

VIQ Solutions Inc.

Q1 2021 Earnings

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C: Alexie Edwards; VIQ Solutions Inc.; CFO

C: Susan Sumner; VIQ Solutions Inc.; President & COO

P: Scott Buck; H.C. Wainwright & Co, LLC; Analyst

P: Daniel Rosenberg; Paradigm Capital Inc.; Analyst

P: Joey Marincek; JMP Securities; Analyst

Operator:

Good day, ladies and gentlemen. Today, we are hosting a conference call to discuss the First Quarter 2021 Financial Results for VIQ Solutions, Inc. (Operator Instructions)

Your host for today is Ms. Laura Kiernan, Head of Investor Relations for VIQ. Please go ahead.

Laura Kiernan:

Thank you so much. Good morning, everyone, and welcome to VIQ Solutions 2021 first quarter results conference call.

Before we begin, I would like to point out that certain statements made on today's call contain forward-looking information subject to known and unknown risks, uncertainties and other factors. For a complete discussion of the risks and uncertainties facing VIQ, we refer you to the company's MD&A and other disclosure filings, which are available on SEDAR at [sedar.com](http://sedar.com) and the OTC in the United States.

As a reminder, all dollar amounts are in U.S. dollars, unless otherwise stated. Certain Q1 numbers -- Q1 2020 numbers have been adjusted to reflect changes, which were implemented in the company's amended filings in November 2020.

With us today, we have Sebastien Pare, CEO; Alexie Edwards, CFO; and Susan Sumner, President and Chief Operating Officer of VIQ, all of whom will be available for questions following the presentation. Following comments from each of them, we will do a Q&A session.

So I will now turn the call over to Sebastien Pare to begin.

Sebastien Pare:

Thank you, Laura. Welcome, everyone, to our first quarter 2021 earnings call. We delivered strong first quarter results, driven by substantial gross margin improvement, steady increase in total revenue and exponential growth in Australia.

The positive response to our unique approach to transform an industry using AI-power solution has clearly accelerated the digital transformation in our markets. Our product portfolio is gaining momentum, and we're keenly focused on strategy and execution.

This is a pivotal year for VIQ as we increased our investments in infrastructure to propel VIQ 3.0 to greater heights, using our technology to broaden our portfolio and support the transformation and the monetization of the vast amount of digital content recorded within our expanding global markets.

We continue to see tangible results from our comprehensive strategy that is starting to flow through our financial statements. We started to reactivate and recognize the backlog revenue as we enter a post-pandemic environment. We have experienced positive proof of this in Australia, where revenue increased 22.5% in the quarter to \$2.4 million versus the prior year.

Additionally, we're very excited about our SaaS technology and related sales, which have started to influence the margin profile with \$1.4 million in sales, representing an increase of 108% from Q1 of 2020. Importantly, growth in our technology portfolio provides the highest gross margin as we compare it to a technology services segment, which includes a human workforce component.

As we continue to execute against our plan, we're confident in our ability to not only increase our market share and our average revenue per customer, but also to deliver revenue growth, higher margins and higher EBITDA.

Now, I will hand over to Alexie to speak to our financial results. He will be followed by Susan, who will provide some insight into our operation. She will hand it back to me when we take some questions. Alexie?

Alexie Edwards:

Thank you, Sebastien. And good morning, good afternoon and good evening to everyone. This quarter results indicate that we're following through with our strategy. We continue to improve quality of revenue moving towards recurrent SaaS accounts, support acquisition strategy through the most effective low-cost liquidity and improve productivity by migrating our clients onto our NetScribe platform that is powered by aiAssist.

Additionally, we continue to improve our balance sheet and capitalization, as we progress towards our uplisting to a senior Exchange in the United States.

Our first quarter 2021 financial highlights include the following. We generated revenue of \$8.3 million in the quarter, which increased 9.4% compared to the same quarter of 2020. Importantly, revenues increased by 22.5% in Australia versus the prior year, while our U.S. revenues decreased by 8.6%.

Gross profit of \$4 million represented 48.7% of revenue compared to \$3.2 million or 42.8% of revenue in the same quarter of 2020. The increase in gross profit is primarily due to a combination of factors, firstly, higher software license and software support revenue, which yield a higher gross margin; secondly, productivity gains from the conversion of the company's technology service clients to the NetScribe platform; and thirdly, the company benefited from approximately \$0.1 million in COVID-19-related subsidies. This was partially offset by costs associated with the onboarding of the company's new Queensland contract, which is expected to be operational in the second half of 2021.

Our adjusted EBITDA was \$0.3 million versus the same period of the prior year adjusted EBITDA of \$0.6 million. The decrease in adjusted EBITDA was driven primarily by higher professional service fees associated with corporate initiatives that were undertaken in Q1 and TSX uplisting fees. This was partially offset by approximately \$0.3 million in COVID-19 rate subsidies, of which \$115,000 of the subsidies flow through cost of sales and \$169,000 flow through SG&A.

In the first quarter, we generated 59% of our revenue in the United States, 29% in Australia and 12% in EMEA and Canada.

Now, I would like to hand over to Susan to speak to our operational highlights. Susan?

Susan Sumner:

Thank you, Alexie, and good morning, everyone. As we emerge from the COVID-19 slumber and we see the U.S. become fully operational, we expect revenues to return to growth. In Q1, we saw U.S. revenues decline 8.6% versus the prior year. However, we saw volumes begin to increase in March, and we expect steady expansion through Q2 as our clients return to pre-pandemic operational levels.

By witnessing the reopening improvements in Australia, we are confident that we will see the same rebound in the U.S. and the rest of world. We also continue to see significant improvements in our -- from our migrations to NetScribe.

From January to March, significant progress has been made. Gross margins on services by U.S. entities have increased by over 26% and productivity gains in our top 40% of our editors is improved by 30%. In Australia, productivity gains related to the deployment of aiAssist are in the 50% range for the court industry. The technology is doing what we said it would do. And while it is progressive -- a progression to weave into our overall COGS, we are getting there in a way that limits disruption to our clients and ensures that our editors maintain their earning potential. This also positions us to compete on large-scale bids that integrate technology and services.

We successfully completed the integration of our global organization and reduced costs by over \$1.2 million. The organizational realignment positions us to quickly expand the development of our AI to continue to increase operational excellence and to expand our solutions in the geographies that we serve.

Our clients clearly see the value in our ability to implement our integrated solutions and service offerings to transform and analyze digital content, and securely generate accurate actionable information. We continue to aggressively assess and add additional speech engines to our arsenal. Our engine agnostic approach ensures that we are utilizing the best and most efficient speech engines based on the characteristics of an audio file. This specialized workflow creates a highly accurate and diarized draft for self-editing or modification by our professional editors.

We use the same AI agnostic approach as we expand the options our clients will have in using the data, whether it is a first draft of a document, a professionally edited transcript, a streamed snippet of text -- of speech to text to create final content, translated text or tagged data. We believe that this expansion, both technologically but also geographically, allows us to be uniquely positioned in the segments that we target.

The launch of FirstDraft, following the completion of our beta test with several of our strategic clients in the first half of this year, will provide an efficient, cost-effective way to digitize the billions of recordings captured each year and thus expanding the total addressable market. In this data, major news outlets and social media organizations will be using our FirstDraft technology in new and novel ways.

For example, we are currently building language models to support a major news outlet to manage more than 700 hours of archival and non-broadcast footage that requires the self-serve functionality of FirstDraft. This footage would likely have been archived and the insights inaccessible. However, with the addition of FirstDraft, we can quickly deliver highly accurate text in a cost-effective manner. Our clients can then choose to search, analyze and share content, self-edit or they may submit files for editing by VIQ's professional staff.

Our strong relationships with partners worldwide have led to increased global interest in our capture technologies, resulting in higher demand for inclusion in government RFPs with over \$15 million in potential contract value to be decided in the next 120 days.

We continue to expand our partner ecosystem in an effort to scale in emerging markets where the international demand increases for digitization of evidence-based workflows. We are excited to see the return to trade shows, which are critical platforms for our networking, lead generation and brand awareness. The value of face-to-face interactions is key to building relationships to share experiences and insights.

We attended the ROCIC in Myrtle Beach in March to showcase the value of our criminal justice solutions and services and to highlight the new launch of FirstDraft. The FBI Association and Law Enforcement Records Management shows are coming up next.

While organic growth remains a key focus in our development and investments in sales and marketing, M&A will continue to be the lever that will allow us to accelerate our

client footprint into new geographies that are synergistic to our current offerings to increase our addressable market and our average revenue per customer.

Our teams are relentless when it comes to making our vision a reality. As we increase the amount of content we capture, our cognitive AI abilities improve, which, in turn, creates more opportunities to monetize the value of the audio and video files we capture. This creates inherent value for our clients, partners and shareholders. We have a huge opportunity in front of us, and we are just getting started.

Now, I'll pass it back to you, Sebastian.

Sebastien Pare:

Thank you, Susan. Before we get to the Q&A, I would like to outline our 2021 priorities. As we mentioned during our year-end call, we're focused on several initiatives in 2021 to drive growth in revenue, profitability and defensibility. These include, number one, driving organic revenue growth to step up investment in infrastructure, including sales, marketing, finance, operation and technology; number two, integrating prior acquisitions and driving productivity gains to enable AI human expertise workforce; number three, migrating clients with full AI-powered technology stack that is not commercially available in every region where we operate. Next one, further global expansion through our net new clients, contract and acquisitions. Also, continued development of the AI-driven solutions for clients; continue of the mitigation of the impact of COVID-19 on the results and process of our customers' backlog. And last, we're committed to aggressively pursuing global acquisition in 2021.

The core aspect of our plan is to doubling down on AI machine learning investment, operating infrastructure and organic growth driving capabilities. Over time, this is expected to result in high top line and bottom line growth, driving continued increases in shareholder value.

We're also very pleased that the shareholders overwhelmingly approved the company's omnibus compensation plan, which modernizes our employees' compensation structure, makes our company competitive for acquiring and retaining talent. This is increasingly important as we scale the company globally. The next grant following the adoption of the omnibus plan is coming up, which will further align management and employees with shareholders with long-term value creation.

This concludes our formal updates for this call. Operator, please go ahead and open up the questions.

Operator:

And your first question comes from the line of Scott Buck from H.C. Wainwright. Your line is open.

Scott Buck:

I was hoping you could give us a little bit more color on the push and pulls on gross margins in the quarter? And maybe when you think the underlying fundamentals of the environment can help get us back to kind of mid-50s towards 60% on gross margin?

Sebastien Pare:

Yes. So this is -- there's a couple -- there's a number of components for the gross margin that are at play. So maybe, Alexie, do you want to take that question?

Alexie Edwards: Thank you, Sebastien. And Scott, good morning and thank you for your question. And as I said in my earlier remarks, Q1 was impacted by our technology sales, SaaS and software license sales and software support, which typically would generate a higher gross margin from those products. And it's a mix of that plus gains from productivity from migrating our customers to -- for the platform.

And as we look forward to the rest of the year, and Susan alluded to this in her presentation, right, we're seeing strong encouraging results that will take time to make their way through the gross margin in terms of the productivity gains that she mentioned in her remarks.

And so going forward, gross margin will continue to be a mix of SaaS technology-related revenue, but it's going to be a mix of that plus transcription services revenue, efficiency gains and, of course, as we do acquisitions in the future, that may impact our gross margin in the short term as we take the time to integrate these acquisitions properly onto our platform.

Scott Buck:

All right, got you. That's very helpful. Second one, on M&A, have we completely moved on from some of the smaller roll up transactions or are you still being opportunistic in looking at some of those types of customer acquisition deals?

Sebastien Pare:

Yes. No, we've -- as we've talked about during the last earnings call, Scott, we've kind of expanded a little bit the -- how we look at M&A. And I think while we still have an interest, obviously, clearly, and what we've done, the M&A pipeline has really opened up. And it's changed quite drastically.

So Susan, on your side, a little bit more colors on that?

Susan Sumner:

Sure. And thanks for the question. I think it's a great one. We remain opportunistic on the smaller opportunities that drove similar to our acquisitions in '18 -- '18 and '19. It's a different world right now because of COVID. We want to make sure, again, that we're buying secure long term revenue. So it's a little less predictable than it was in the past.

We certainly believe that there are opportunities globally that we're aggressively assessing, but we are more -- we are slightly more cautious in terms of U.S. markets just to make sure that we believe that we're better positioned for strong organic growth here so we can be a little more selective in the actual targets that we have in the U.S.

Scott Buck:

Great. Thanks, Susan. That's very helpful. And last one for me. Can you just remind us what the sales infrastructure looks like, especially outside of the U.S.? I mean, how many folks do you have, that sort of thing?

Susan Sumner:

Sure. So as I said in the last call, we're increasing our sales organization to about 16 through this year. We just added two additional salespeople in the last week that will handle global partner alliances and will lead the insurance sector.

We have three sales representatives in the Asia-Pac region and one in Europe right now. And each of those regions are currently hiring to expand in all of the sectors that we're servicing across all of the products that we're selling.

Operator:

Your next question comes from the line of Daniel Rosenberg from Paradigm Capital. Your line is open.

Daniel Rosenberg:

I just have a question to dig a little deeper on the sales hires. So to get to that 16 number, how many additional hires do you have to make in the year?

Susan Sumner:

You're going to make me do math live. So we need -- it will be almost doubling the sales organization. By the time we get to the end of Q3, I think we will still have five additional hires to make -- to get to that 16.

Daniel Rosenberg:

Okay. Thanks for that. And in terms of the [obvious] strength that we saw in the quarter, I was wondering, what does the revenue profile look like in the second half as you onboard the large Australian contract that you signed? Is that all going to be incremental or did any of that contract show up in this quarter?

Susan Sumner:

There is no revenue tied to Queensland in Q1 or Q2 from the transcription contract. That will all be in the second half of the year, although you do see certainly some expense relative to the buildup of the readiness of the organization to deploy that contract.

Sebastien Pare:

Yes. I think, Daniel, it's very consistent with some of the other larger contracts historically. There's always a four to six months kind of scalability readiness investment

upfront, but that \$30 million contract over a number of years is expected to start hitting the revenue in Q3 and Q4 of this year.

Operator:

Your next question comes from the line of Pat Walravens from JMP Securities. Your line is open.

Joey Marincek:

This is Joey Marincek on for Pat. Congrats to you guys. First, just going back to Australia, I kind of want to dig into that result there. What were the main drivers you saw there for the outperformance?

Sebastien Pare:

I think there was a -- go ahead, Susan. You go ahead.

Susan Sumner:

No, what I was going to say is, first of all, Australia was the first to shut down for all of our regions last year. So the growth that we're seeing is really just what we had expected in 2020, and we're accelerating that in 2021. So in February, our largest customer literally closed its stores. And obviously, when the states are shut down, law enforcement is less active. And so our sources of volume were diminished.

So in addition to increased volumes from increased demand and also some pent-up demand relative to the closings, we are seeing just a full rebound from the impact of COVID quarter-over-quarter.

Joey Marincek:

Awesome. That's super helpful. Next, I wanted to touch -- touch on your partner channel. Maybe if you can just give us an update there and how you see that being a differentiator for VIQ?

Susan Sumner:

Well, if you dig into some of our sales for Q1, you'll see that a lot of our growth on the technology side came from Africa. That's all due to acceleration in our partners. We are revamping that globally. We believe that alternative distribution channels are certainly the way that we will accelerate growth globally in regions where it just doesn't make sense for us to have direct sales organizations like Africa.

You will see us building channel support infrastructure through our sales and marketing organizations to help those channel partners accelerate their growth through marketing programs, through more consistent resources that we add to them in collaboration to allow them to build brand awareness for VIQ in those regions.

We're also seeing expanded partnerships that will be announced in the next couple of quarters with industry partners that will allow for collaborative expansion, both at a hard

integration level into their technologies and into our technologies but also from a commercial perspective as well.

Joey Marincek:

Awesome. And then last one from us, maybe for Sebastian. What are you guys doing around cyber defense to protect client data?

Sebastien Pare:

Sorry, I missed that one. Would you mind repeating that?

Joey Marincek:

Yes, no problem. Just what are you doing around cyber defense to protect client data?

Sebastien Pare:

So we've got a whole arsenal of tools that have been put in place. If you kind of break it down, we've got basically pieces of protection as well as compliance at the points of capture, that's with the -- when the audio and video gets captured in the first place then the migration into the cloud. I think we've made it very clear last year that obtaining our CJIS Compliance was a very critical milestone last year in our cybersecurity protection, which we've achieved that. Basically, we've achieved the same kind of certification across each of the regions. But then we also have the protection that is happening within that cloud environment behind the scene on how we do it.

So it's, basically, we've got three tiers of protection. Some of them are quite visible to the outside world through the different levels of compliance and certifications and some of them are obviously unique and to how we've built our technology stack because remember that we've been saying for two years that cybersecurity is the core of what we do. If you look at the kind of material that we are involved with and how critical the security and the cybersecurity around the content is for evidence purposes, you can appreciate that it took years of investment to build, that's kind of cybersecurity protection in the cloud that we've been able to move our clients into.

So if you remember last year, even the year before, we spent a lot of time explaining that the migration to NetScribe aiAssist was taking time. There's a whole process with each of the customer one by one to get to the cybersecurity compliance, but all of that now is behind us. And I think commercially, with the kind of results we posted last year and a record Q1 historically, despite all the impacts of the pandemic this year, speaks volume for the strength of what we've been able to do commercially with the new technology. And with that came with each client one at a time to get sign off on the cybersecurity compliance. So it's obviously at the centerpiece of what we do on a day-to-day basis.

Joey Marincek:

Thank you so much and congrats again, guys.

Sebastien Pare:

No, thank you. Thank you. No, it's been quite a quarter and quite a start of the year, and I think what we all saw happening in Australia coming out of the pandemic, and now we're starting to see the same thing in the rest of the world. I think that was really a key, a key component that we were all tracking, and sure enough, I think the record revenue for this quarter, despite all of that speaks volume for what's happening in our space and people emerging out of the pandemic, are also taking acknowledgment that the current legacy infrastructure in a post-COVID environment is not going to work. It's not going to cut it.

So now there's an accelerated amount of investment, as Susan mentioned, in RFPs and RFI and all of that because now people are rushing in order to modernize the end-to-end platform. And I think we're at the right time, at the right place with the right offering. And I think our growth in the last year and a half plus this quarter speaks volume for where we are in the industry because this industry is truly being transformed as we speak. And everybody on this call will agree that this industry will never look the same three to five years from now. And I think VIQ is extremely well-positioned to continue on its phenomenal growth as we speak.

Operator:

And there are no further questions at this time. Mr. Sebastien Pare, I turn the call back over to you for some closing remarks.

Sebastien Pare:

No. Thank you. Thank you, everyone, for joining us today on the call. Please follow-up with Laura Kiernan with any questions you might have. You all know how responsive we've been over the last several years, and we're planning to keep this up. We look forward to speaking with you again when we report our second quarter results. Until that time, stay safe. Thank you.

Operator:

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.