

OneSpan Inc(Q4 2024 Earnings)

February 27, 2025

Corporate Speakers:

- Joe Maxa; OneSpan Inc; Vice President of Investor Relations
- Victor Limongelli; OneSpan Inc; Chief Executive Officer
- Jorge Martell; OneSpan Inc; Chief Financial Officer

Participants:

- Gray Powell; BTIG; Analyst
- Catharine Trebnick; Rosenblatt Securities; Analyst
- Anja Soderstrom; Sidoti; Analyst
- Andres Miranda; D.A. Davidson; Analyst

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the Q4 2024 OneSpan Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your first speaker today, Joe Maxa, Vice President of Investor Relations. Please go ahead.

Joe Maxa^ Thank you, Operator. Hello, everyone. And thank you for joining the OneSpan fourth quarter and full year 2024 earnings conference call. This call is being webcast and can be accessed on the Investor Relations section of OneSpan's website at investors.onespan.com.

Joining me on the call today is: Victor Limongelli, our Chief Executive Officer; and Jorge Martell our Chief Financial Officer. This afternoon, after market closed, OneSpan issued a press release announcing results for our fourth quarter and full-year 2024.

To access a copy of the press release and other investor information, please visit our website. Following our prepared comments, we will open the call for questions.

Please note that statements made during this conference call that relate to future plans, events or performance including the outlook for full year 2025 and other long-term financial targets are forward-looking statements.

These statements involve risks and uncertainties and are based on current assumptions. Consequently, actual results could differ materially from the expectations expressed in these forward-looking statements.

I direct your attention to today's press release and the company's filings with the U.S. Securities and Exchange Commission for a discussion of such risks and uncertainties.

Also note that certain financial measures that may be discussed on this call are expressed on a non-GAAP basis and have been adjusted from a related GAAP financial measure.

We have provided an explanation for and reconciliations of these non-GAAP financial measures to the most directly comparable GAAP financial measures in the earnings press release and in the investor presentation available on our website.

In addition, please note that all growth rates discussed on this call refer to a year-over-year basis unless otherwise indicated.

The date of this conference call is February 27, 2025. Any forward-looking statements and related assumptions are made as of this date. Except as required by law, we undertake no obligation to update these statements as a result of new information or future events or for any other reason. I will now turn the call over to Victor.

Victor Limongelli^ Thank you, Joe. And good afternoon, everyone. Thank you for joining us today. I am thrilled that we reported another solid quarter of profitability, driven by the team's continued hard work and focus on operational excellence.

We achieved record high adjusted EBITDA in the fourth quarter and for full year 2024. Fourth quarter adjusted EBITDA was \$20 million or 32% of revenue, and both business units were again profitable on a fully burdened basis.

Full year adjusted EBITDA was \$73 million or 30% of revenue. ARR grew 8.5% to \$168 million including 12% growth in Digital Agreements and 6% growth in Security.

Subscription revenue, driven by demand for our software, authentication and e-signature solutions grew in excess of 30% for both the quarter and year. Subscription revenue for the full year accounted for 57% of total revenue, an increase of 12 percentage points year-over-year.

Software and services revenue or revenue including subscriptions, but excluding hardware, grew 16% in 2024 and accounted for nearly 3/4 of total revenue, up from roughly two-thirds of revenue in the prior year. Total revenue declined 3% in the fourth quarter and grew 3% for the year.

Strong growth in subscription revenue in both periods was partially offset by the expected decline in hardware that we discussed on prior calls, and to a lesser extent, by a decline in maintenance revenue as we transitioned to SaaS and term software licenses over time. I continue to be pleased with our cash generation.

We generated \$12 million in cash from operations in the fourth quarter and \$56 million for the year, which is a significant improvement from the prior year. Last year, we generated \$3 million in cash during the fourth quarter and used \$11 million in cash for the year.

As of December 31, we had \$83 million in cash on hand, an increase of \$40 million from the beginning of the year.

During the year, we achieved several significant operational milestones that helped us to achieve the financial results I just discussed, and that I believe better positions us to drive increased revenue growth and profitability over the long term. Notably, our sales team continued focusing on transitioning the company to more higher-margin software revenue and successfully closed additional multiyear software term deals, which helped to drive our strong subscription revenue growth and record gross profit for the year.

We also substantially completed our multiyear cost savings initiatives as discussed last quarter. The cost savings related to these initiatives, combined with our improved software revenue mix resulted in significant increases in profitability throughout 2024.

Three additional contributing factors to our strong 2024 results include: first, a year-over-year improvement of nearly 700 basis points in our on-time renewal rate, driven by great work by our renewals team; second, improvements in our SaaS offerings by the R&D team, which resulted in increased operating efficiencies and which were reflected in our higher gross margins; and third, the sunsetting of certain low return on investment products that we discussed on prior calls, which, although this impacted our ARR and revenue by several million dollars each, it also helped to improve our operational efficiency and profitability. Turning to our two business units.

In Security, Q4 subscription revenue growth was very strong at 49%, primarily driven by continued demand for software authentication solutions from existing customers including an increase in contracts extending to multiyear agreements upon renewal, perpetual term conversions and an overall increase in on-time renewals.

The decline in hardware revenue was driven by banks in EMEA and to a lesser extent, in APAC, adopting mobile-first policies with respect to consumer banking. We expect this trend to also impact hardware revenues in 2025.

In Digital Agreements, Q4 subscription revenue growth was driven by expansion contracts and to a lesser extent, new logos. Both business units were profitable at the segment level in the quarter and for the year, with Security continuing to be very profitable.

Our goal continues to be for both units to deliver growth and strong profitability. We expect to continue to make progress on this goal in our Digital Agreements business segment in 2025, and we expect to continue driving strong profitability in Security.

We made dramatic strides in 2024 in terms of cash generation from operations and profitability, and we expect to improve on these metrics in 2025, though with more modest increases in cash generated from operations and adjusted EBITDA compared to the dramatic improvements we achieved in 2024.

The trust placed in us by our tremendous customers including more than 60% of the world's 100 largest banks, provides us with an opportunity to increasingly innovate to deliver value-added solutions that help our customers and prospects solve current and emerging business problems. To deliver on that, we recently hired a new CTO with significant digital identity expertise, and we are thrilled to have him leading the R&D effort.

Finally, as you are probably aware, two weeks ago, we paid the first quarterly cash dividend in OneSpan's history. We plan to announce the timing of our next dividend payment when we report our first quarter results. Payment of that dividend is expected to occur in the second quarter of 2025.

Bear in mind that even after paying the quarterly dividend, we expect to be generating additional cash, and the Board will continue to operate with a balanced capital allocation strategy, weighing potential increases in the capital return to shareholders as well as organic investments in the business and targeted M&A. With that, I will turn the call over to Jorge. Jorge?

Jorge Martell^ Thank you, Victor. And good afternoon, everyone. I am pleased that we reported another strong quarter and full year results. ARR grew 8.5% in 2024 to \$168 million, and our net retention rate was 106%.

As compared to last year, ARR and NRR primarily benefited from customer expansion contracts and ARR to a lesser extent, also benefited from new customers. Growth in ARR and NRR was impacted by churn related to end-of-life products as discussed on prior calls.

Fourth quarter 2024 revenue was \$61.2 million or 3% lower than last year's Q4, primarily due to the previously discussed expected decline in Security hardware revenue. Security software and services revenue, that is Security revenue, excluding hardware, grew 20% and Digital Agreements revenue grew 8%.

For the full year 2024, revenue grew 3% to \$243.2 million, driven by 14% growth in Security Software and Services and 20% growth in Digital Agreements, partially offset by the expected decline in Security hardware.

Subscription revenue grew 32% to \$36.1 million in the fourth quarter, led by 49% growth in Security Solutions and 15% growth in Digital Agreements. The strong growth in Security subscription revenue was primarily driven by expansion contracts with existing customers for Authentication and Transaction Signing Solutions including an increase in multiyear term license deals from existing customers and to a lesser extent, the improvement in on-time renewals versus the prior year.

For the full year 2024, subscription revenue grew 31% to \$139.4 million, led by 33% growth in Security Solutions and 28% growth in Digital Agreements. Maintenance and support and professional services and other revenues declined in the fourth quarter and

for the full year 2024 by design, primarily due to our transition to SaaS and term software licenses over time. Fourth quarter gross margin was 74% compared to 69.1% in the prior year quarter.

For the full year 2024, gross margin was 71.8% compared to 67.1% in the prior year period. The increase in gross margin for both periods was primarily driven by a favorable product mix within our Security segment including an increase in software and a decrease in hardware revenues.

Fourth quarter GAAP operating income was \$11.8 million compared to \$1.8 million in the fourth quarter of last year. The strong year-over-year increase was primarily driven by an increase in gross margin and gross profit dollars due to the favorable product mix just discussed, a decrease in operating expenses, primarily from lower headcount and vendor-related costs and lower restructuring costs.

Full year 2024 GAAP operating income was \$44.8 million compared to an operating loss of \$28.9 million for the full year 2023. The significant year-over-year improvement was driven by the combination of increased revenue and like the Q4 period, favorable product mix, significantly lower operating expenses and lower restructuring costs. GAAP net income per share was \$0.72 in the fourth quarter of 2024.

This compares to GAAP net income of \$0.01 in the fourth quarter of 2023. GAAP net income per share was \$1.46 for full year 2024 as compared to a GAAP net loss per share of \$0.74 for the full year 2023.

Fourth quarter and full year 2024 GAAP net income per share included income tax benefits of \$0.58 and \$0.59, respectively, related to the release of the valuation allowance, the sunseting and liquidation of our Dealflo subsidiary and the transfer of our Security intellectual property from Switzerland to the U.S. as part of our restructuring efforts. Non-GAAP earnings per share, which excludes the income tax benefits just mentioned, long-term incentive compensation, amortization, restructuring charges, other nonrecurring items and the impact of tax benefits was \$0.24 in the fourth quarter of 2024 and \$1.32 for the full year 2024.

This compares to a non-GAAP earnings per share of \$0.19 in the fourth quarter 2023 and \$0.01 for the full year 2023, respectively. Fourth quarter adjusted EBITDA and adjusted EBITDA margin was \$19.8 million and 32.4% as compared to \$11.2 million and 17.7% in the same period of last year, respectively.

Full year 2024 adjusted EBITDA and adjusted EBITDA margin was \$72.5 million and 29.8% compared to \$12 million and 5.1% in the prior year. Turning to our Security Solutions business unit. ARR grew 6% in the fourth quarter to \$107 million.

ARR growth was negatively impacted by approximately 1.5 percentage points to the relocation of identity verification products to our Digital Agreements business unit at the beginning of the year.

In addition, ARR headwind related to end-of-life products was negligible in the quarter and approximately \$2 million for the full year 2024. Fourth quarter and full year 2024 Security revenue declined 6% to \$45.5 million and 1% to \$182.2 million, respectively, primarily due to the expected decline in hardware revenues. Hardware revenues declined 36% to \$14.4 million in the quarter and 23% to \$58.9 million for the year.

Security subscription revenue increased 49% to \$20.9 million in the fourth quarter and 33% to \$80.6 million for the full year 2024, primarily driven by expansion of licenses from existing customers for software-based authentication products, partially offset by the sunsetting of our Dealflo Solution.

Q4 2024 gross profit margin was 75% as compared to 67% in the same period last year. The increase in margin is primarily attributable to an increase in subscription revenues and favorable product mix and customer mix.

Security Solutions operating income in the fourth quarter was \$23.3 million or 51% of revenues compared to \$20.4 million or 42% of revenues in Q4 2023. The strong increase in gross profit margin, combined with lower operating expenses, primarily attributed to restructuring and other cost reduction activities drove the majority of the improved performance. Now turning to Digital Agreements.

ARR grew 12% to \$61 million. ARR growth benefited by approximately 3 percentage points due to the relocation of identity verification products to this business unit at the beginning of 2024. ARR headwind related to end-of-life products was minimal at \$0.1 million in the fourth quarter and approximately \$3 million for the full year 2024. Fourth quarter and full year 2024 revenue grew 8% and 20% to \$15.7 million and \$61 million, respectively, as compared to the same periods in 2023.

The increase in revenue for both periods was primarily driven by new contracts and expansion of renewal contracts and to a lesser extent, the relocation of identity verification products, partially offset by a reduction in maintenance revenue related to the sunsetting of our on-premise e-signature product.

Subscription revenue grew 15% in Q4 and 28% for the full year 2024 to \$15.2 million and \$58.8 million, respectively. Fourth quarter gross profit margin was 70% as compared to 75% in the prior year quarter.

The year-over-year change was primarily driven by higher cloud platform costs as a result of increased e-signature transaction volumes, lower maintenance revenue as we transition to 100% SaaS licenses and an increase in depreciation of capitalized software costs.

Digital Agreements operating income was \$2.6 million or 17% of revenue as compared to an operating loss of \$0.7 million or 5% of revenue in the year ago quarter. The year-over-year improvement in performance was driven by an increase in revenue and a decrease in

operating expenses, primarily attributed to restructuring and other cost reduction activities.

Turning to our balance sheet. We ended the fourth quarter of 2024 with \$83.2 million in cash and cash equivalents compared to \$42.5 million at the end of 2023. We generated \$56 million in cash from operations during 2024 and used \$9 million in capital expenditures, primarily capitalized software costs.

We have no long-term debt. Geographically, our revenue mix by region in the fourth quarter of 2024 was 48% for EMEA; 36% from the Americas; and 16% from Asia Pacific. This compares to 49%, 34% and 17% from the same regions in the fourth quarter of last year, respectively.

For the full year 2024, the revenue mix by region was 44% from EMEA; 36% from the Americas; and 20% from Asia Pacific compared to 47%, 34% and 19% from the same regions in 2023, respectively.

I will now provide an update to our financial outlook. For the full year 2025, we expect double-digit subscription revenue growth.

We expect certain perpetual maintenance contracts in our Security segment to transition to on-premise subscription licenses, and as Victor mentioned, for the recent trend in hardware revenue to continue in 2025.

We believe our strong focus on operational excellence will enable us to achieve another year of strong profitability and cash generation and enable us to return capital to shareholders via quarterly cash dividends and potentially other methods as part of a balanced capital allocation strategy.

For the full year 2025, we expect revenue to be in the range of \$245 million to \$251 million, ARR to be in the range of \$180 million to \$186 million and adjusted EBITDA to be in the range of \$72 million to \$76 million. That concludes my remarks. Victor?

Victor Limongelli^ Thank you, Jorge. I want to conclude today's remarks by first thanking the entire OneSpan team for delivering a very strong quarter and full year. Their hard work and dedication to operational rigor over the last several quarters has us in a much better position to drive increased growth and profitability over the long term.

We remain committed to delivering value to our customers and to returning value to our shareholders by growing revenue efficiently and profitably.

We will continue to focus on driving higher-margin software revenue and remain committed to driving towards achieving a Rule of 40 performance level. Jorge and I, now will be happy to take your questions.

QUESTIONS AND ANSWERS

Operator[^] (Operator Instructions) Our first question comes from the line of Gray Powell of BTIG.

Gray Powell[^] Okay. Just had two or three on my side. So maybe just kind of looking back at the last year, it looks like your results came in at the high end of your initial ARR guidance. You basically hit the midpoint on revenue, and then you substantially exceeded on EBITDA, like well above what I think anyone was expecting.

So I guess my question is, how do you feel about things today versus a year ago? And where do you think you have the most potential to surprise on the upside if it plays out well in 2025?

Victor Limongelli[^] Yes. Thanks for the question. So we're in a tremendously better shape than we were 12 months ago. We were able to get the cost structure of this company in the right spot where we can generate increased profits as we grow revenue. There's a couple of things to consider. First, on the Security side, I think it's important to realize that we have a very broad authentication solution.

If you think about what we're offering, we have On-prem and Cloud, we support OTP and FIDO, hardware and software, and we can offer multiple use cases across login, transaction signing. We serve Retail and Corporate Banking, and we have emerging workforce authentication use cases.

So we feel like we have a good opportunity to grow that business going forward, and it's an area we're going to be investing in. And we're continuing to invest in Digital Agreements, but we're going to layer in additional growth opportunities, we think, on Security.

So if we look at our 2025, one of the things when we set the guidance, when we looked ahead for the year, we were doing our budget planning in November and heading into December. And one of the things we saw is that the euro-dollar exchange rate shifted quite a bit.

So one of the things we kept in mind as we were getting set to tell you how we thought we were going to do for 2025 is that, that shift caused us to be a little bit more cautious maybe than we would have otherwise been.

So if you look at our business, about 40% of our business -- of our revenue is in euros. And we're naturally hedged as a company because we have a couple of hundred employees in Europe. So this isn't really an EBITDA side of the ledger.

But on the revenue side, the difference between \$1.10 and \$1.11 versus \$1.04 and \$1.05 is about \$5 million. So it's a couple of points of growth there. So we kept that in mind as well just to give you a little context on how we were looking at it.

We're not intending to get into a constant currency type analysis. But just -- I'm just bringing it up to highlight one of the reasons that we kind of steered towards being prudent in the revenue guidance for '25.

Gray Powell^ Okay. That's helpful. And then maybe a follow-up question. So I think I'm having a little bit of trouble reconciling the ARR guide for fiscal '25, which is pretty good at about 10% growth versus the total revenue guide at only 2%. Your FX comments help.

But I guess -- and I know there's not like a direct translation between ARR and revenue, but I mean does your outlook imply that hardware or nonrecurring revenues like declined by 20% or something in 2025? Or is there something else going on that I'm potentially missing?

Victor Limongelli^ Yes. I'll let Jorge comment as well. But I mean definitely on the hardware side, like if you look at the business, we had the decline last year, but it's not been a one-year trend. It's been something that's been going on for a long time.

We've been successful, just to be clear, in transitioning a lot of that revenue from hardware into software to software authentication. But we're definitely trying to be realistic.

If you look at the business last year, there was a big decline in hardware, and we thought it would be imprudent to say, "Oh, that will magically turn around because the calendar flips over from '24 to '25." Jorge, I don't know if you want to add additional color?

Jorge Martell^ Yes. So Gray, the other thing to consider about that aspect is the way revenue is recognized for term, particularly multiyear term licenses on the Security software, Gray.

So you would have a higher benefit on the revenue. And then the ARR is -- you only have obviously one year, right? But also -- sorry, go ahead, you were going to add something else?

Gray Powell^ No. I just said yes. I got it. Understood.

Jorge Martell^ So we -- to Vic's point, we do factor in a little bit of a decline on the hardware side. The other thing to balance as well is we do have a little bit end of life going through from a revenue perspective, Gray, that is higher than ARR. And that is because particularly on -- I guess, it's probably half and half within Security and DA or mainly DA, I guess, in this case, going to 2025, where we did recognize on-prem and maintenance DA revenue in the first, call it, half of 2024 that you're not going to see in 2025. And so those contracts ended.

So the ARR impact was already taken in 2024, but then you're going to see more of that revenue hit in 2025 if -- when you look at comparatively. So that's another factor to consider.

But I think overall, to Vic's point, we were trying to be balanced when it came down to the revenue guidance. All these -- you have the puts and takes on the multiyear, the hardware, the FX exposure that Vic mentioned, but -- and then the end of life that I just mentioned.

But also keep in mind, we still expect to have double-digit growth on the subscription revenue for both business units.

Operator^ Our next question comes from the line of Catharine Trebnick of Rosenblatt Securities.

Catharine Trebnick^ Can you put some color around where you are in your product roadmap? I know last summer, there were some interesting products that you were coming out with in new partnerships. And the second part of the question is you were looking to expand your ecosystem and where are you on that?

Victor Limongelli^ Yes. Thanks, Catharine. I mean both of those things are ongoing, I would say. We have expanded our ecosystem in terms of our channel development. And some of this -- those two things are related.

So the FIDO2 tokens have an application in the Workforce Authentication market, and that's a market we want to reach through channel partners.

We don't want to, and I don't think it would be feasible for us to hire enough direct salespeople to try to contact every possible company that might use hardware tokens for workforce authentication.

So we're going to do that through channel partners, and we're continuing to develop that. And it takes -- that's not something where you flip a light switch and all of a sudden, you have dozens of channel partners that are hugely productive. It's an ongoing process, but we're making progress on it.

Catharine Trebnick^ All right. And then the follow-on question is, you did say that there was some deceleration again in the Security hardware, correct? I did hear that right. And is it similar for modeling purposes, it's similar to what we saw in 2024? And I'll cede the floor then for someone else.

Victor Limongelli^ Yes. Sure. I mean Jorge, I don't know if you want to talk on the specifics, but we have planned for additional decline in the traditional hardware -- Consumer Banking Hardware Authentication business.

Jorge Martell^ Yes. So I can add context, I think. So Catharine, thanks for the question. So I think if you look at historically over the last, say, decade or so, the hardware revenue has been going down about 8-or-so-percent year-over-year when you look at it from that standpoint on average for that time period. And so we factored some similar decline in 2025, and that's part of our guide.

Operator^ Our next question comes from the line of Anja Soderstrom of Sidoti.

Anja Soderstrom^ Congrats on the nice progress here. In terms of new logos, it seems like you -- the growth has mainly been coming from expanding with existing customers. But how is the new logo trending for you?

Victor Limongelli^ Yes. So with respect to new logos, I think if you look at the growth of the business, there's more new logo growth historically on the DA side than on the Security side. We do see an opportunity in the workforce space to be adding new logos.

On the Consumer Banking Authentication, Retail Banking Authentication, whether it be software or hardware, that's an area where I think the customers move switch vendors a lot more slowly.

So it's proportionately harder to get new logos there. It also benefits us because we have a lot of the banks.

So our retention rates are good as well. But the two areas where that we can expect to see better new logo performance, I think, would be in the Digital Agreement space and then also through channel partners.

Anja Soderstrom^ Okay. And in terms of inorganic growth, how actively are you looking there? And what are you seeing in terms of opportunities and how the market is trending there?

Victor Limongelli^ Yes. It's something we alluded to, I think, in the prepared remarks, it's something that we'll certainly consider. I would -- I think the right phrase to think of is targeted M&A.

It's much more likely that we would do something where there's some good or interesting technology that we could sell to our customers. I mean we have thousands of customers.

And if we can find something valuable for them, I think that potentially makes sense for us rather than trying to buy revenue, that's unlikely to be something that we're going to be aiming for. So it's more likely to be targeted than kind of super large scale.

Operator^ Our next question comes from the line of Rudy Kessinger at D.A. Davidson.

Andres Miranda^ This is Andres for Rudy. Just a couple of ones. In terms of your fiscal '25 guidance, could you maybe expand a little bit on your net retention rates and new logo expectations embedded in that? Any extra color because you guys have been doing well on the new logo side, you just mentioned that. So any expectations moving forward for '25?

Jorge Martell^ Yes. I can answer that. Thanks for the question. So when you look at our NRR numbers historically, they've been operating within a tight band between 106% to 108%. Obviously I think in some of the quarters this year, you could see some noise, I would say, because of a couple of things.

One is the end of life, obviously introduces some noise there. But I think for 2025, you would expect us to be within the same tight guide, 106%, 108%. It all depends on some of these, like I said, in particularly on the DA side, you will land a larger deal, then you will see that a little bit of uptick.

For the full year, we're going to be within that band. And so we do have as well as I mentioned, in 2025, a little bit of end-of-life impacting there. But I think that will be -- we'll land within the same guide, I'd say, 106%, 108%, that will be the guide, Andres.

Andres Miranda^ And obviously you guys have been doing great with free cash flow. And I know you guys are not guiding into it, but maybe could you talk about your expectations moving forward, like building on the momentum on cash flow generation?

Jorge Martell^ Yes. Listen, we're pretty pleased with our cash flow generation. And all of this obviously kudos to the entire team for the execution of that. So the dramatic change you saw from 2023 to 2024 is really, really remarkable. For 2025, we expect modest increases in it.

Also consider Andres, that we're going to be investing, as Vic mentioned, in our Security software business on both on the product side as well as a little bit on the channel. And so taking that into account, I would say, modest improvement in the cash flow generation and also the free cash flow conversion from either revenue or adjusted EBITDA compared to 2024.

Operator^ I am showing no further questions at this time. I would now like to turn it back to Joe Maxa for closing remarks.

Joe Maxa^ Thank you, everyone, for joining us today. We do appreciate your time. Have a nice day.

Operator^ Thank you for your participation in today's conference. This does conclude the program. You may now disconnect.