FINAL TRANSCRIPT

Redline Communications Group Inc.

Fourth Quarter 2020 Earnings Call

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CORPORATE PARTICIPANTS

Stephen Sorocky
Redline Communications Group Inc. — Chief Executive Officer

Philip Jones
Redline Communications Group Inc. — Chief Financial Officer

PRESENTATION

Operator

Ladies and gentlemen, thank you for standing by, and welcome to the Redline Communications Group Inc. Fourth Quarter 2020 Earnings Call. At this time, all participants are in a listen-only mode.

After the speakers' presentation, there will be a question-and-answer session. To ask a question during this session, you will need to press *, 1 on your telephone.

Please be advised that today's conference is being recorded.

If you require any further assistance, please press *, 0.

I would now like to hand the conference over to Mr. Stephen Sorocky, CEO. Please go ahead.

Stephen Sorocky — Chief Executive Officer, Redline Communications Group Inc.

Thank you very much and good morning, everyone. Thank you for joining us today.

I wish to remind everyone that some statements made on today's call are forward-looking in nature and, therefore, subject to certain risks and uncertainties, which are all outlined in detail in Redline's regulatory files, which may be found on sedar.com.

On this call, I'd like to give a perspective on the quarter and 2020 and describe some of the positive accomplishments in regard to progress on our strategy in this current pandemic environment.

In many ways, 2020 can be summarized as the year of advancing our product innovation strategy while riding out COVID. We are excited about sales of our LTE solution in Q4 to multiple clients in mining and remote learning applications, capitalizing in part on demand enabled by the increased spectrum availability from the CBRS band in the United States.

We maintained our critical investments in our product development for our target market in mission-critical and reliable solutions. In spite of the continuing pandemic impacts on our markets, we succeeded in improving the cash balance at the end of Q4 over Q3, and we delivered significant progress on our target to reduce inventory levels.

While we have had some good quarters, the COVID-19 pandemic created many challenges. We have been challenged by customer order uncertainty as access to their sites was reduced, timing of deliveries affected, and some sites shut down entirely as global travel was restricted and as shipping products across borders was difficult and occasionally impossible. As a result, overall revenues in the year were lower than in 2019.

That said, the Company has realized some strong results on the cost side of the equation. Gross margins were maintained at the level of those in 2019, and expenses were reduced by 6 percent. Careful cost and cash management remains a key area of attention for the management team.

While lower revenues contributed to an EBITDA loss of $4 million, thanks to strong inventory, working capital, and cash management, including a deferral of capital expenses into 2021, cash balance net of borrowings were reduced by less than $0.4 million in the year, and cash was increased in Q4 by $200,000.

We delivered continuing steady inventory reductions, and our accounts receivable management achievements have now become ingrained in our operations.

Redline ends 2020 with a strong backlog of orders to be shipped within the next 12 months and, with a $2 million Qatar order announced in Q3 2020, expect it to be fully shipped in 2021.

We also enter 2021 with eight consecutive quarters of growth in maintenance revenue, which is both reoccurring and very profitable and with a new generation of products coming available in 2021. This has been a key emphasis in our sales growth efforts and is delivering steady results.

The mining and oil and gas sectors continue to suffer from COVID-related delays, but there are some positive signs in other markets, specifically those with early access to newly available CBRS spectrum, where Redline's LTE product delivers significant value.

This new and growing CBRS spectrum availability is enabling growing interest in our LTE products, and in December, we signed four contracts for our LTE products. This means that we've had more LTE sales in December than any month to date.

All of these are initial orders and have the potential to grow beyond the initial first order size. While LTE is still a small portion of our business, we anticipate that CBRS will continue to become more available and will drive additional revenues from our LTE products.

We are also seeing opportunity in worldwide efforts to improve connectivity for remote communications, distance learning, and telemedicine as a result of the changes from work-from-home and the pandemic environment. Our reliable solutions are well suited to this market.

In addition to the LTE product line, we have also invested heavily in the next generation of our cornerstone RDL-3000 product line. This version, the RDL-3200, is a next generation Virtual Fiber platform that incorporates all of our internal and external learning and customer feedback over the last years. As I mentioned in the last earning call, we started internal testing of the new product in October, and the results exceeded our expectations.

We moved to a customer beta with a Tier 1 oil and gas company in December and plan to incorporate their continued feedback into a final development phase, with an expected product release in the summer of 2021. Supporting our customers' fixed wireless mission-critical network expansion through the development of enhanced products, coupled with the addition of mobility layered onto those fixed networks through our LTE solutions, is essential to our product development investment.

All in all, we enter 2021 with optimism about the coming relaxation of COVID restrictions on the horizon, with ongoing strong financial controls and discipline, with CBRS poised to drive the LTE product demand, and next-generation products on the horizon.

With that, I'd like to hand over to Philip Jones, our CFO, for his remarks. Phil?

Philip Jones — Chief Financial Officer, Redline Communications Group Inc.

Thank you, Stephen, and welcome everyone. The earnings press release for Redline Communications was issued yesterday morning, followed by a re-release issued yesterday afternoon due to a presentation issue with the prior comparative year annual cash flow statement. The press release accompanied our filings on SEDAR of the 2020 annual audited financial statements, Management Discussion & Analysis, and the Annual Information Form.

My comments will focus on key highlights of our financial results, followed by a Q&A at the end of the session.

Looking at the results for the 3 and 12 months ended December 31, 2020, and comparing the current quarter to both the prior quarter and the same quarter in 2019, as well as the same 12-month period in 2019, we experienced the following.

Looking first at the balance sheet, the overall cash position increased by $0.2 million during Q4, from $5.1 million at the end of Q3 to $5.3 million at the end of the quarter. This marks the second quarter in a row the Company has grown its cash balance.

Throughout all of 2020 and continuing in 2021, the Company has been focusing on cash preservation through a combination of controlling expenditures and continuously striving to improve working capital management, most notably in reducing the amount of inventory being carried and improved accounts receivable collections.

Inventory balances have declined by $1 million from $6.5 million at the end of 2020 Q3 to $5.5 million at the end of Q4. The inventory reduction is mainly the result of the Company's ongoing transition to a build-to-order inventory model. The Company continues to prioritize the need to reduce its level of inventory and overall non-cash working capital requirements.

Shifting our focus to the income statement, we note that overall revenue for the quarter was $4.7 million, down $0.6 million or 11 percent from the prior quarter and down $0.3 million or 7 percent from the same quarter in 2019.

The COVID-19 pandemic continues to impact not only the timing of customer purchase decisions, but also the ability to access customer sites for sales efforts, installation of equipment, as well as the completion of professional services, which are often the first step in the solution delivery and revenue cycle.

Revenues for the 12 months ended December 31, 2020, were $18.5 million, down $5.1 million or 22 percent from the prior year. Driven primarily by maintenance and support agreements, recurring revenue continues to grow quarter over quarter and has reached eight consecutive quarters of incremental growth.

The Company continues to evolve its sales efforts towards complete solution selling, which includes extended support and maintenance components in each sales transaction, in addition to equipment and software sales. Maintenance and support revenues also earn the highest gross profit margin amongst all the revenue streams.

The core verticals of oil and gas, mining, and utilities represented 55 percent of revenues in the quarter, down from 84 percent in Q3 2020 and compared to 59 percent in the same period last year. The sequential change in vertical mix from 2020 Q3 to Q4 was largely the result of large sales to oil and gas customers in Q3 which did not repeat in Q4. Furthermore, sales to our distribution channel partners increased significantly in Q4 over both the prior quarter and the same quarter in the prior year. Distribution channel partners support all of our customer verticals.

On a geographic basis, revenues increased quarter over quarter and compared to same quarter in 2019 in North America, Europe, Africa, and the Asia-Pacific regions.

Revenues by product type were higher quarter over quarter in hardware and software products, as well as maintenance and support services. Revenue decreased in professional services and third-party equipment mainly due to large shipments to two customers in Q3 that had previously been held due to COVID-19 restrictions that had a large third-party equipment component.

Q4 2020 order bookings were $5.5 million, down from $6.5 million in Q3 and $6.4 million in the same period in 2019. Overall bookings for the year were $22.6 million, slightly down from the $23.9 million recorded in 2019. Bookings represent the total value of accepted contracts or purchase orders received by the Company in the period.

Total backlog was $11.8 million at the end of the quarter, up 7 percent sequentially from Q3 and up 38 percent over the same period in the prior year. Our backlog represents the value of all open product and service contracts and purchase orders not shipped or earned at the end of the period. Longer-term support and warranty contracts represent $3.8 million of the backlog total, up 10.6 percent or $0.4 million from both Q3 and 2019 Q4.

Gross margin was 52 percent in Q4, unchanged from Q3 and down from 59 percent in the same quarter in 2019. Gross margin in Q4 was suppressed due to a one-time write-down in the carrying value of specific items within the Company’s component inventory, this write-down being charged to the costs of goods sold.

Overall operating costs for the quarter were $4.3 million, an increase of $0.8 million from Q3 2020 expenditures of $3.5 million and $0.2 million above the $4.1 million in the same quarter in the prior year. Quarter-over-quarter increases are the result of accruals for year-end variable compensation, an increase in the provision for doubtful accounts, as well as overall increases in R&D spend related to new product development. Furthermore, expenditures in the Q3 comparative period were reduced due to the recognition of investment tax credits received in that quarter.

The Company continues to monitor controlled expenses closely in the wake of COVID-19, including limitations on travel rate expenses and optimizing staffing levels across the Company.

In March 2020, the Canadian federal government announced the Canadian Emergency Wage Subsidy or CEWS program as a response to the COVID-19 pandemic. In the quarter, the Company received a $0.1 million benefit under this program, down from the $0.3 million received in Q3 2020, due to changes in the program. The Company has received a $1.2 million benefit under this program during 2020. Please note that this benefit has been excluded from our adjusted EBITDA calculations.

The Company reported an adjusted EBITDA loss of $1.6 million in the quarter, as compared to an adjusted EBITDA loss of $0.4 million in the prior quarter and $0.9 million in the same quarter last year. After taking into consideration the non-operating income and expense items, net loss for the quarter was $1.6 million compared to $0.4 million in the prior quarter and a loss of $1.3 million from the same quarter in the prior year.

Adjusted EBITDA for the 12 months ended December 31, 2020 was a loss of $4 million, compared to a loss of $2.3 million for the same period in 2019.

Net loss for the 12 months ended December 31, 2020 was $3.9 million, compared to a loss of $3.7 million in the same period in the prior year, despite the drop in revenues. On a per share basis, 2020 Q4 resulted in a loss of $0.10 per share, compared to a loss of $0.08 per share in Q4 2019.

With that, I will turn the call back over to Sharon for our Q&A.

Q&A

Operator

If you'd like to ask a question at this time, please press *, 1 on your telephone keypad. If you would like to withdraw your question, press the # key. We'll pause for just a moment to compile the Q&A roster. Once again, that's *, 1 if you would like to ask a question.

And we did not have any questions at this time. I will turn the call over to the presenters.

Stephen Sorocky

Thanks very much, Sharon. Thank you, everyone, for joining us this morning. We wish you safe and healthy times and have a great day. Thank you very much.

Operator

This concludes today's conference call. You may now disconnect.