MDA Ltd.

Q1 2021 Earnings Conference Call

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CORPORATE PARTICIPANTS

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Vito Culmone
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CONFERENCE CALL PARTICIPANTS

Thanos Moschopoulos
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Kristine Liwag
Morgan Stanley — Analyst

Doug Taylor
Canaccord Genuity — Analyst

Paul Steep
Scotia Capital — Analyst

PRESENTATION

Operator

Good afternoon. My name is Joanna (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the MDA Q1 2021 Earnings Conference Call. All lines have been placed on mute to prevent any background noise.

After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during that time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, please press *, followed by 2.

Mr. Greenley, you may begin your conference.

Mike Greenley — Chief Executive Officer, MDA Ltd.

Great. Thanks very much, Operator. Hello, everyone. Welcome to the first earnings call of the new MDA.

It's our pleasure to be here and start this journey with you as a newly publicly traded company. We're pleased to announce our first set of quarterly results as a new publicly traded company.

With our IPO behind us, we are well capitalized to fund our strategic growth initiatives, and we see an increasing pipeline of business opportunities ahead. Our focus continues to be on successful program execution, including the three flagship programs we which we've discussed through our IPO, which will underpin our growth over the next number of years.

MDA is off to a strong start in 2021, as you'll hear from Vito when he reviews our financial performance. You'll see that 2021 should be a steady year with consistent financial performance as we execute on a business that is returning to more traditional levels.

As we execute on our business throughout the year, we will be hiring significantly to build up our execution teams for our flagship programs. This execution will be enhanced by a growing backlog throughout the year that will result in a unique step-function increase to our business levels as we transition from 2021 into 2022.

You will see us track this pattern through the year. Steady business execution, constant hiring, building backlog, followed by a significant step-up in business activity level in 2022.

The first quarter of the year has started this pattern of steady execution combined with backlog growth. During the quarter, the Company was awarded a number of new orders, a number which I'll quickly highlight.

First, we were awarded an initial contract with the flagship Canadian Surface Combatant program, valued at more than $60 million, to provide the laser warning and countermeasure system that will protect the Royal Canadian Navy warships against laser and optical threats. This starts our production orders on this key flagship program.

In addition, in the past quarter, it was announced that MDA was selected for a major role with Telesat on their Lightspeed program for a LEO constellation communications satellite constellation.

Our role is to provide critical digital satellite technology subsystems for that program. MDA will provide the direct radiating array, a revolutionary phased array, electronically steered, multi-beam antenna that will provide unlimited coverage flexibility and agility through advanced beamforming technology. In addition, we're engaging in the negotiations for full satellite production for spacecraft Assembly, Integration and Test.

MDA was also awarded a three-year contract under the Dark Vessel Detection program this quarter to use satellite technology to detect vessels engaged in illegal, unreported, and unregulated fishing when they had turned off key ship identification sensors. Our advanced analytics, multi-sensor data fusion platform and expertise in maritime domain awareness will support the international community to combat the challenges facing our oceans and environments through illegal fishing.

In addition, we were very pleased to be awarded a contract by the Canadian Space Agency this past quarter to provide satellite flight operations and data management services for CSA's Earth observation and Space Situational Awareness satellite missions. The total estimated contract price is valued at more than $30 million and covers a three-year period with an option to renew the contract for up to two additional years.

Q1 has seen our Satellite Systems business return to typical revenue levels with new orders from Airbus for subsystems on their OneSat digital satellite platform. This is an important program for MDA as it will provide significant heritage for new technologies and cement our position as a key provider of equipment for next-generation reconfigurable satellites.

On OneWeb, MDA revised its production contract and returned to full-volume production activities in Q1. OneWeb's first-generation constellation will consist of 648 low Earth orbit satellites and will deliver high-speed, low-latency global connectivity, with MDA continuing as a key supplier to that program.

And finally, I'd like to highlight a string of awards in recent months to provide sensors to support flight to the lunar surface over the next several years. The Company now has contracts to provide sensor solutions for five lunar missions and expects more to come as we progress through 2021.

So overall, an exciting quarter with these new developments combined with solid execution as we grow our backlog and deliver on solid financial results.

I would like to pass it over to Vito Culmone, our CFO, to review that financial performance associated with all these developments.

Vito Culmone — Chief Financial Officer, MDA Ltd.

Thank you, Mike, and good evening, everyone. It's an absolute pleasure to be here with you today to walk through our Q1 results.

I wanted to start off with a few administrative matters. As you may have noticed, the Q1 interim financial statements, other than the balance sheet for the three months ended March 31, 2021, do not provide comparative information.

And the reason for this is straightforward. The Company only commenced active operations on April 8, 2020, the date of the acquisition from Maxar. However, we thought it was important to give you as much context to our Q1 results as possible, and accordingly, in the MD&A, you will find constructed Q1 2020 MDA carve-out results. And as we move beyond Q1 and into Q2, the financial statements themselves will display the prior-year comparatives.

Second matter. You might notice a few tweaks to the P&L presentation, the most meaningful one being the stand-alone reporting of the amortization of the acquisition-related intangible assets in operating expenses. These expenses were previously included in cost of revenue.

Our team's overriding objective when arriving at financial statements presentation is a set of statements that best convey to the reader our underlying business while, of course, complying with all necessary accounting standards, and we feel these changes are in service of that.

Let's get into the Q1 results. Overall, as Mike has noted, we're quite pleased with how Q1 has unfolded.

Total revenue for the three-month period ended March 31, 2021 was $123.4 million. This is up $20.2 million or 19.6 percent over the same three-month period ended Q1 2020.

Geointelligence revenue was $49 million, $4.7 million or 10.6 percent ahead of Q1 2020, primarily due to an increase in sales of satellite imagery and analytic services.

Robotics & Space Operations revenue was $34.3 million in Q1 2021, $8.2 million or 31.4 percent ahead of Q1 2020. This was primarily due to the ramp-up of work performed on the new Canadarm3 program and an increase in activity across a number of other programs.

Last but not least, Satellite Systems revenue in Q1 2021 was $40.1 million. This is $7.2 million or 21.9 percent ahead of Q1 2020. And this increase was primarily due to the growth and work performed on newly awarded contracts in the back half of 2020.

Gross profit reflects our revenue less our cost of revenue, and gross profit for the three months ended March 31, 2021 was $38.4 million compared to $23.2 million for the same period last year.

A significant portion of the increase was due to increased volume in satellite imagery and analytic services sales and increased activity on awarded programs across all three businesses, as already noted.

Gross profit percentage for the three months ended March 31, 2021 was 31.1 percent compared to 22.5 percent for the same period last year. We're pleased with this level of GP percentage, and the increase reflects increased volume and higher-margin data sales and improved cost performance on programs.

Turning to operating expenses. Operating expenses for Q1 2021 were $33.6 million compared to $17 million for Q1 2020. And the increase was almost exclusively driven by non-cash expense increases in both the amortization of intangible assets of $13.6 million and share-based compensation of $2.6

million. And both these items resulting, of course, from the April 2020 acquisition of MDA by Northern Private Capital.

Adjusted EBITDA for Q1 2021 was $39.1 million compared to $17.1 million, attributed primarily to the increase in gross profit of $15.2 million, combined with the inclusion of Canada Emergency Wage Subsidy income received in the quarter of $10.1 million.

Adjusted EBITDA as a percentage of revenue for Q1 was 31.7 percent versus 16.6 percent for the prior year. Excluding the impact of the Canadian Emergency Wage Subsidy in Q1 this year, the adjusted EBITDA as a percentage of revenue remains a healthy 23.5 percent.

In terms of cash flow in Q1, a couple items to call out. Our capital expenditures in Q1 aggregated to a modest $10 million. And consistent with our IPO messaging via our capital expenditures will ramp up significantly meaningfully in the coming quarters, with 2021 focus on SARnext, our next-generation commercial EO satellite mission providing Synthetic Aperture Radar -based imagery analytics and information services. And Telesat Lightspeed, the Telesat LEO constellation program.

Second item on cash. Our cash from operations in Q1 was essentially nil, and it reflected a larger-than-normal increase in working capital. This was largely attributable to a reduction in year-end provisions and an increase in accounts receivable related to the increased revenue in higher-than-normal collections in the prior quarter; that would be Q4 of 2020.

We do expect the balance-of-year working capital requirements to settle into a more normative range, and our early Q2 activity supports that.

On April 7th, 2021, MDA completed its Initial Public Offering, pursuant to which MDA issued 28,571,500 common shares at a price of $14 per common share for total gross proceeds of approximately $400 million.

Following the closing of the offering on April 14, 2021, the overallotment option granted to the underwriters under the offering to purchase up to an additional 4,285,725 common shares at a price of $14 per common share was exercised in full, generating additional gross proceeds for the Company of approximately $60 million.

Post IPO and the exercise of the overallotment option, and giving consideration to the share consolidation, the resulting outstanding common shares are approximately $119 million.

The Company intends to use the net proceeds of their offering to repay a substantial amount of its outstanding indebtedness in Q2 and fund a portion of our ongoing growth initiatives that require capital investments.

In summary, we are executing on specific growth strategies and leveraging our competitive strengths to capitalize on the fastest-growing areas of the space economy.

As we articulated in our prospectus, we believe an opportunity exists to grow our revenues from approximately $411 million in fiscal 2020 to between $800 million and $900 million in fiscal 2022, and further, grow our adjusted EBITDA from approximately $127 million in fiscal 2020 to between $160 million to $180 million in fiscal 2022.

Our backlog at the end of Q1 stood at $684 million, an increase of $122 million from the end of 2020. We expect the backlog to continue to build as we move through 2021. A significant portion of this expected growth is underpinned by the recent award of our flagship programs that Mike walked you through.

Mike, before I hand the call back to you, I just wanted to give a shout-out to all the amazing folks who work here at MDA. In my short time here, I’ve been so impressed with their commitment, the customer-centric passion, and above all, their amazing talents.

The combination of our incredibly talented people and our proprietary technologies positions us very well to execute what is before us here in the next couple of years and further step into the evolving broader and deeper strategic growth opportunities.

Mike, back to you.

Mike Greenley

Thanks very much, Vito. That's a solid overview of a solid quarter. It's been a great adventure working with everybody in the community as we've brought MDA out into the public markets. We really enjoyed that process and all the interactions.

As you can see, it's been a solid, steady quarter. Not much new information for those that were involved in the IPO process, but important for us to make sure that we did the call, we provided everybody with an update, and we continue the excellent dialogue that we started throughout the process that we've been on in the last several months.

Operator, we can turn it over to you to be able to manage the phones for any questions that people might have.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press the *, followed by the 1 on your touch-tone phone. You will hear a three-tone prompt acknowledging your request. If you are on a speakerphone, please lift the handset before pressing any keys.

This question comes from Thanos Moschopoulos at BMO Capital Markets. Please go ahead.

Thanos Moschopoulos — BMO Capital Markets

Hi. Good afternoon. Congrats on the IPO and on a solid first quarter. I appreciate you don't provide quarterly guidance, but as we think about the remainder of the year, any quarterly nuances we should think of heading into Q2? Should we think about revenue to be guided at a similar level? Or anything you'd call out as a quarterly dynamic?

Vito Culmone

Yeah. No. Thanos, I think—first of all, it's great to hear your voice. And as you heard Mike articulate, 2021 is really about building the backlog orders into 2022. We expect steady performance but with strong gross profit percentages consistent with what we reported here in Q1.

With respect to the revenue profile, the big step-up is into 2022, as we've articulated.

Thanos Moschopoulos

I realize it hasn't been that long since the roadshow and IPO, but in that brief period of time, how would you characterize your progress in the flagship programs? Is that exactly as expected? Or any variation there in terms of initial expectations?

Mike Greenley

Yeah. It's Mike. I would say that absolutely as expected. All the teams continue to make progress on those programs, and we continue to build momentum on each one.

Thanos Moschopoulos

Okay. And Maxar recently called out an industry-wide issue related to a shortage of the Honeywell components. Is that something that might affect your business? Or is that not something that will impact you?

Mike Greenley

It could affect our business in terms of the overall satellite programs that are relying on those components. But in terms of us having our orders and delivering into them, that does not get in the way of our systems and subsystems and what we're delivering. So right now, we're not impacted by that in any material way.

Thanos Moschopoulos

Great. And last one from me. How should we think about the wage subsidy dynamic for the upcoming quarter?

Vito Culmone

Yeah. Thanos, we're digesting, obviously, the latest update from the government in that respect. There are some provisions going forward with respect to potential clawback going forward as you look at executive compensation in 2021 versus 2019.

So we'll continue to make the claims and obviously continue to digest that there's not a lot of information on how to interpret some of that in this point in time. So TBD on that going forward.

Thanos Moschopoulos

All right. Thanks, guys. Congrats again. I'll pass the line.

Mike Greenley

Thank you.

Vito Culmone

Thanks a lot.

Operator

Thank you. The next question comes from Kristine Liwag at Morgan Stanley. Please go ahead.

Kristine Liwag — Morgan Stanley

Hey. Good afternoon, guys, and congratulations on your IPO.

Vito Culmone

Thanks, Kristine.

Mike Greenley

Thanks, Kristine.

Kristine Liwag

Mike, to clarify, the order that you mentioned from Telesat Lightspeed, is this the same contract you were expecting? Or was there an expansion of your expected work scope?

Mike Greenley

This is the same contract we were expecting. As we go through the flagship programs, there'll be a series. We've been selected for them all, received all our initial orders, we're under work. And then we'll keep getting incremental orders as we round out the order book around those programs. So it's just a continuation of that process.

Kristine Liwag

Great. And can you quantify the five sensors to the lunar missions that you highlighted in your prepared remarks? How big are these programs?

Mike Greenley

In combination, they're in millions of dollars. I don't want to be able to quote individual sensor orders for competitive reasons. It's a super-competitive market area right now.

Kristine Liwag

Great. And maybe one modelling question. Vito, how should we think about share-based compensation beyond this year? Should we think about it to be in a similar amount of about $5 million when we get to ’22, ’23?

Vito Culmone

I think your Q1 share-based comp, which is over $3 million, clearly reflects a little bit of a catch-up. And I think your range, as you go into the out years, Kristine, you should be seeing share-based compensation come down off of our 2021 levels.

Probably premature for me to give you guidance around an absolute number, but directionally, what you’re describing is what we would expect, for sure.

Kristine Liwag

Great. Thank you.

Vito Culmone

You’re very welcome.

Operator

Thank you. Next question comes from Doug Taylor at Canaccord. Please go ahead.

Doug Taylor — Canaccord Genuity

Yes. Thanks. Good evening. I think you confirmed the $350 million you expect from flagship programs anticipated next year towards that $800 million to $900 million bogey that you’ve laid out. I wonder if you could help us think about what out of those flagship programs you might expect this year, however small or large, so that we might think about the growth in your business outside of those programs and track that over the coming year.

Mike Greenley

I’m just trying to think. In terms of sort of where we’re at at the moment, I’m trying not to be too specific on revenue by program as it relates to the flagships.

They’re performing at a steady level withinside that revenue level that we’re seeing right now, which we expect to hold steady as we go through the year.

Vito Culmone

Yeah. And, Doug, I’ll jump on on that one a little bit too. When it comes to our 2021 revenue, the three flagship programs will contribute a de minimis amount to that revenue. So I think when you really step into 2022 is when you’ll see the flagship from a revenue perspective. Clearly, as we build the order book here into the out years and as our backlog builds, flagship program will be contributing significantly to the composition of that.

But as far as our 2021 revenue, yeah, I’ll use the word de minimis, but that’s basically our core existing business.

Doug Taylor

Okay. I ask only because you mentioned that you had done some work on the Canadarm3 program which contributed to the strong robotics in the quarter, I believe.

Vito Culmone

Yeah. And C3 would be the largest one of the three flagships contributing to our 2021 revenue. But again, still a fairly small percentage of our overall revenue.

Mike Greenley

Compared to the rest. Yeah.

Doug Taylor

Okay. Well, thank you for clarifying that. Congrats on your first quarter. And I’ll pass the line.

Mike Greenley

Okay. Thank you.

Vito Culmone

Thanks, Doug.

Mike Greenley

Thank you, Doug.

Operator

Thank you. Next question comes from Paul Steep at Scotia Capital. Please go ahead.

Paul Steep — Scotia Capital

Congrats on the IPO. And I guess the first question would be for Mike. Mike, can you maybe talk about the Airbus project that you talked about in the MD&A? On page 9, you talk about the OneSat digital satellite platform doing a long-term supply agreement there. Maybe give us context around that as much as you can.

Mike Greenley

We provide like a number of components into that satellite. Some of those are mechanical components. Some of those are antenna related. And so, we have two or three different products that are in that arrangement so that as that new line of reconfigurable satellites moves out, then we are, as you would say, designed into that satellite in the long-term supply agreement so that we can participate on a regular basis.

Paul Steep

Great. And then, Vito, maybe just talk to, I guess, three impacts. I'll wrap it in one to be mindful of people's time. How we should think about FX with the Canadian dollar rocketing up here; the impact to top line and bottom line in Q2 and Q3. Anything we should think about around lockdowns? Obviously, it would mainly, I guess, affect Brampton, given the current circumstance.

And then the final one, maybe broader than where Thanos went. Any impact you guys are seeing from supply chain with component shortages? Thanks, guys.

Vito Culmone

Thank you. You want to take COVID and supply chain?

Mike Greenley

So from a lockdown perspective and a supply chain perspective, we're doing well. We continue. We have operated with essential operations in Montreal satellite manufacturing, Brampton Robotics, Rover-related manufacturing throughout the entire COVID period. We've implemented really strong safety measures within the facility. We continue to track all aspects around COVID really well.

We've implemented antigen-based rapid screening. Everyone on site is available to be able to screen for COVID twice a week. And we continue to do that, while encouraging the population to get vaccinated as the opportunity to do so increases throughout the community. So, we continue to operate well even in the hot spots like Brampton, like you mentioned.

From a supply chain perspective, when COVID first started a year ago, there was a normal clumsiness as everyone tried to figure out how to adjust their work practices. But in the current performance environment, we don't have any COVID-specific supply chain challenges. People have worked the kinks out of that. The space community in general, I find, has been able to work through the COVID period very well.

Vito Culmone

And, Paul, in respect to your foreign exchange question. You will have seen that, at least as it relates to Q1, there was just under a $3 million loss recognized in our operating expenses, and all of that is essentially unrealized.

As we move forward here in the back half of the year, you're absolutely right. Our US dollar cash inflows do exceed our US dollar projected cash outflows. So to the extent that there is some continued strengthening in the Canadian dollar, there's this potential headwind there.

But overall, we feel pretty good with where we're sitting right now. We do have, I'll say a modest hedging program in place. We're reviewing that to ensure that we feel comfortable with where we're standing. But nothing, I would say, overly material from a financial statement perspective to call out at this point.

Paul Steep

Okay. Thank you.

Vito Culmone

You're very welcome.

Operator

Thank you. We have no further questions at this time. I'll now turn it back over for closing comments.

Mike Greenley

Great. Thanks very much. From my perspective, it's been great to be able to continue to engage the community post IPO and be able to report on a steady quarter as we go through the year. Vito?

Vito Culmone

No. That's great. Thank you, Mike. And we're really excited to be here. And everything we've seen on the ground since IPO just gives us even further confidence, not only on a growth aspect, but also the capabilities of the team. So very excited and we'll catch you on the Q2 call. Thanks very much.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating, and we ask that you please disconnect your lines. Enjoy the rest of your evening.