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PRESENTATION

Charlie Ehrlich - *Robert W. Baird & Co. - Analyst*

Okay. Hi, everybody. Welcome to Baird's Global Consumer, Tech & Services Conference. I'm Charlie Ehrlich. I work on the cloud software team here at Baird, and it's my pleasure to welcome to the conference OneSpan. OneSpan is a developer of security solutions for identity and business productivity. And from the Company today we have CEO, Scott Clements.

So we are going to start with a presentation from Scott and we will leave some time at the end for any questions. And if you do have a question, you can submit it in the ask a question box at the top of your browser and I will try to work them in.

So without further ado, Scott, please take it away.

Scott Clements - *OneSpan Inc. - CEO and President*

Right, Charlie. Thanks very much. Thanks, everyone, for joining the meeting here today. And I've got a few slides I will run you through to give you some background on the Company and the status of our transformation.

During the slides, I will just flip my camera off and then I will share the screen with you. And then when we get to the Q&A, I'll come back to you live. All right, everybody. Charlie, can you see the deck now? All right, perfect. Thank you. All right, let's go ahead and jump right in here.

All right, here we go. OneSpan has been in business since 1991. The Company has been focused most of that time on identity, security, and authentication for banking and financial services. We're quite a global company. About 25% of our revenue is in the Americas, about 50% in Europe, and about 25% in Asia Pacific. About 60 of the top 100 global banks are our customers.

We have been very focused on financial services through most of our -- of the Company's life. And -- although we're beginning to broaden out into some adjacent spaces as well. I think today, probably around 70% of our revenue is from banking and financial services across our main product areas. Beyond that top 100 category, we serve many other financial institutions; and by our estimate, we have been able to reduce fraud losses by something on the order of \$15 billion over the past decade.

Primarily the biggest part of the business is consumer banking authentication. That uses a variety of technologies and solutions to authenticate users into their bank accounts, either in the mobile or the online digital channel. And then we have an e-signature business, a very good e-signature business as well, which I'll give you some perspective on in a moment.

You can see on the right that the markets that we serve are quite large. Multibillion-dollar TAM is available here, breaks down into these three categories, pretty good growth characteristics across those product and markets that we serve.

Here you can just get a sense for our customer set. Banking, as I mentioned, on the left you will see many names that you will recognize there in terms of, not only traditional banks, but also some of the newer digital banking properties that are coming up. Other financial services like automotive finance, for example -- insurance is a significant category for us in e-signature in particular.

And then government and healthcare are two verticals that we participate in, have participated in for some time but which we think offer increasing and additional growth opportunities over the next few years.

Those are a couple of areas that we're beginning to look at more strategically and more seriously. Government is really being driven by the increased recognition that digital services, digital citizen services as well as security for government employees and agencies has been -- needs to be quite a bit better, I guess -- let me put it that way.

And then in healthcare, the trend, particularly over the last year or two, in terms of digital healthcare is something quite interesting to us both from an e-signature and a security -- identity security perspective. Obviously, that is a very data-rich environment with lots of personally identifiable information that would be of high value for fraud and for hackers.

And so it is an area where we think it is in many ways analogous to banking and financial services, and there are opportunities for improved security and digital transaction support in digital healthcare.

We operate in two main business areas today. On the left-hand side here, you can see our more traditional business of authentication and digital identity. Anytime we talk about authentication, it's important to understand that that is a system -- a system that includes endpoint devices as well as host-side software.

And so we have on the host side, either an on-premise or cloud-based authentication software products; and those interact with, either hardware authentication devices -- which is the long-running part of the Company's business -- but increasingly and more often, a mobile security software that either provides authentication services of different types in different technologies but also does a lot to protect a bank's mobile application, for example, and the transactions that occur on that mobile app to protect those from hacking and penetration. We have a number of technologies that protect the app, that manage the biometric interfaces, that do transaction data signing and encryption on the transaction information that occurs at those endpoints.

On the right-hand side of the slide here, you can see what I'm calling right now secure process digitization. That's really about our core e-signature solution, OneSpan Sign, and that's a business that we acquired about five, six years ago and is growing quite fast now and doing very well.

And we are beginning to wrap additional high-value services around core e-signature, including integrating some of our identity verification capabilities into e-signature and then combining that with the virtual room technology which uses digital video and co-browsing technology so that you can have a very personal experience if you are a bank or a mortgage company or some other type of an institution that is working with customers and taking them through an onboarding process or a new product addition process or really many other types of transactions where there's an e-signature in the middle but there is a real desire, a real benefit, for a more personal interaction with the user.

And then that -- we'll be adding sort of on the downstream side in the next few quarters, a remote online notarization capability that takes high-value transactions like mortgages and other things -- that traditionally require notarization -- and delivering that service digitally rather than offline which has been the practice and is still mostly the practice until today.

So a lot of opportunity not only for growth in core e-signature, but the addition of these high-value additional services around e-signature which will not only give a significant growth opportunity, we believe, but also raise the average transaction price significantly beyond what a simple or standard e-signature would cost.

Let me give you just a sense for the transformation of the Company over the last few years. I became CEO at OneSpan in the middle of 2017. We launched a whole series of actions -- transformational work streams for the Company that included the early phase of development of our cloud solutions and some of our mobile capabilities.

We also went through a pretty significant underlying business transformation during that time period in terms of replacing all of our IT systems and business systems; lots of business process and practice; and really kind of a top to bottom rebuild of the Company to be one that would be more suited towards a software company and a software business as opposed to only the traditional hardware authentication product line.

We are in the midst right now of a transition of those software and services to recurring revenue -- recurring revenue contracts and business model. We will be largely done with that transition this year. We expect to be north of roughly 85%, somewhere probably in the 85% to 90% of our software and services revenue will be recurring by the end of this year. It was actually I think above 85% already in the first quarter of 2021.

And then we have continuing work going on around platform development and platform consolidation, which going forward will make both the solutions and the business more cost-efficient and more agile; and then beginning to layer in more focus on innovation.

I would say a lot of the work over the last two, three years has really just been trying to build the basic new capabilities and catch up with technology. And then as we go forward, we want to add more innovation to the solutions that we offer to our customers, particularly in the areas of mobile security and analytics and machine learning technologies.

We also, as I mentioned earlier, are in the early phases of an adjacency expansion beyond financial services, particularly into government security and also digital healthcare, as I mentioned earlier. We think these are adjacencies where our solution technologies can be transferred relatively easily and where there are significant growth opportunities that are existing and emerging.

So over the last few years and as part of the transformation, we have made, as I said, significant changes to our operation and our business. You can see that we have substantially increased our R&D investment over the last couple of years -- two, three years to support the new cloud services as well as modernize some of our mobile capabilities and related technology.

And then if we look on the right-hand side, at the same time, we've been making a very substantial transformation of the sales organization into one that is really focused primarily on software and services sales that are high margin, relatively.

I should note that our hardware product line -- which works as an integral part of our larger authentication services business -- is a very good product line for us. It is one that is a profitable and cash-generating product line. And actually more than half of our top 200 customers use both mobile and hardware authentication endpoints as part of their authentication solutions. And that's also true of nine of our top 10 customers.

So the breadth of our authentication capabilities across hardware authentication devices and mobile software -- mobile security software is a really important part of our value proposition to our customers. We are -- a majority of our revenue is the software and services today. And as I've mentioned previously, the majority of that software and services -- the large majority is now recurring.

Just another look at the portfolio of offerings, particularly the newer offerings that we have that are more cloud and mobile centric. Our core OneSpan Sign, e-signature product line, is doing very well. That saw a triple-digit bookings growth in 2020. We expect to see very strong double-digit growth in recurring revenue and SaaS revenue for OneSpan Sign this year.

That business -- the large majority of that business is subscription SaaS. We do have a small amount of on-prem -- legacy on-prem business there but that really is a SaaS business today fully. I talked about the addition of the OneSpan Sign virtual room capability which we launched here just about a month or so ago. We have -- I think this is going to be very high impact for the business.

And then we offer identity verification services as part of our account opening capability today in general. But we are, as I said, integrating that now into e-signature to provide a very high-powered identity verification capabilities on the front end of the e-signature process. That's an upsell opportunity for us across many of our existing e-signature customers. Many of the large banks that we serve in e-signature have been asking for this capability and this integration over the last couple of years, so we are really excited about that as well.

And then Mobile Security Suite is probably the most long-standing solution category on this page, but it is one that still has very good growth drivers and value, I think, for our customers. And it is one where we are making some significant incremental investments to modernize and add capabilities here to consolidate into a fewer number of platforms, and really be able to deliver a world-class mobile security capability that also is central to our data strategy and our ability to collect relevant data and feed machine learning engines going forward.

And then the cloud authentication capability -- really new in the last couple of years, and we're off to a good start there -- you will see in an upcoming slide. Banks have been relatively slow, I think, to move to the cloud because of the regulated nature of their business and because they have such large traditional investments in on-premise software capabilities. But the competitive dynamics and the economics of banking are really driving banks increasingly to move more of their activity and their services into the cloud.

And so we're positioned, and I think ready to take advantage of that with our core cloud authentication capabilities, which also can bring a risk-adjusted authentication capability to that. So beyond just basic authentication, we can also do analytics to assess transaction risk and adjust the authentication process to match the risk of that transaction.

So there are lots of additional things we can do here in terms of cloud authentication, but we are seeing an increasing number of customers moving in that direction.

You can see on the right, I think the lower slide is kind of -- or the lower graphic is kind of interesting. It shows how over the last five years, the business has really flipped from being driven -- the authentication business was mostly hardware authenticators with a small amount of mobile authentication, to the large majority of the endpoint authentication being handled by mobile security and mobile authentication products.

So this is a little bit of a look -- a more coherent look, I think, at how the revenue mix of the Company has evolved over the last few years. It's really since 2015 -- again overall, I think flipped in terms of software and services versus hardware authentication solutions. That is partly just based on the shifts in the security part of our Company, but also with the addition in solid growth that we're seeing in e-signature helping to drive that shift.

And so we're seeing very good ARR growth, which I will talk about more in a moment; about 120% dollar-based net expansion on average and -- over the last year, year and a half. And then now, we have targeted to have -- we initially targeted to have 75% of software and services recurring by 2022. We upped that target to 85% last year, and very likely that we will hit 85% actually this year -- really a year ahead of schedule.

So this chart gives you a little bit of a view of, sort of, by product category on how things are shifting over the last few years. This is really looking at our top 200 customers, and you can see that on-prem authentication services, authentication tokens -- still are significant parts of our business but becoming a smaller part of the product mix. And that is being offset by the increase in mobile security, the growth in e-signature, and the early but increasing penetration of our cloud-based authentication security solutions into our top 200 customers.

So I think you can see across these several slides, I think, how the transition of the business is taking place, and in fact accelerated really over the last couple of years. This is a look -- just taking a look at one specific customer, a top 10 global bank, and one of the things that we have been saying for a couple of years now is that with the expansion of our portfolio, we have additional sales opportunities within our existing customer base. And that's really critical because of the long history that we have in banking and financial services, the trust that these institutions have in us that leads us to being present in 60% of the top 100 largest banks around the world.

And so here, we've seen that we have been able to significantly grow our revenue within an existing top bank through some of the new service offerings and capabilities that we have; and at the same time, shift that mix towards more recurring revenue.

Here's just a financial look at the trends in the business over the last couple of years. You can see that the dollar-based net expansion rate is holding right around 120% on average over that time period. I think that's quite good and quite important to our business model and is a significant contributor to the recurring revenue growth that you see happening here. We have set a target to grow, over the 2020 to 2022 time period, of ARR in the neighborhood of 25% to 30%. I think we're on track to do that.

In 2020 and through the first quarter of 2021, we have actually been growing near the top end of that ARR, near the top end of that range. So I think we are in good position to deliver something that is certainly in the ballpark with that goal for ARR growth.

And then on the right here, you can see that the gross margins for the Company are pretty good. They have been increasing gradually into the 70s overall, and that is a mix of software and services which runs north of 80% gross margin -- the high-growth part of the Company.

And then the hardware products -- the authentication hardware products tend to run in the low to mid -- the lower 50s, I would say, in gross margin which is pretty good for actually a hardware product line; and the R&D investments and things like that are relatively low there. So that is a very profitable part of the Company, even though the gross margins are a little bit below the overall average for the Company.

So just a couple slides to wrap up here and we'll have a few minutes for questions. In the first quarter, pretty good outcome, I think, as I mentioned earlier. ARR growth was up around 29% in the quarter. Subscription and Term ARR growth in excess of 50%. And 87% of our revenue -- software and services revenue were recurring, ahead of our goal for 85% this year. So we'll be materially done with that transition to software or recurring revenue in software and services this year.

That's important because we have about a 10 -- well, actually in 2021, about a \$15 million to \$20 million revenue headwind from the transition away from perpetual license revenue to recurring revenue. So being materially complete with that transition this year is important because we should start to see the top line -- overall top-line growth in software and services, and for the Company really start to show through as that headwind from the transition is substantially diminished going forward.

Just a quick look at the guidance this year. Total revenue on the \$215 million to \$225 million range; of that, \$120 million, \$125 million will be recurring. ARR growth -- we've actually got a little bit below the 25% target. We may get to 25% or above. We get some tough comparisons in the latter part of the year, so we will see how that goes. But it will be a very strong recurring revenue growth, I think, that stays on track for our three-year goal.

And then we've set approximately breakeven on EBITDA for this year -- a little negative to a little positive depending on how the year shakes out. And we have generally been profitable throughout this period of transformation. We have a very strong balance sheet -- about \$120 million of cash on the balance sheet and no debt; and we've been able to really sustain that strength on the balance sheet throughout this time period of transformation.

And just kind of a wrap-up slide which I won't spend a lot of time on here. This really summarizes many of the points that I've made over the past few minutes here.

So I think with that, Charlie, why don't we go ahead and shift over to the Q&A. And I will see if I can get my camera going again here.

QUESTIONS AND ANSWERS

Charlie Ehrlich - Robert W. Baird & Co. - Analyst

Great, yes, no. Thanks, Scott, for that presentation.

Scott Clements - OneSpan Inc. - CEO and President

Here we go.

Charlie Ehrlich - Robert W. Baird & Co. - Analyst

I just wanted to maybe start with an e-signature question and then go to some broader questions after that. But just on e-signature -- DocuSign is obviously a huge player in the market. Do you run into them a lot, and how do you compete against them? What sets you apart from DocuSign?

Scott Clements - *OneSpan Inc. - CEO and President*

Yes. Well, obviously, we do run into them all the time. I think we run into them probably more than any other competitor that we see. There are a couple of things that are a little bit different about our solution -- the way we do business. We are really focused -- tend to be pretty focused on use cases that are highly integrated into the customers' workflow in many cases, and banks in particular. So we have banks, for example, that use our e-signature product in their new customer account opening workflow in all their branches nationally.

And so we do some things there that are really important to those customers like white labeling -- something as simple as white labeling. So if you go into one of those banks that uses our product, you won't see the OneSpan name; you'll see the customer's name in that e-signature part of the process. And DocuSign tends not to do that. They like to have their brand up there. And for a lot of customers, that's an important issue. So there's that one.

Then there's also the audit trail -- visual audit trail capability that we have which is very extensive. And as we add ID verification to the front-end of e-signature, that audit trail extends into the ID verification, and then downstream, ultimately, in the remote online notarization work that gives -- really it's a non-repudiation capability that people can't say -- or the institution can demonstrate that the customer really went through the process -- they had the opportunity to see every page and how they stepped through that whole process. So in the event of a dispute, the institution can really demonstrate that the customer went through each page and initialed each page, and how they did it, and how much time they spent, and all of that.

And there are a number of other underlying features and things like that that can be a little differentiated. I think DocuSign is very strong in what we would call the user initiated sphere -- that's kind of the retail, small real estate agent or insurance broker, things like that, and they are very good at that; and their brand is very important for them in that scenario where we don't play as much today. We really focus more on the enterprise space, and that has worked out well for us.

Charlie Ehrlich - *Robert W. Baird & Co. - Analyst*

Got it. It looks like we have just about a minute here, so maybe I will squeeze one kind of bigger-picture question in. You talked a lot about the transition you guys are making to recurring revenue. It seems like it will be, for the most part, finished this year. How should we think about overall revenue growth and profitability in 2022 and beyond?

Scott Clements - *OneSpan Inc. - CEO and President*

So we are working through an updated long-term outlook over the next few months. And we intend to share that with investors later this year in how we see the upcoming three-year period of 2022 through 2025 -- 2024, I guess it would be, if it was three years.

And so we think our goal is to sustain ARR growth in the mid to upper 20s in our software and services product areas; and we want to do that by continuing to extend and expand the product line capabilities and then also adding some adjacency spaces. Most of the growth that we've done today or in recent years has been with our existing customer set. The large majority is growth through our existing customers.

So we want to add to that in some of these adjacent spaces where we think there are significant security issues and a real opportunity for us to do more. Even in the policy and the communication that President Biden put out here just a couple of weeks ago, in that letter, he spoke specifically about multifactor authentication. So we think that there's a lot of opportunity that remains in the core business as well as in e-signature.

And then I think as we go forward and we see that top-line growth, we are also starting to have a hard look at opportunities around structural costs and how can we run the Company more efficiently. Frankly, we've been very focused just on the transformation and the building of some of the new products, and really just building organizational capabilities -- building a software company.

We really weren't a software company three years ago, and so that has been really the focus. Now as we go forward in the next few years, we want to take all of those IT investments that we've made, and start to drive more productivity in the operation and consolidate the number of product

platforms that we have today -- we have more than we'd like to have today. And we'll consolidate those platforms. And so as we do all that, I think we're going to see increasing efficiency in the business. And that growth, along with that increased efficiency, should be rewarding on the bottom line, we believe.

Charlie Ehrlich - *Robert W. Baird & Co. - Analyst*

Right. Well, it looks like we're out of time. Thanks so much for being here, Scott. It's great to hear more about the Company. (Operator Instructions) Thanks again, Scott. Appreciate it.

Scott Clements - *OneSpan Inc. - CEO and President*

Thanks, Charlie. Thanks, everybody, for joining today. Appreciate it.

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