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<<Shaul Eyal, Analyst, Cowen Inc.>>

Good afternoon everybody. Thanks for joining us. My name is Shaul Eyal and I cover the cybersecurity universe at Cowen. We're very pleased to host Scott Clements, the CEO of OneSpan. Scott will take us through a presentation and we will leave some time for Q&A. So feel free to send your questions directly to my email inbox or also you can use the chat box that appears in front of you. And with that Scott thank you for joining us. The floor is yours.

<<Scott M. Clements, Chief Executive Officer and President>>

Shaul, thank you very much and thanks to Cowen for inviting us to the conference here today. So why don't we go ahead and try to jump right in here. Here we go. So OneSpan is a company that's been around for a long time, about 26 years. It has changed quite a lot in the last few years in particular. But we are a company that really focuses historically on financial institutions globally. We serve 60% of the top 100 global banks as our customers and thousands of other financial institutions and companies. We do operate in some other vertical spaces, which I'll talk about in a minute.

And by our estimates, we have been able to reduce fraud, particularly in banking and financial services by over $15 billion in the last decade. You can see on the right that we serve some end markets and identity verification, e-signature and security and authentication that are both sizeable and have good double-digit growth rates in general. These are the customer sets that we serve. You can see banking obviously, as I've already talked about, as well as other financial service companies, including new types of digital banks and other online financial services and auto finance, for example, is a big area for us then insurance and then a couple of areas that we're just beginning to delve into a little bit more deeply as government and healthcare, digital healthcare in particular. A lot of the core value propositions that we deliver have applicability in government and healthcare.

In particular, there is a very broad move globally around digital identity programs that are being sponsored by governments and finally, including the U.S. government, but also in Europe and a number of the key city states in Asia Pacific as well. And then digital healthcare, as you all know, has become a very big area over the past year in particular because of the pandemic it's become one of the largest areas for venture investment over the last couple of years in digital healthcare. And so the processes that people go through digitally and remotely are very analogous to what happens in banking and financial services.

Okay. So let me talk for a minute about the business that we're in and what we actually do. There are two key areas that you can see here on the left authentication and digital identity and on the right secure process digitization. And this is – the sort of unifying theme here certainly across both of these areas is digital identity and helping people and companies to remotely interact with high value transactions in a safe and secure way. And so on the left here, you see the authentication and digital identity. This is the traditional business for OneSpan, although as I noted it's evolved quite a bit in the last few years. And we have four real solution elements, I think, in this area that all interact with each other and interplay with each other.

On the host side, we have on-premise authentication software, and just now in the last couple of years we've launched a family, the early parts of a family of cloud authentication offerings that also add a risk – a risk component, a real-time risk assessment component to them. And then on the endpoint side, we have both mobile security software and applications that do not only authentication, but also lots of – provide a lots of other software services for mobile application protection and interface. And then the hardware authenticator is the traditional core business of the company historically, but it is really now an important solution element for us in all of the authentication areas.

About nine out of our top 10 authentication customers use both mobile security and hardware authentication as part of their solution. And both of those endpoint types can then communicate to the same backend or the same host side, whether that's on-premise or in the cloud. And that's because these institutions have very heterogeneous customer environments, and they also have employee environments that are really important here obviously from an authentication and remote access perspective. And different consumers and different employee applications used – sometimes use hardware authentication, sometimes use mobile authentication, but it all has to work together.

And on the right side here in the secure process digitization piece, the core of this is our e-signature product line, OneSpan Sign. We have really been extending that core e-signature value proposition with some new capabilities. And most recently, just about a month or six weeks ago, we launched a service called Virtual Room, which combines a digital video and co-browsing in the browser environment help, so that banks, for example, can take customers step by step through a complex e-signing process and deliver a level of intimacy and in the digital channel that's been hard to get in the past.

Also on the front end of that, we are integrating our identity verification capabilities. This is the ability to validate the identity of a new customer, for example, into the e-signing process. And then later this year or early next, we'll be launching a set of capabilities around remote online notarization. So you really can have an end-to-end highly secure non-repudiating process for carrying out contracts and relationships in the digital channel. Interestingly in both identity verification – well, all three identity verification, remote online notarization and the virtual room capabilities all have transaction values that are much higher than a traditional or a core e-signature transaction. So they not only create –

these things not only create new revenue opportunities, but also really will help to raise the average transaction value that we get in e-signature.

So those changes that I've spoken about are part of a multi-year transition for the company that started back in 2018 timeframe. And there are multiple phases to this from the launch of some of our initial cloud products, the rebranding of the company to OneSpan, a very substantial business transformation in terms of our business operations, our IT systems, and many other things. And then those of you who have watched the company over the last year, year and a half, we've been talking a lot about our recurring revenue transition that is underway in which we think will be materially complete this year.

And then we will continue to develop our platform over the next couple of years, a increased focus on innovation and differentiation and then a more concerted effort into adjacency expansion to have more of our revenue would be comprised of opportunities outside of financial services. There is a lot of growth available in financial services, but there are adjacent spaces, as I mentioned, that use – have very similar use cases and will help us to diversify our revenue base and have new and incremental growth opportunities. So we're really still very early in this transformation.

We have been essentially become a cloud company really only in the last two or three years. And most of the cybersecurity peer companies that we follow in some of our peer groups on average have been at this more than a decade, really on average about 15 years. So we're very early in the transition here. I think we're making very good progress on it. So, obviously, a lot to do, a lot of hard work, but I think the metrics is you'll see in the next few slides look pretty good and moving in the right direction.

Now, to – as big parts of this transformation of our company, I'll just focus here briefly on these two areas around R&D and our sales capability. We have essentially doubled our R&D head count over the last couple of years or so. And that's been adding both capability and capacity to support the new cloud offerings and the expanded offerings that I talked about in process digitization with e-signature and update – and upgrades some of our other legacy solutions. So, in doing that really, we have deployed over the last couple of years a really modern, agile development environment with all the things that you would expect to see in a successful cloud product company.

So, the R&D expense rate has gone up quite a bit over the last few years to support the launch of these new solutions in the development of our platform offerings. You'll see in a moment our gross margins have remained pretty good in the business throughout this period. So by and large, we've been able to stay profitable or near breakeven really throughout this transformation period. We also have realigned our sales force to support the selling of new solutions. We've hired a lot of sales talent and technical sales talent to support cloud and SaaS offerings and be able to sell complex enterprise software solutions, which we didn't really do a lot of until really the last two or three years. And we have also increased the size of the sales force to be able to capture the opportunities that we believe are out there for us to support our long-term growth of the business.

And so, the portfolio from this R&D investment and some acquisition, we haven't done a lot of acquisition recently but we have done some. OneSpan Sign I talked about, and the mobile security suite is a solution that's been around for a few years now. Those are our two biggest software categories in mobile security and OneSpan Sign. But as I mentioned, we're adding virtual room, and identity verification, remote online notarization and cloud authentication, all of these are recurring revenue offerings that are driving growth in our recurring revenue that you can see on the right.

You can also see, there has been a very dramatic shift on the bottom here in terms of the number of mobile security license we sell versus the number of hardware authentication devices. It's really more than flipped over the last five years, so that now 75% of our user license sales are happening in mobile security and much less in hardware authentication. Although, as I mentioned earlier, hardware authentication remains an important part of the offering to our customers. More than half of our top 200 customers, are both mobile and hardware authentication users.

So, looking at the numbers here, kind of how this is evolving, on the next few slides here, you can see this flip from 2015. This is another look, a little different cut at the data. But 22% of our revenue was software and services back in 2015, today that's 75%. And about 85% of that software and services will be recurring by next year. We're actually above that number in the first quarter of this year. So, we'll be in certainly the 80% to 85% range, I think, this year and at 85% or better in 2022.

One important attribute of our company and our business is because of our strength in financial services, the relationships we have with those customers around the world, the difficulty that it is – that occurs when a bank tries to qualify a new cybersecurity vendor, it can take a year or more for that to happen in many cases. So, our relationship with our customers is quite strong and they drive the majority of the growth in our business today. We're getting a good growth in software and services, and recurring software. And we're doing that mostly with our existing customer base.

So, as we go forward and we expand into new areas with new opportunities, we think there is additional growth opportunity beyond even what we're seeing today. And the takeaway from the chart here is that if you look at more of our traditional products in terms of server or on-premises authentication software, hardware tokens, and so on, the penetration on our top 200 customers has actually come down in those two areas. But you can see that's been offset by the growth in mobile security, in e-signature and in our newer cloud-based authentication and software offering.

So, we are getting penetration with the newer stuff into our existing customer base. We do have a lot of new customers that happen in e-signature. That's a more of a horizontal solution, so we do see a significant number of new customers there. But a lot of our growth across the board is being driven by increased usage of our products by existing customers and those customers using some of our newer solutions as well.

Here's a look at a particular customer. And just as one, example this is one that over the last three years is a top ten global bank that has really been a customer for a long time. But they have increased their usage in particular of mobile security, but also our authentication software and our e-signature software, all contributing to the growth and the recurring revenue at this top ten bank. You can see also here that hardware authenticators, remains an important part of the picture for them to illustrate what I talked about a little bit earlier. But all of the growth here has been in recurring software.

So. look at some of the headline numbers here just moving left to right, we have a really strong dollar-based net expansion rate in our business that reflects, what I was talking about over the last two slides, which is a big growth driver for us is existing customers using more of what we have to offer and driving a solid dollar-based net expansion rate. That's leading to a strong recurring revenue growth over this time period. We are targeting in the 25% to 30% range compound over the years from 2020 through 2022. We're on track to achieve that at this point. And so, really solid ARR growth has been pretty consistent for over the last couple of years now, for sure.

And then you can see on the right here, there is some margin volatility from quarter-to-quarter based on product mix, generally. But you can see that the general trend here has been for increasing gross margins, two, three points over the last couple of years. And we think there's opportunity for additional gross margin accretion as our product mix continues to shift towards our recurring software. There are a lot of puts and takes in these numbers, so they do bounce around a little bit. But despite all of the change and all of the work that we've been doing, we've been able not only to maintain, but actually improve our gross margins over the last a couple of years.

And that has continued to be reasonably good here. And then it just finished first quarter not too long ago that we reported with a 29% ARR growth, really strong subscription and term ARR growth and actually over 85% of our software and services being recurring in the first quarter at 87%.

So just to wrap up here on a couple of things, the 2021 outlook and the guidance that we've given, we affirmed that when we reported a first quarter. And so, what you see here is that the overall top line number is not growing a lot. And that's really because of a couple of things. The recurring revenue piece is growing very strongly, as I noted. But we do have this year about $10 million to $15 million headwind to our revenue line from the transition away from perpetual license to recurring. As I noted earlier, we expect that transition to be materially complete this year. So, when we get into 2022, we should start to see more of that growth filter through to the overall top line growth.

The other is a little bit of a headwind here is on the hardware authenticators. Those are not growing very much right now. We think there's some good opportunities going forward. But we're coming off a really robust period in 2019 that was driven by regulatory issues in Europe, PSD2 that drove a lot of demand for hardware. But we do see that stabilizing going forward. And so, again, as we look at into 2022, I think, we'll start to see the overall top-line show through along with continued growth in recurring revenue.

So, I think that – I think we can stop the presentation there and leave this page up and we can try to answer any questions that are coming in if any.

<<Shaul Eyal, Analyst, Cowen Inc.>>

Sure, Scott. Thank you. Thank you so much for this presentation. How should we be thinking about the competitive landscape and I know you guys touched on a number of, in a way you can look at categories as, is that much of a short demented market, or are there like, well defined participants doing pieces of what you do or kind of also doing or providing more of an end-to-end type of platform?

<<Scott M. Clements, Chief Executive Officer and President>>

Yeah, our competitive environment is unfortunately or fortunately, I'm not sure which is pretty complex. We – because we're a vertically oriented company, in particular, that really narrows the field, I think a little bit in terms of who we as a practical matter who we compete against. Just in a couple of the areas that are – where it's pretty straightforward when we look at e-signature obviously DocuSign and Adobe Sign are the two primary competitors that we run into. There are some others certainly, but those are the ones that kind of day in and day out, we compete with.

We've been seeing very, very good growth in e-signature. Our orders were grew over 100% last year. Our revenues are growing very strongly as well. And so that has been really, we put a lot into that. So product line to strengthen it over the last a couple of years and we're really starting to see the benefits from that, not only in North America, but also globally and other parts of the world. So we think there's a ton of opportunity there along with some of these additional services that go along with e-signature that I talked about earlier, when we look in the authentication space and the security piece, it gets quite a bit more complicated.

There are some traditional competitors that we know like Gemalto, who is we've competed with them for many, many years. There are some newer players and sort of the authentication software space, a company called Transmit Security that we run into from time-to-time. And then in mobile, there is – there are quite a lot of companies that are in a mobile security space. Most of them at this point are not really optimized for financial services and cover all of the different things that we do on mobile security, which is way beyond just authentication.

And so, but there are quite a few of them out. There's probably 10 or a dozen different mobile security customers. They're mostly focused on enterprise use cases but we do see some of them in financial services from time-to-time companies like Arxan, for example. And then I guess, in the ID verification, there are a whole bunch of companies that are trying to do different types of identity verification schemes. And they all emphasize different strengths and use cases. But there are quite a few of those that are out there too, and there's a whole long list.

So those are, I think – there isn't anybody that really sort of, that really matches up to us across the portfolio, I would say. And one of this ID verification capability that I talked about that we started out with or through an acquisition a couple of years back is really a unifying theme across the process digitization, e-signature space and the security space. It really utilizes technologies from both areas to do something that we hope and we think will be unique.

<<Shaul Eyal, Analyst, Cowen Inc.>>

You've mentioned on the international expansion opportunity, what's the current geographic mix U.S. predominantly or EMEA represents some courses over that?

<<Scott M. Clements, Chief Executive Officer and President>>

Yeah, we're actually quite global for a company our size and it just reflects our customer base, big financial institutions. So you can roughly break the company down. This goes up and down a little bit, but you can roughly break the company down into four even sized pieces in the Americas is one, then Northern Europe, then Southern Europe and Africa, North Africa and Middle east is the second and third. And then the fourth is Asia-Pacific.

So they're roughly about the same size, but when you get at the – down at the product line level, that differs quite a bit, for example, e-signature today is dominantly a North America product line. Most of the sales are in Canada and the U.S. but if there is a real demand and real growth for this digitization capability around the world now. And there's a lot more greenfield opportunity globally than there is even in North America, although, there's still a lot of opportunity there too.

<<Shaul Eyal, Analyst, Cowen Inc.>>

Got it. And when we think about the go-to-market strategy, does it differ on the various product lines? Are these the same buyers, just maybe help us understand a little better?

<<Scott M. Clements, Chief Executive Officer and President>>

Excellent, good question. Important question. So, the buyers are generally not the same between the security and authentication product lines and the process digitization product lines. The same – it very often can be the same company or the same institution, but the individual buyers within those institutions will very often be different. There's usually some security connectivity there, but the business drivers are a little bit different. And the security side, it's obviously fraud – protection from fraud and all that goes along with that. And then in the e-signature area, it's really more about productivity and customer experience and things like that.

So the buyers do tend to be a little bit different. We do have a survey, a different sales model in North America than we do in the rest of the world there. We have a group of people who are really dedicated to e-signature in North America, although, our security salespeople can also sell e-signature. But it's really driven more by the dedicated e-signature team. When we get outside of North America, then it's really the same team that is selling all of the solution – software solution categories anyway across process digitization, e-signature and security. And then we back them up obviously with specialists.

<<Shaul Eyal, Analyst, Cowen Inc.>>

And maybe just to wrap it up the balance sheet and liquidity and cash flow generation, what's the current status of that point?

<<Scott M. Clements, Chief Executive Officer and President>>

Yeah, we have – throughout all of this, a transition that I've been talking about here. We've maintained a strong balance sheet. We have somewhere in the neighborhood of $115 million to $120 million of cash on the balance sheet with no debt. So we do have capacity to make strategic acquisitions and things like that that can accelerate the transformation, the evolution of the company. And have the financial strength to go through a period maybe like last year where we thought things might be a little tough. It turned out that we actually added some cash to the balance sheet last year.

So it was something that we managed through, I think pretty well. There was – third quarter was a little tough last year, but we – that has not really affected our financial strength and our balance sheet. And we do think that acquisitions will be an important part of how we develop the company and our solution offering in the years ahead. But we've been quite disciplined about it. We've walked away from more than one deal because it didn't have – it didn't end up in the due diligence to have everything that we thought was required. But balance sheet is strong, company is financially quite strong, we have capacity to do what we need to do.

<<Shaul Eyal, Analyst, Cowen Inc.>>

So I want to thank you so much for joining us this afternoon. Good luck. And we'll talk to you soon. Appreciate it.

<<Scott M. Clements, Chief Executive Officer and President>>

Thanks everybody for listening in. We really appreciate it. Thanks Shaul.

<<Shaul Eyal, Analyst, Cowen Inc.>>

Thank you so much.

<<Scott M. Clements, Chief Executive Officer and President>>

Bye-bye.