

It's the biggest jump I think we've ever seen. Is there some catchup in there or is it just, you know you're winning new customers and can you talk at all about, you know, what are the services or platforms [and] where you're winning contracts there?

James Lorimer:

Sure, I'll maybe start it in terms of the numbers, then turn it over to Richard to elaborate more on the platforms. So this was the first quarter that we included the MCC results in there and a good chunk of that increase was related to including the MCC technology services. They tend to not have a lot of subscription services like we do, they tend to be more professional services and program management fees, but there's great opportunity for us to move their clients over to some of our technology platforms.

And in fact their legacy platform, which would be comparable to our Flex platform is called Custom Point. We've already started to migrate a number of their customers over to our Flex platform and, you know, there's great excitement in terms of some of the other platforms that we have.

Richard Kellam:

Yeah. And in addition, we have had a couple of recent wins, Noel, [including] one pretty sizable win for a managed service model for digital asset management solution for a large transportation company that flowed through in the quarter. And some of the monetization efforts that we're heading around our DCM Flex platform are starting to flow through as well.

Noel Atkinson:

Okay, great. That's it for me. Thanks so much.

James Lorimer:

Thanks. And then we have a call, I believe this is uh, Chris Thompson from eResearch.

Chris Thompson:

Thanks… am I unmuted?

James Lorimer:

Yes, you are. Go ahead, Chris.

Chris Thompson:

I just wanted to ask a couple of questions. You answered some of Noel's that were similar. On the restructuring charges you've talked about, [for] the Edmonton plant, there's a large, $7 million restructuring charge this quarter. As you go through the other plants, is this the high watermark, that every quarter we're going to see like $1 million to $2 million because you're closing and shifting plants or how is that going to play out over the next four quarters?

James Lorimer:

Yeah, Chris, there'll probably be some, you know, kind of modest restructuring in the in the fourth quarter. You know the bigger plant closures are going to be our Fergus and Trenton plants, and those are expected towards the end of 2024. So it may be actually a little bit lumpier than that. We'll probably see some kind of modest expenses and you're probably not far off with that $1 to $2 million a quarter.

But probably a little bit lumpier as we firm up our plans in the second half of next year on some of the bigger plant closures. With our Thistle move into Bond, that's not expected to have any kind of material restructuring expenses.

So it's really the two bigger plants towards the end of next year.

Chris Thompson:

Okay. And then on the on the revenue side, just looking at typically your Q3 historically has been one of your lowest quarters with the merger happening. I also wanted to comment on your comments on the actual market you're seeing.

You know, there's a lot of talk about slowdowns, etc. How are you seeing this revenue number for Q3 as a benchmark, say, for the next couple of quarters with what you're seeing from client demand?

Richard Kellam:

Chris, our client demand is still very strong. We're not seeing none any kind of impact from existing clients and the way we look at it is quite simple, right? It's a $10 billion market. We call it combined, annualized $530 and $540 million in revenue. So [there are] a lot of opportunities for us to deliver new business development and we've got a very growth-obsessed commercial team and a really good structure for us to go and identify and secure new business opportunities.

And so, even if there are, you know, any potential kind of headwinds that we'll experience—we are not seeing any right now, Chris—but if they if they do materialize at some point the growth agenda we've got is solid growth agenda.

Chris Thompson:

Okay. Yeah, that's all my questions.

James Lorimer:

And then I might elaborate. Yeah, yeah, I might just elaborate a little bit, Chris, as well.

Just in terms of kind of quarterly patterns, you know, we typically as you rightly noted, Q3 tends to be weaker, Q4 tends to be stronger than Q3 from a from a revenue perspective. And then both the kind of legacy DCM and the legacy MCC businesses tend to have, you know, very strong quarters in the first quarter. So kind of fourth quarter kind of builds and then first quarter tends to be stronger and that's largely due particularly the first quarter. MCC does a lot of year-end tax statements and transaction statement processing and you saw that kind of higher gross margin that Richard alluded to in that in the slide showing kind of historical quarterly gross margins that's also kind of associated with a higher revenue in that quarter as well.

And then we also have some kind of projects in the first quarter that tend to help us to just kind of timing in the first quarter.

Chris Thompson:

Great. Thanks for answering my questions.

Richard Kellam:

Thanks, Chris. Right.

Yeah, we got a couple of questions that were emailed in overnight here, James. You're making me put my reading glasses on now. [This] came from Aaron:

I believe last quarter you guys were in beta testing for more of the DAM [digital asset management] products. How's it going?

So that's our I think the question is relating to our ASMBL . We actually are in beta right now. It's going very well. We're still, obviously, learning through beta [things] that we can incorporate into our we call our MVP, but essentially our our that we will go to market with. Sort of towards the end of quarter one next year, but we're getting, we're getting good, good results from our beta test with the with the clients both internal and external clients that are using it. So not a lot more to say on that [but] great progress and good momentum there. I'm a development perspective.

Question to you, or maybe I'll turn to you, James, if we could, if you could break down the amount of subscription/digital services revenue for the quarter compared to last year's quarter, that would be great. So we talked a little bit about that.

James Lorimer:

Yeah we talked a little bit about that earlier in our in our detailed financial statements. I think it's note 15. We lay out how we kind of segment our revenue between product sales, warehousing and freight services, which are typically kind of hand in hand.

I will also break out technology-enabled hardware solutions and that would be a lot of product that that we resell, you know applications there would be distribution centres or healthcare networks, where they're using printers and scanners and tied into some consumable products that we would sell. So equipment that we that we resell and get a pretty good margin on. There [are] also some modest other things in there.

We also break out tech enabled subscription services and fees and we don't, at least today we don't, break that out specifically, but it includes a mixture of program management fees, subscription fees that we charge for our products like Flex and ASMBL and PRSNL and some of those other marketing campaign management tools.

But it also includes some professional services fees and you'll see a big jump when you look at those numbers for the three months last year. We reported a 1.4 million four in that category.

This quarter, we've reported $4.5 million and the you know a big part of that jump is really now including the MCC business and then likewise on a year to date basis, we reported about $3.6 million and for the nine months ended this year, we reported $9.3 million and you know that kind of not I guess that $4.5/$5 million bump is largely related to MCC, and they typically don't have a lot of subscription services. A lot of their revenue is really more program management and recurring programs that they run every year. [I] hope that helps.

Richard Kellam:

Okay. Thanks James. We had one final question from Aaron here:
What would be the biggest disappointment metric so far in the past year and what do you guys plan to do to improve?

Well, great question. Look, we were very, very well planned through due diligence and coming to into the acquisition of MCC. I think we told shareholders we used Boston Consulting Group who I had done a lot of work with in my prior world. So we were very well prepared, so it would be, uh, there's really nothing disappointing in the metric so far.

Things have gone very well. You can see that we're over target on integration [and] our growth momentum continues. We have a path back on our gross margin, which we fully kind of planned and baked into the deal as well. We've got a fantastic team, acquired team, a new team. an integrated team, so really nothing disappointing. Not from my side.

[This is] the first time we've seen the question. James anything disappointing from your side?

James Lorimer:

No, I'd echo Richard's comments. You know, we are very pleased with how the integration is going. Obviously there's a bit of, you know, noise in our financial results this year given you know the magnitude of the acquisition. But as we continue to report combined numbers, we think that'll help the street kind of better understand what the combined business looks like.

Richard Kellam:

Okay. I think that's all the questions, right, James?

James Lorimer:

Yeah, I don't see any further questions. So thank you very much everyone for attending. Richard and I are certainly available if anyone has any follow-up questions.

Richard Kellam:

Thank you everybody and a big thanks to our entire DCM team for delivering a very solid quarter and I look for reporting quarter four and year end.

Thank you.