mdf commerce inc. (Q3l 2024 results)
February 14, 2024

Corporate Speakers

- Luc Filiatreault; President and Chief Executive Officer; mdf commerce inc.
- Deborah Dumoulin; mdf commerce inc.; Chief Financial Officer

Participants

- Kevin Krishnaratne; Scotiabank; Analyst
- Jesse Pytlak; Cormark; Analyst

PRESENTATION

Operator^ Thank you for standing by. (Operator Instructions) Welcome to the mdf commerce third quarter Fiscal 2024 Financial Results Investor Conference Call.

Today's call will provide information and commentary on the corporation with a focus on the financial results released yesterday after the markets closed.

We will hear from Luc Filiatreault, President and Chief Executive Officer; Deborah Dumoulin, Chief Financial Officer.

If you have questions following the call, you can reach mdf commerce at the address on their website, www.mdfcommerce.com.

First, here are a couple of housekeeping notices. (Operator Instructions)

This call is being recorded. We expect that the recording will be available on the mdf commerce website later today.

The information in today's remarks, including any forward-looking statements have been prepared as of the 31st of December 2023, unless otherwise indicated.

mdf commerce assumes no obligation to update or revise the forward-looking statements to reflect any new events or circumstances, except as may be required pursuant to securities law.

We remind you that today's remarks will include forward-looking statements and non-IFRS measures that are subject to important risks and uncertainties.

For more information on these risks and uncertainties, please see the reader advisory at the bottom of the mdf commerce's new release, which is on the website and has been filed on www.sedarplus.com.

The company's actual performance could differ materially from these statements.

I will now hand the call over to Mr. Filiatreault.

Please go ahead, sir.

Luc Filiatreault^ Thank you, [Judith]. Good morning, everyone. Thank you for joining us for our Q3 fiscal ’24 financial results call.

Before turning to the actual results that we filed after the markets closed yesterday, I’ll present an overview of the corporation’s performance and an operational update.

Q3 revenue were $30.2 million, with recurring revenue as a percentage of total revenue representing more than 80%, actually 82.2% of total revenues. Q3 ’24 and Q3 year-to-date ’24 results show significant improvements in profitability and cash flows from the same period the last year.

This is a direct result of the various initiatives that we’ve undertaken to reduce costs, and importantly, from new customer revenue growth mainly in our eprocurement platform. New sales and eprocurement and the eprocurement stake transaction models, what we call our TRX models, are contributing positively to cash flow from operations.

In our TRX model contracts, we collect fees based on a percentage of our estate customers spend on eligible fee-bearing goods and services contracts.

The cash generated on these models has increased in Q3 year-to-date versus the same period last year, and we expect the cash generation from these TRX models to continue to substantially increase over time.

For over two decades now, our e-Procurement solutions have been at the forefront of delivering best-of-breed procurement solutions to public sector organizations across North America.

We have the required public sector expertise to serve clients of all sizes and scope from small city to large states and provinces, of course.

Our e-Procurement platform now represents approximately 69%, almost 70% of total mdf revenues.

Just as a reminder, when I joined four years ago, we were just under 40% of procurement revenues.

Our fully integrated end-to-end suite of eprocurement products are offered in modules.

Source, contract, procure, connect and shop.

These solutions enable a complete transformation program for public sector procurement.

Our full suite of products uniquely supports digital transformation in the public sector, bringing efficiency, transparency and modernization to customer procurement processes and that positions us well for increased market penetration.

Our solutions and the services that we provide to customers are tailored for public sector procurement and provide a strong competitive advantage for both state, large cities and for our mid-market agency customers as well as for our supplier network.

We have the largest supplier network in North America (inaudible) suppliers and over 6,500 buying organizations on our network. With this large customer base and a strong presence in the U.S. states, we believe this positions us well for market growth. eprocurement revenue grew 4.5% Q3 over Q3 and 7.4% year-to-date Q3 versus last year, year-to-date Q3. With recurring revenue in the procurement platform continuing to trend at 88% of total revenues.

We are pleased (inaudible) offerings compared to Q3 prior year. With the exception of a normal level of churn from the legacy supplier platforms that we migrated on our more modern bid net direct during this year.

Just as a reminder, we offer our products to three segments in eprocurement. First, to large Tier one organizations such as states, provinces, large counties, where we offer million-dollar multiyear contracts. Second is to mid-market buying organizations such as cities, counties, districts and certain departments that range from tens of hundreds of thousands of dollars of annual recurring revenue with contracts usually in the three- to five-year range.

Third, to suppliers where we offer RFP access to more than 650,000 suppliers, for which we received from a few hundred to a few thousand dollars per year, mostly on one-year contract.

During the third quarter, we welcome new market customers to our procurement community including several multiyear contracts for our eprocurement solutions, mainly focused on source, connect and contract.

Since we started offering that mid-market strategy in April of 2023, so just nine months ago, we have already signed up more than 50 customers to our SaaS products.

Our mid-market strategy, we are not only successful converting agency customers that historically had free access to our source module, or it was the suppliers that paid for subscription. We're also seeing an increase in selling our solutions to new agency customers. There's the large address for mid-market offerings. Demand for eprocurement digitization in the mid-market is strong, and we expect to see continued acceleration.

As the mid-market offering gains traction with customers, pipeline conversion is a focus area to generate revenue growth. Since the beginning of the year, we have won several new buying agency customers, resulting in contracts, which will have a positive impact on revenue growth over the next few quarters.

We continue to focus on modernizing our full suite of eprocurement offerings to bring value to our customers.

Over the past few months, we made significant progress on our strategy to consolidate our supplier platform technology, which simplifies our product offering and will reduce our costs. Supplier-based customers were using six legacy platforms that we all migrated to a single BidNet direct platform over the course of the year, and we have decommissioned these platforms.

Those platforms provide a robust set of features use by government agencies to publish, distribute and award contracts.

By consolidating our legacy supplier offering to one single platform, suppliers receive exclusive bid opportunities directly from our buying agencies network. This consolidated effort provides one hub for our buying agencies to reach all of our suppliers while providing the suppliers the benefits from a single platform on which they access bid opportunities. For the last 20 years, we focused our attention on building a supplier-based business model, which generates revenues of a few hundred to a few thousand dollars per year for each supplier that needed access to our network.

While this accounted for the majority of our revenues until 2021, we were obtaining small dollar contracts from a large number of suppliers.

Over the last two years, we have consolidated our product offering to offer a fully digitized government -- sorry, procurement platform that is buying agencies such as states, counties, cities, et cetera, the ability to gain efficiencies associated with the implementation of our technology. This has shifted annual recurring revenue from tens of thousands dollars to hundreds of thousands and even millions for larger organizations.

By shifting in the focus to buying agencies, we’re leveraging our existing network to add a completely new source of revenue, which allows big dollars from all of our buying agencies.

Overall, we have many new customer wins over the past months including the state of Hawaii, which was announced last quarter, and those are starting to show in our financial results as customer deployments ramp up. The state of Hawaii contract is a multiyear agreement for the use of our entire procurement suite, including our innovative shop module.

The SAP module offers the marketplace environment where public organizations can shop off-state contracts creating savings to all governments that wasn’t the benefit from the state purchasing power for various goods and services. This shop module offered to all our state transaction model agreement customers allows the bolting authorities in each of these states to easily shop off of statewide procurement contracts and leverage the buying power of the flow community. This month, we also renewed a large customer -- large state customer for another four years. This customer has been using our procurement solution since July of 2017, and we expect to renew our first original transaction model state in the coming weeks.

As I conclude my remarks on eprocurement, we are particularly enthusiastic about the recent acceleration in new eprocurement customers and the revenue growth that this will bring over the coming quarters.

With a robust pipeline of opportunities, both in Tier one and in mid-markets, we believe that we are well positioned to capitalize on both larger estate contracts and the mid-market opportunity that we believe is ahead as public agencies digitize their procurement solution. In our e-commerce, our platforms continue to see headwinds as revenues generated from customer order volumes throughout our various retail and busy clients is still trending up or under minimum thresholds of our various. These online order volumes tend to follow them through economic terms in the environment.

We see tire orders on days like Black Friday Cyber Monday Boxing Day and even on some culture day when retail customers shop, and growth customers order more online. For e-commerce, there's traction from our Acumatica Therapy ERP e-commerce solution in the B2B space, where transactional effects fading to manufacturing and distribution customers.

We participated in the Acumatica Summit in January, and I can tell you that we're (inaudible) about the opportunities for our solutions. The large number of (inaudible) Acumatica ERP and outlooking for the e-com solution is impressive. This gives us confidence that this is a vector of growth for our e-commerce platform. In key marketplaces, our platform continue to deliver strong profitability across all solutions, although two of our platforms have been increasingly impacted by the current economy. Jobboom, which serves the job market in Quebec has been unfavourable to our Jobboom revenue for which many companies are (inaudible) that trended over the last few years.

For Broker Forum, the high growth that we saw over the past years, where severe supply chain issues resulted in worldwide shortages of electronic component parts and suppliers and buyers would then turn to our solutions to locate inventory.

We unfortunately see that, that has started to ease off.

We operate our emarketplaces platform efficiently and profitably by maintaining these pricing and by managing costs. And now Deborah will comment on the corporation's financial results.

Deborah Dumoulin^ Good morning, everyone. You can find our Q3 financial results, including the press release, MD&A and financial statements on our website and also on www.sedar.com.

As Luc mentioned earlier, Q3 fiscal 2024 total revenues were $30.2 million. This represents a decrease of $1.5 million or 4.6% compared to Q3 2023. You'll recall that we sold a subsidiary last year on October 2.

This was InterTrade, and if we exclude the InterTrade revenues, including other revenue from the post-closing transition services that we offered, the decrease in revenues is quite a bit smaller at $200,000 or 0.6%. The eprocurement platform performed well with revenues of $20.7 million. This represents Q3 year-over-year growth of 4.5% compared to $19.8 million in Q3 of last year.

The Q3 year-to-date eprocurement revenues grew by 7.4% compared to the same period prior year, and recurring revenues for the eprocurement platform continues to trend at 88% of total revenues. New customer wins in the fiscal year, including the state of Hawaii, which we announced last quarter, and the acceleration of wins within our mid-market strategy that Luc spoke to earlier, are starting to show in our financial results as customer deployments ramp up.

We note that the full impact of these new customer accounts many of which are agency customers that we have signed with multiple year contracts is not yet fully reflected in our Q3 financial results. It is typical for sales with government agencies that implementation work has started several weeks or even several months after the contract is signed. We started the onboarding process with the state of Hawaii.

Over the last year, we've successfully completed the most significant components of implementation milestones for our first three states, the transaction model agreements, the TRX. Therefore, as expected, the professional services revenue from these large implementation projects have decreased as compared to the prior year, while the subscription and managed services revenue are recurring in nature.

The cash generated on these TRX models increased in Q3 year-to-date versus the same period prior year.

Once implementation is complete, the costs related to operating these programs decreases significantly.

Before I turn to our other platforms, e-commerce and e-marketplace, I'll highlight the significant improvements in profitability and cash flow that we've achieved compared to Q3 prior year. Q3 2024 had adjusted EBITDA of $2.5 million. This is a significant improvement of $1.6 million compared to $900,000 in Q3 2023.

And this marks the sixth conceptual -- sorry, sequential quarter with a positive adjusted EBITDA. Adjusted net loss saw a significant improvement of $3.6 million. It was $4.2 million in Q3 2024 compared to $7.8 million loss for Q3 2023. For Q3 '24, the net loss position is mainly driven by depreciation and amortization on our various intangible assets.

You can see this if you refer to Appendix A on the slide deck that provides the reconciliation of net earnings and loss to adjusted EBITDA and to adjusted net earnings and loss.

The numerous business activities that we've taken over the last year to improve our financial results, has led to noticeable improvements in profitability and have also had a positive impact on cash flows.

We reported positive net cash generated from operating activities of $6.4 million for the third quarter, which compares to a net use in operating activities of $2.8 million in Q3 prior year. This strong improvement in cash flows over the prior years has been used to reduce long-term debt. There was a favourable change in nonworking capital for the third quarter of fiscal 2024.

We’ve seen higher year-over-year cash flows generated from our eprocurement transaction model agreements, the TRX models that are state contracts that use this program, and these programs are beginning to mature.

The TRX program effectively drives the consolidation of spend on statewide contract. And as a reminder, for these TRX models, we collect fees over the term of the contract based on a percentage of our state customers’ actual spend on eligible goods and services.

During the quarter, we also benefited from favourable timing of collecting certain e-business tax credits that are receivable from the Quebec Government. The claims for these credits are filed annually and are typically collected several months after year-end.

We closed Q3 with over $5 million of cash and $1.5 million in borrowings drawn on the revolving facility under the credit agreement, which together represented a positive net cash position of $3.5 million.

This is a notable improvement when we compare it to where we started the year at March 31, with cash and cash equivalents of $4 million and $7.1 million drawn on the revolving facility, therefore, a net debt position of $3.4 million.

Some levels of variability are expected in our business can impact cash, working capital and borrowing on the credit facility. If I turn now to the other platforms.

Our e-commerce platform had revenues of $5.4 million for Q3 this year compared to $5.5 million for Q3 prior year.

If we exclude InterTrade -- sorry, that’s the number excluding InterTrade.

But in our public reporting, we do refer to total unified commerce that had revenue of $6.8 million in Q3, and those numbers are the ones that include InterTrade. Recurring revenue compared to prior year was stable for e-commerce platforms, both for Orckestra and k-Commerce with a year-over-year small decline in professional services, mainly due to completing the completion of some customer integrations.

The Orckestra platform continues to see market headwinds, as mentioned by Luc, earlier. This is on new sales, but also on the revenues generated from customer order volumes through our various retail and grocery clients, with most clients currently trending at minimum volume orders. For the K e-commerce platform, there is traction in the B2B space for e-commerce solution for Acumatica ERP that gives us confidence that there’s a vector of future growth.

The e-commerce platform is modern, scalable, and we’re optimistic about future growth potential. In our e-market platforms -- sorry, e-marketplace platforms, revenue was $4.1 million for the quarter. This is a decrease of $900,000 compared to Q3 of last year. Recurring revenue for the e-marketplace platform is high and continues to be high at 88.9% compared to 81% in Q3 of 2023. In recent years, certain marketplaces solutions such as the Broker Forum and Jobboom benefited from the macroeconomic conditions.

Yet as expected, we've seen the landscape changing over the last few quarters.

As the worldwide supply chain issues experienced over the last few years subside revenues from the broker form, which is an electronic marketplace -- electronic component parts marketplace decreased $700,000 in Q3 24 compared to Q3 2023. And a softer labour market in 2024 has impacted Jobboom, which saw a $200,000 decrease in revenue from Q3 over -- Q3 this year over Q3 last year.

The closure of Indi contact and Power Source Online, which was at the end of November 2023, contributed to a $100,000 decrease in revenues compared to Q3 of last year. Revenues for the other emarketplaces solutions were stable compared to Q3 last year.

Our new marketplace platforms are mature. They generate significant profitability and cash. And as Luc mentioned earlier, we're going to continue to operate those effective efficiently and profitable. Finally, before I close my remarks, I do want to address the Q3 adjusted EBITDA of $2.5 million, which is lower than the $4 million reported in Q2.

So, a sequential decrease this is really relating to emarketplaces revenue spoke briefly about Jobboom and the Broker Forum.

There was also sponsorship revenue, which was nonrecurring relating to a trade show included in those numbers in Q2.

Our e-commerce platform had a $100,000 decrease that was professional services and the InterTrade nonrecurring revenue was $300,000.

So, these decreases were really offset by a nice increase in $500,000 in our eprocurement platform, which, as we mentioned earlier, continues to perform well. Finally, sequential decrease in EBITDA has to do with wages and salaries, about $700,000.

While our workforce is stable, the sequential decreases are not about change in total headcount, and it really has more to do with the higher vacation that we've taken in the summer months, which essentially draws down the vacation accrual rather than impacting the salary expense.

And finally, we did see a small increase in web hosting costs sequentially, and this is as we continue to complete our cloud migration strategy, which is scheduled for completion at the end of February, and also from some of the new customers that we've onboarded recently. With that, I'll turn it back over to Luc.

Luc Filiatreault^ Thank you, Deborah.

So, acceleration of growth in eprocurement is notable, and it's starting to show in our quarterly results, 4.5% in the quarter, 7.4% year-to-date. Positive cash flows from operations of $6 million in the quarter. That all makes us confident that we will continue to see top-line growth in recurring revenue over the coming quarters.

This all bodes well for the future. Thank you very much, and we now like to open the line-up for questions. [Judith], please open it up.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) The first question is from Kevin Krishnaratne with Scotiabank.

Kevin Krishnaratne^ The color on the EBITDA going down, answer a lot of questions. I just had a question on the cash flow.

So, I think you mentioned in the quarter, you had some benefits working capital. Did you say that those continue into the next quarter?

I think you said after year-end, there's a couple of months lag between the filing and collection.

So, do we see another working capital quarter in Q4 and then a reversion up on EBITDA as well just on some of the business that you see in the pipeline?

Just trying to get an understanding of what the cash flow from could look like in the final quarter.

Deborah Dumoulin^ Thanks, Kevin. I'll give you a couple of more general answers.

As we know, we don't give you guidance on actual numbers.

But we are seeing favourable impacts on working capital, and this has a lot to do with the cash we're collecting from our new customers as well as our transaction model customers.

So, we do anticipate that the cash flow will continue to be positive from that perspective.

We did have favourable cash collection from e-business tax credits that we collect from our Quebec Government, but this is relating to the end -- to the year fiscal 2023.

So, they pay us several months after the year-end.

We still have quite a bit to collect.

We do believe we'll collect that in Q4.

So again, something Q4, Q1 next year, we do think there'll be positive results there again.

There is some choppiness in the timing of cash flows, though, when our large states pay us based on spend, it vary in terms of weekly, monthly, how much is sent over.

So, there is timing differences, but we expect that overall positive cash flows will continue. With respect to EBITDA, the new contracts that we signed will deploy at some point.

So, we do expect that we will continue to be EBITDA favourable and that over time, EBITDA will continue to increase without giving you any specific guidance on Q4.

Kevin Krishnaratne^ That's helpful leading to sort of a next question.

So these contracts, as you start to sign them, to get signed and deploy in the months afterwards. These are multiyear contracts of assuming that they're paid annually, I'm just trying to get an understanding of the flow. Would we start to see nice moves up in the deferred revenue line as a leading indicator to help us sort of understand the forward quarter as they translate to revenue. Just can you -- how do we think about the flow on the financial statements as you start to really, really ramp these big opportunities?

Deborah Dumoulin^ Yes, exactly.

So, any Tier one customers, a large state customer that's on a typical SaaS arrangement or any of the mid-market customers are typically customers that pay us in advance and pay us in advance for a year.

So you're correct, the cash flow comes in positively at the beginning and then the revenue gets deferred over the 1-year contract period. Even when we sign multiyear contracts, typically, they -- some of them will renew.

So, the cash will come in annually and the deferral will happen over 12 months.

So, you are correct.

We would expect to see deferred revenue as a leading indicator of positive cash at the beginning and then future revenue to follow.

Kevin Krishnaratne^ So just as an example, like with the Hawaii win, which seems like a bigger one, is that in the deferred revenue right now, or is it to come?

I know any -- like is that in there right now, and you're going to start looking at.

Deborah Dumoulin^ Hawaii is a little bit different because you'll recall that Hawaii is a transaction model.

So, the way that works is from the point of view of the subscription revenue, we do recognize it when we enable the system and work with the client on it.

So, revenue has begun for that transaction model. However, because the transaction model is based on collection of spend on the state spend it is not deferred revenue. It's not received in advance like a subscription.

It’s received as the customer spends for regular goods and services, and we collect a portion of a fee on that.

So, it’s not deferred revenue. In fact, it is what sits on our balance sheet is unbilled receivable until such time as it gets reported, and we collect it.

Luc Filiatreault^ May be if I can just -- Deborah for (inaudible) if we take some of our pure (inaudible) I mean we do -- in the early years of the contract, we do invest to get the solution and collection builds over time.

So in the early years, we received less than we book, but towards the end of the track, we receive a lot more cash than we book, right?

So, a little bit counterintuitive, but that’s the way it works with the TRX model, and that’s contributing to the elevated cash flows that we see now because some of our contracts are now at that maturity point where everything has been installed, suppliers are they’re using it, the customers as they’re using it and we receive large amounts of cash compared to the early years of the contract where we were actually implementing the solution.

Kevin Krishnaratne^ Okay. Great, Luc. Maybe the last one, the 4.5% eprocurement growth in the quarter, how do we talk -- how do you think about any impact from that I think you call it churn, the BidNet sort of migration. Is there any way to quantify some of the impact and what the growth would have been in the quarter excluding that?

Luc Filiatreault^ I did mention a note on that. As you saw, we retired all of our old supplier platforms. Our supplier revenue is just a little higher than 50% of our total procurement revenue.

We did see a bit more churn than usual because we were migrating customers from old legacy solutions to a much newer platform. Most of them stay and continue.

Some of them just use the opportunity to leave.

So, we’re seeing a little higher churn than usual and also our sales teams are busy converting these customers talking to those customers. So, there’s a little bit lifetime to address net new customers.

So yes, you could think that over the last few months, we had on the supplier business only, right, not on the agency business, but we had turns which were a little higher than usual, but that should settle down and resume normal increases, which we feel could be easily in the double digits going forward.

Operator^ The next question is from Jesse Pytlak with Cormark.

Jesse Pytlak^ Kevin already hit on most of the questions I wanted to ask.

So, I just have one. When I look at your U.S.-based eprocurement revenue for the quarter, $15.5 million, up from $15.1 million, sequentially. I understand that, obviously, there'd be some churn impact on that, but it still seems rather modest compared to the number of new contract signings that you've had through the back half of the last calendar year.

So I'm just wondering, how do we think about kind of the cadence for eprocurement growth in the U.S.

business as you kind of bring on these new customers.

Luc Filiatreault^ So, the question (inaudible) right?

Most customers are U.S.-based. The share size of the (inaudible) government -- general government compared to Canada. This -- there is a -- it's relatively slow to start booking.

Obviously, on all of our SaaS contracts that starts with some services and not only does the customer have to put together the team in order working and configuring the platform, but that takes the -- for government agencies, it takes more time than typical private businesses.

So, that the factor that explains the slow increase in recognized revenue, but that should accelerate over time as we kind of get going on the rhythm.

But you can think that after contract signature it's (inaudible) weeks, even a couple of months, before we can actually even start to do any work.

So, there's a natural delay there that we have to take into consideration.

Jesse Pytlak^ Okay. And maybe just following from that, then given kind of the pacing of your signings last year, will there be one or two quarters where we'll actually maybe see a step change in growth, or should we expect it to just be more gradual?

Luc Filiatreault^ I think it will continue to be gradual, maybe the odd exception could make a difference, but we're really seeing the curation of these signed deals. Like I mentioned on the mid-market, we currently had -- we're just north of 50 new deals in the last few months. Where you could see a material step-up in signing of the large state or SaaS or TRS because, of course, once that starts to activate numbers are bigger, and they come in, in one year in core.

We do have quite a bit of pipeline in large Tier 1. Actually, our pipeline is probably 4, 5x the size it was last year at the same time.

So, that's what can trigger a step up because the contracts, as I mentioned, can be multimillion dollars per year of ARR.

So, factor that into any given quarter, the large one of these could easily bring a significant amount in one given quarter once it starts.

Jesse Pytlak^ Okay. Then just on your comment there about your pipeline being four to 5x the size as it was last year ago. Is that just amongst Tier 1s, or is that your overall eprocurement pipeline?

Luc Filiatreault^ It's true overall the procurement. It's been mentioned by numerous organizations, state governors addresses that digitizing their procurement is one of their top priorities pretty much across all of the U.S.

Into certain of the larger Canadian places. It's been publicly said by something called NASPO, which is the National Association of State Procurement Official. You can find that on their website.

Gartner also presents it as one of the last pieces of efficiency that governments can bring to their full economy.

So, we are seeing an increase in demand, which is accelerating, and we're obviously better and better equipped to serve our customer base with our integrated platform, simplified offerings.

We clearly have a very strong fit in that market.

Operator^ (Operator Instructions) There are no more questions registered at this time.

I would like to turn the conference back to you for any closing remarks.

Luc Filiatreault^ Well thank you, [Judith]. Thank you, everyone, for being with us this morning.

As you can probably hear in our tone, we're excited over what we see coming in the future.

Our government business is really at the right place, the right time in the right markets, and our solution is really top notch.

So, we're very excited over what goes for the future. Thank you, all.

And we'll speak soon.

Operator^ The conference has now concluded. Thank you for attending today's presentation.

You may now disconnect.