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mdf commerce inc. Q2 2022 Results Call
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C: Luc Filiatreault; mdf commerce inc.; Head, IR
C: Deborah Dumoulin; mdf commerce inc.; CFO

P: Unidentified Participant; Echelon Partners; Analyst

+++ presentation
Operator^ Welcome to the mdf commerce inc. Conference Call on Second Quarter of Fiscal 2022 Financial Results. At this time, all participants are in a listen-only mode. After the speakers' presentation, there will be a question-and-answer session.

(Operator Instructions)

I would now like to hand the conference over to your speaker today, Luc Filiatreault. Thank you. Please go ahead.

Luc Filiatreault^ Thank you, Stephanie and welcome everyone to the mdf Second Quarter of Fiscal 2022 Earnings Call. Before we begin, we'd like to take a moment to remember those who served and sacrificed their lives for peace on this Remembrance Day. Thank you.

We hope that you are following along on the webcast because we are accompanying our prepared remarks with a slide presentation and a video. Once we have completed our prepared remarks, Deborah Dumoulin, our CFO and I will be available for analyst questions. Of course, the transcript of the call will be available on our website a little bit later.

mdf commerce enables the flow of commerce for businesses and governments globally. We're a global company with more than 800 employees and offices in five countries. We are focused on growing two platforms, first unified commerce and two, eprocurment. Following our strategic acquisition of Periscope Holdings on August 31st to just about two months ago, we rebranded the strategic sourcing platform as eprocurement to better reflect the more complete product and solution offering that we now have.

During the second quarter, we completed the acquisition of Periscope Holdings, a public eprocurement platform based in the U.S. With this transformation acquisition, historical annual revenue on the combined basis was approximately 116 million and we're trending towards recurring revenue of approximately 80%.

With Periscope, eprocurement will represent approximately 55% of our total consolidated revenue while unified commerce will represent about 30, sorry 35%. Together, these two core platforms will represent now approximately 90% of our consolidated revenue.

Deborah Dumoulin^ Good morning. I'd like to take you through the Q2 Fiscal 2022 highlights from a financial perspective. The consolidated revenue was 25.1 million for Q2. This is an increase of 20.8% from the 20.8 million in Q2 of the previous year.

On a constant currency basis, the Q2 Fiscal 2022 growth was even higher at 23.2% compared to the same quarter prior year. With just one, only one month of revenue from Periscope, the eprocurement platform generated $11.3 million revenue. This is a 40% increase compared to the 8 million for Q2 in the previous year.

Unified commerce, its revenue also grew, increasing 10% to 10 -- from, sorry, to 10 million, up from 9.1 million in Q2 of the previous year. While net loss for Q2 was 6.3 million, Q2 results were impacted by 4.6 million of acquisition-related expenses for the Periscope transaction and 600,000 of restructuring costs during the quarter. Net loss was also impacted by newly acquired assets which resulted in non-cash amortization expense on property equipment, intangible assets on right-of-use assets relating to leases.

Adjusted EBITDA loss for the quarter was 400,000; however, adjusted EBITDA loss to 400,000 for Q2 has improved relative to Q1 which had an adjusted EBITDA loss of 1.5 million. This sequential improvement of 1.1 million includes $2.4 million from Periscope which generated a positive contribution for one month of operation.

Q2 also benefited from high -- from, excuse me, from higher e-business tax credits and income tax recovery and these of course are partially offset by some higher cost of professional services incur to support both our strategic initiative and to support some of our larger client contract implementation.

As you can see on slide five, our fix six months year-to-date clearly shows progress on all front and on all platform. With the addition of Periscope, our U.S. based revenue now represents approximately 50% of total Q2 revenue which is up from 43% in Q2 of the prior year. With one month of revenue recognition from Periscope, the eprocurement platform has generated 20.1 million, a 28% increase compared to 15 million in the previous quarter. At the end of Q2, eprocurement recurring revenue represents 93% of the total platform revenue.

Unified commerce revenue grew by 10%, 9.7. In contrast, the eprocurement Q2 recurring revenues for e-commerce represents just short of 60% of total revenue. While e-commerce continues to benefit from recurring right-of-use, subscription revenue, professional services revenue which is mainly from large client deployment is not included in monthly recurring revenue.

Year-to-date net loss was 10.6 million and again this is impacted by the 4.6 million of acquisition related cost and 600,000 of restructuring cost during the quarter. Year-to-date adjusted EBITDA loss was 1.9 million compared to 4.5 million in fiscal 2021.

Year-to-date adjusted EBITDA loss has decreased compared to -- or has year-to-date adjusted EBITDA has decreased compared to the first six months of fiscal 2021 but this is mainly relating

to foundational investments and operations including additional salaries and benefits, higher year over year sales and marketing and technology costs.

In addition, higher professional fee expense which is incurred to support our implementation of corporate strategic initiative, our transformation plan and again large clients deployment. We closed off the quarter with a strong balance sheet. As of September 30th, cash and cash equivalents represented almost 9 million and the company incurred long-term debt to finance a portion of the acquisition. This includes at September 30th, a balance of long-term debt of 47.7 million from both of revolving facility and a term loan representing net debt of 38.7.

With that, I'll transfer back over to Luc.

Luc Filiatreault^ So now on slide six and as you can see, we're quite satisfied with our overall progress during this last quarter. Now this being said, I have to say that we are thrilled about the progress we made over the last two years.

Within a couple of months after we started in the fall of 2019, remember the old days, we all used to go in the office, which is also when the new management team began joining the company, we presented to the board and to the shareholders a five-year plan to transform mdf into a focused, high-growth and profitable SaaS commerce operation.

We're now in the second year of this transition. When comparing our Q2 revenue for fiscal '22 to Q2 Fiscal '20, total quarterly revenue over these two years increased by 38%. You will notice on the chart on slide six that revenue growth even accelerated in the second year. By platform, unified commerce has grown by over 70% over the last two years since Q2 fiscal '20.

And eprocurement has grown almost 48%, boosted recently by the acquisition of Periscope for which only one month of revenue is included in this Q2. These results are strong indicators of the impact of our transformation plan is having on our business.

Our revenues are now more focused on our core platform. As I said earlier, they represent not more than 90% of our revenue and these platforms are future pacing. Our growth trajectory has significantly accelerated. The transformation is on track and we are pleased with the progress so far.

Slide seven shows that we are continuing to invest in two areas. First, improving the scalability of our operations, so that the company can grow at an accelerated pace and second, generate reasonable cash flows and returns for shareholders on a per share basis. As we began pushing towards higher growth in our two core areas of concentration, the management team found some foundational issues that require addressing.

We've already fixed many of the issues and we're confident that these were the right moves to make. In the short term, these required investments are impacting margins of course. However, they'll enable us to scale much faster which will contribute better margins overtime. Relating to our two-core platforms, unified commerce is expect, sorry, unified commerce's growth is

expected to come from organic sales to both direct and third-party channels with the focus on grocery and general retail.

We made some recent announcement about some wins that we're in really close partnerships with our partners. That network is starting to work. Our growth in eprocurement was expected to appear both organically with the addition of buying agencies and suppliers but also through consolidating regional government procurement vendors primarily in the U.S.

The acquisition and integration over the last fiscal year of U.S.-based vendor registry which we acquired in November of 20202 is a textbook example of that strategy as outlined in our transformation plan. It helped us to increase our geographic footprint and added to our roster of buying agencies and suppliers and that was exactly what we had anticipated. Earlier this summer, the acquisition of Periscope represented a step function in the progress of our plan and that has positively jolted our transformation plan.

On slide eight, you'll see that the acquisition of Periscope is still meaningful to our operation that we actually rebranded the strategic sourcing platform as eprocurement.

We will now turn our attention to a short video that describes the advantages of our complete solution and the very large market opportunity in front of us. The video will play on the webcast platform. For those of you who have dialed in through analog, today's presentation including the video will be uploaded on the mdf site shortly after this call. Let's watch the video.

(video playing)

Luc Filiatreault^ We're now on slide 10 and hopefully the video presentation helped you understand not only the business model but also the immense opportunity for growth that we see in front -- in front of us for this eprocurement platform.

In the nutshell, the transaction fee solution, mdf will now select a fee on almost every purchase made by the government agencies that are on our platform. We now increased our geographical footprint to 40 U.S. states and 10 Canadian provinces and expand our reach to government agencies in the entire U.S.

We now serve over 6,000 government agencies and over 500,000 suppliers who bid on government procurement contract. We have closed the procurement value loop, so that we now provide a full end to end eprocurement solution, offering from bidding to sourcing, fulfilling to order management, contract management and payment management.

Even more exciting to us, our new highly scalable transaction fee model that already includes three U.S. states, creates the opportunity to deploy in our current network. We've already added a new state since we closed the transaction and we are in discussions with various other state -- states, sorry, which we hope will result in near term new wins. We obviously will be informing you of these new wins as soon as we obtain permission from the client.

In addition to a traditional SaaS subscription model, we now have the ability to collect the transaction fee from suppliers on the government spend that flows through our system. This is a high-margin, highly scalable revenue stream that we are starting to earn right now. Right-of-use revenue from the transaction model is not limited to a capped monthly fee. If something is procured from suppliers, either on or off the platform, we receive a transaction fee, as simple as that.

It doesn't matter if its office supplies, vehicles, safety gloves, legal services or anything else that the various government agencies require. We will earn a fee from the supplier based on the value of the spend. Government agencies adopt this model because it's easy for them to deploy and it's at no cost. It's very flexible and very scalable. This means that government agencies can attract more competitive bid and access more goods and services than ever before.

The entire model works similarly to how consumers, e-commerce vendors like Shopify or Amazon provide consumer value and generate revenue. So, we are executing on our strategic plan for eprocument, focusing on first, converting as many of our existing agencies as possible to the transaction fee model. That's the first priority of all of the integration efforts that we are doing currently with Periscope.

Second, we're adding opportunities for more spend volume to the transaction fee model in jurisdictions where it's already deployed. We add buying agencies to the existing contract date. Three, we'll be capturing new states and new government agencies as clients. And we did mention that we're currently in discussions with approximately eight states at various levels of advancement.

I'll now move to slide 13. Since that transaction model was introduced in 2019, entire U.S. states have chosen to adopt the transactional model solution as their standard procurement model. After the first states started in 2019, two more states have already came on with this approach. Another and -- sorry, another eight are at various stages of adoption. Since the inception of that transactional fee model, Periscope has experienced accelerated growth.

Given Periscope's calendar year-to-date performance and high near term visibility for contracted revenue and pipeline development, we remained confident that we can achieve those revenue of approximately U.S. 33 million in calendar year 2021 compared to 23 million in calendar year 2020. The corporation is now benefiting from this performance as of the acquisition date of August 31st. So, the Q2 results include one month of revenue of 2.4 million, not counting the deferred revenue.

Management also continues to estimate annual revenue synergies of at least 15 million and annual cost synergies of approximately 5 million within three years of the August 31, 2021 acquisition date. We are certain that existing mdf commerce clients will find the model compelling.

And we're also eager to keep adopting states on current trajectory as government agencies gained access to more infrastructure budget, especially since the U.S. Congressional approval of the

Biden's plan just last week, we believe that there is a tremendous market tailwinds for us to exploit.

Slide 14, how do we convert more mdf clients to that transaction fee model? First, we're combining and training our eprocurement team, sales teams and third-party channel partners to develop and execute a specific sales plan in Canada and elsewhere in the U.S. We're also going to ensure that we're applying continuous innovation to the solution to maintain a competitive edge as we expand the reach of the transaction fee model in our own client base.

Second, it is essential to the success of the transaction fee model solution to increase the spend on the platform in states where it is deployed. To do this, we are enabling more local, state level suppliers on the platform to give buyer access to more choices. Examples of programs include state to state contract, sharing and national cooperatives.

Third, we need to create those community-led marketplaces to promote usability by converting all suppliers to the marketplace to make procurement more like a consumer online shopping experience and integrate our business direct to the marketplace.

And fourth, we'll be harmonizing the supplier offerings across states to improve access to bids and improve the solicitation process to suppliers to keep the supply side engaged and active. Ultimately, we aggressively pursue the Periscope transaction because we knew it would transform our business for the better.

We also did not want our current or potential competitors to box us out of one of our core growth platform. Upon closer examination, that transaction model solution offers more shareholder value than we had originally anticipated. With a single acquisition transaction, we have not catapulted ourselves into a leadership position in eprocurement in North America.

The integration efforts are going extremely well. The teams have already been blended together. There is a single management team in eprocurement which includes executives from both the Periscope side and the mdf side and we are in the process of launching a complete town hall which will be held next Friday from the Austin offices about galvanizing the 300 or so people in that team to execute on the various strategic elements that I mentioned in this slide.

So, we're very happy about that eprocurement acquisition and the future that it's building for us but that's about 55% of the story. There's another 35% which is our unified commerce platform, so let's talk about those. Fundamentally and I'm on slide 17 here, fundamentally unified commerce consists of three brands that addressed different markets and different areas of the e-commerce value chain.

Orckestra is our headless enterprise-grade solution that is mostly directed at grocery and retail. K-ecommerce is a B2B ERP integrated solution for SMB and InterTrade is a supply chain collaboration and EDI solution.

On slide 18, I want to take a moment to highlight the tremendous progress accomplished with our unified commerce platform over the past two to three years. Leveraging our legacy supply

chain solution as a foundation, we've effectively now built this platform into a high-growth future-pacing revenue stream.

Transformed by two highly strategic acquisition, this platform is now in a strong position to compete in a high-growth market of e-commerce and demonstrating organic growth. Since fiscal 2019, the platform has growth 72% and year-to-date results are defining continued strong performance.

On slide 19, over these last two years we advanced our grocery technology to the point where we offer immense value to our customer. We have helped solve that last mile delivery problem. We have added multiple functionalities such as dark store handling, added zone picking to improve picking rates, added many end customer features in something we call my favorites and my usuals for reordering regular supplies, for handling recipes and other quite funny -- quite useful features.

We've released our first large scale integrations with SAP S/4 HANA at one of our large B2B customers. This opens a large pool of SAP S/4 HANA customers and potential partnership with the largest ERP system in the world. And that is now operational and working and creating value at that large customer. We are looking into how to scale this to other SAP S/4 customers.

We've completed a large portion of our cloud migration for our supply chain technology that has improved performance from long minutes of processing through under just a few seconds. So over time, mdf commerce has built a reputation in food, grocery, as well as high-end retail.

We continue to scale well overall but we have had some deployment delays in some areas, primarily due to the scarcity of HR and the impact of worldwide supply chain disruptions. Although transaction volumes are impacted by these supply chain disruptions, we are continuing to add new customers constantly to our platform solutions.

North American volumes have remained stable and resumed slight growth after the semi-end of the pandemic. In Europe, however, volumes are still being fairly impacted by the macro economic elements, especially in the U.K., where both supply chain disruptions and Brexit issues are creating some quite strong business problems.

So on slide 20, with the recent investments that we've made, we've improved the scalability of those platforms, and we've adopted a four pronged approach. First, we have now upgraded our senior sales and marketing resources and are leveraging newly optimized sales process.

Second, with several product improvements and innovations, we've removed implementation friction which helps to implement faster and to start collecting our revenue faster. It helps to broaden our network of implementation partners. We now have active customers being implemented without any mdf folks working on them. It's the partners that are leveraging this.

Third, we broaden our third-party sales channels, like I just mentioned, new sales leadership is focused on co-marketing and co-selling with those partners. And fourth, we've implemented new pricing strategies that are appealing to the market and help protect our future gross margins.

Understand that the cost of our primary resource that is manpower has increased a lot more than the usual 2%, 3% over the last few quarters. So, we need to have discussions with our customers about adapting to that situation like in any other business right now.

So, I'd like to finish with slide 21 saying that Q2 was really a transformative quarter for us. Those of you who remember the five-year plan that we showed two years ago, we now have visibility in reaching the goals that we had set. We're there. We need to execute on it.

With that Periscope transaction, we swung for the fences and we are happy to report that we believe that we've hit it out of the park with this. We are now a leader in eprocurement with a new business model that should not only accelerate growth but also help us to make us more profitable in the coming quarters.

We continue to invest and improve some of the foundational scalability issues that threaten the trajectory of our five-year plan. And as we explained, we're already implementing programs in the unified commerce that were directly enabled by these foundational investments in scalability. We are more confident than ever in the future performance of mdf commerce.

And at this time, I'd like to open up the line for questions from analysts. In closing, I'd like to thank all mdf commerce employees for their hard work and determination in driving the execution of our strategy for our transformation plan. And of course, I also want to thank our shareholders and stakeholders for their continued support.

Go ahead, Stephanie. I'm sorry about that.

+++ q-and-a
Operator^ (Operator Instructions).

Your first question comes from Amr Ezzat with Echelon Partners.

Unidentified Participant^ Good morning, Luc and Deborah. It's [Michael Zacarino] here on behalf of the Amr. Thank you for taking my questions. So excluding Periscope, your revenues are essentially flat over the last two quarters at 22 million, excuse me. Can you walk us through the dynamics in each of the divisions? What is stalling organic growth?

Luc Filiatreault^ Hello, Michael. Thank you for your question. So we -- if you look at each of the platforms, if you look at the unified commerce, we're actually reporting a 10% increase compared to the Q2 of last year.

And as I mentioned, there are two major dynamics here the -- we collect the revenues which are always proportional to the volume of goods that are procured through the e-commerce platform. And we are seeing, unfortunately, that the various supply chain issues are limiting the growth of the number of orders that come through the various websites.

This being said, we are keeping -- we are constantly adding new customers. And once the supply chain problems resume, we feel that with that growth will come then from added volume on the transaction.

On the eprocurement side, we're seeing some very significant growth in our U.S. operation. The Canadian operations, the various ways in which the Canadian government agencies procure their goods and services is not creating the growth that we are seeing in the U.S. So if you separate the US and the Canadian operations, you'll see strong growth in the U.S., less so in Canada. And obviously, we still have the e-marketplaces which not now are at on an ongoing basis less than 10% of our revenue.

So, we feel that the impact of the drag of these e-marketplaces will fall overtime to negligible amounts. And today, we only have one month of Periscope. Once we have the full benefits of Periscope in there, those e-marketplaces will represent just a fraction of our revenue and will not hamper growth.

Unidentified Participant^   Thank you. So on Periscope, you had mentioned that three states used the transaction fee solution. How should we think about the pace of converting the SaaS states to transaction? Is there an opportunity to do the same in Canada?

Luc Filiatreault^ Well, that's what we -- as I mentioned there, we currently are in discussions with eight states at various level of advancements. We have already signed one since the transaction. However, we still don't have the rights to announce this. We need to obtain customer permission to do that. We will also be looking into promoting this solution to Canada, which Periscope was not doing.

We do have relationships with the 10 provinces in Canada, and that's a fairly large portion of the cross-selling that we intend to do. Since the transaction is very recent, we're only starting to approach the various government agencies and provinces in Canada, so we expect more movements over the coming quarters.

Unidentified Participant^   Thank you. Can you give us a sense of what normalized OpEx looks like going forward? There are a couple of moving parts during the quarter with one-offs and only the one month contribution for Periscope as well should we be expecting more restructuring charges in the short-term?

Deborah Dumoulin^ In terms of OpEx, obviously we're going to end up with more cash, non-cash amortization, so those are some of the higher costs that come on. Obviously, Periscope has -- brings on an additional portion of OpEx but there are a lot of one-time or non-recurring costs that are to come. So, we'll be able to return back to a more normalized OpEx. Obviously, there is some high transaction costs in the quarter.

With respect to restructuring of 600,000 that we did take in the quarter, we're continuing to look at operations to make sure that everything is as synergistic as possible and over time as we integrate the teams, there possibly will be some more restructuring but I believe there's nothing big plan for the next couple of quarters on that front.

Unidentified Participant^   Okay, great. And can you list the full balance of deferred revenues for Periscope, and how many quarters to go through that, an estimate?

Deborah Dumoulin^ Yes. So, deferred revenues relating to the payments that were on -- cash that was received by Periscope pre the acquisition, so unfortunately this is really an accounting adjustment that IFRS requires when we put a fair value look to those revenues, that liability on the balance sheet.

So the fair value adjustment in Q1, sorry, Q2 relating to the one month of Periscope was approximately 1 million, and that will continue over the next two, three, four quarters, sorry, three more quarters. However, the largest hit per month is now, because the deferred revenue balance does decline over time, so we will see this for the next three quarters.

Unidentified Participant^ OK, great. One last question and I'll pass the line. You had a large working capital [cost] in the quarter, what is that related to? And should we expect that to normalize going forward or does Periscope have larger working capital needs?

Deborah Dumoulin^ A large portion of a change in working capital is really coming from just bringing Periscope on to the balance sheet. So as we brought on their assets and their current assets and current liabilities that is driving a large portion of the change. Clearly, we also had payables relating to the one-time acquisition costs.

The model in Periscope does have a situation where you do recognize revenue and the cash comes a little bit later just because of the way that different states report and collect their spend, so there is a small lag there. So, we do expect it to be, sort of there is a higher working capital in that model but there is a lot -- a lot of it that's really just about bringing on like it's the balance sheet of Periscope.

Operator^ (Operator Instructions). We'll pause for just a moment.

At this time, there are no additional questions. I would like to turn it back over to management.

Luc Filiatreault^ Well, thank you all for being with us this morning. And we're looking forward to reading about your comments on this quarter, I guess in the in the coming days. Have all a great day. And again, let's turn our attention to this Remembrance Day and think about those people who fought their lives, so that we can live in peace today. Thank you very much.

Deborah Dumoulin^ Thank you.

Luc Filiatreault^ Thank you, Stephanie.

Operator^ Thank you. This does conclude today's conference call. You may now disconnect.