Blackline Safety Corp.
Fourth Quarter 2021 Results
Conference Call Transcript

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Speakers:

Scott Boston
Director of Finance

Cody Slater
Chief Executive Officer & Chair of the Board

Shane Grennan
Chief Financial Officer

Operator:
Welcome to the Blackline Safety's Fourth Quarter Results Conference Call.

The conference is being recorded.

I would now like to turn the conference over to Scott Boston, Director of Finance. Please go ahead.

Scott Boston:
Welcome and thank you for joining us

I'd like to remind everyone that this call is being recorded today, Thursday, January 20, 2022. With me today is Cody Slater, CEO and Chair of Blackline Safety Corp., as well as CFO, Shane Grennan.

Before turning the call over to Cody, I would like to note that some of the information discussed in this call is based on information as of today and contains forward-looking statements that involve risks and uncertainties. Actual results may differ materially from those set forth in such statements. For a discussion of these risks and uncertainties, you should review the forward-looking statements disclosure in the earnings news release as well as in the Company's SEDAR filings.

During this call, there will be a discussion of IFRS results, non-GAAP financial measures, non-GAAP ratios and supplementary financial measures. A reconciliation between IFRS results and non-GAAP financial measures is available on the Company's earnings news release and MD&A, both of which can be found on our website, blacklinesafety.com, and on SEDAR. All dollar amounts are reported in Canadian dollars unless otherwise noted.

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With that, I will now hand the call over to Mr. Slater

Cody Slater:

Thank you, Scott. Good morning, everyone, and welcome to Blackline Safety's Q4 2021 earnings call.

Today we will be discussing our fourth quarter and annual results, which were issued before market opening this morning. To set the agenda for today's remarks, I will start by providing a broad Company overview, Shane will then discuss some of the highlights of our fourth quarter in greater detail, and I'll conclude with the Company's outlook and some closing remarks before we take a few questions.

While the last two years have been challenging with the impact of the pandemic, Blackline has not only been able to maintain growth during this period, but we have also taken the bold strategy to **Invest to Grow**, positioning us to achieve even more aggressive growth when the world returns to a new normal business environment. Although as demonstrated by Omicron, we are not through this yet. I am pleased to say that our Q4 shows the impact of this business strategy. Our fourth quarter revenue was $19.3 million, up 67% compared to fourth quarter last year, and 52% over our Q3 revenue, representing one of our strongest quarter-on-quarter rates of growth ever. This has led to a record annual revenue of $54.3 million, which represents 42% growth year-on-year. The investments we've made will continue to drive strong year-on-year growth throughout 2022. With the addition of our new product line, such as G6 and expanded services, we see the Company on track for more record growth through this year and into the next.

Outside of our home market here in Canada, total revenue grew 80% year-over-year for a total of $15.6 million as we announced five large multiyear contract wins in the United States and the U.K. with new and existing customers. This demonstrates the value of our suite of connected worker and area monitoring solutions to large enterprises, as well as our ability to retain and expand our service levels with these customers. Our service revenue exceeded $8 million for the first time ever in Q4, growing 22% compared to Q4 over the prior year. This also represented a 10% increase over Q3 of this year with even greater growth to come as the impact of the record new hardware sales in Q4 begin generating service over the next two quarters. In fact, it is our Hardware-enabled Software-as-a-Service business model that has kept us resilient through the pandemic with our service revenue growing 64% for the year when compared to the pre-pandemic year ended October 31, 2019.

I will now turn the call over to our CFO, Shane Grennan, to discuss our fourth quarter results and financial position in more detail.

Shane Grennan:
Thank you, Cody, and good morning all.

As Cody said, we achieved a new record of $19.3 million in revenue, including product revenue of $11.1 million, which represents a 129% increase from the same quarter last year. Product revenues in the fourth quarter included large previously announced customer contracts with a Texas-based turnaround service provider, a U.K. defense contractor, the U.S.-based Natural Gas and Electric Utility Company, and two U.K. water and wastewater authorities. These contracts and our strong retention will drive service revenue growth in the coming years, with the bulk of the units being deployed by Q2 of Fiscal 2022.

We continue to see strong demand for our G7 EXO area gas monitor with several of these significant sales contracts for the quarter including this product line. Service revenue grew to $8.2 million from $6.7 million or 22%. Software services revenue remained the most significant portion of our service revenue to 83%. In the fourth quarter, total service revenue was boosted by rental revenue of $0.6 million, up 539% from the prior-year quarter due to the strong performance of G7 EXO in the industrial turnaround and maintenance season this fall in the United States. While we won't see a repeat of this in Q1 due to seasonal industry factors, we see this as a potentially significant market for us in the U.S. and Europe throughout Fiscal 2022 and beyond.

As part of our **Invest to Grow** strategy, we have built out our sales team in the United States over the past year and we saw significant dividends from this investment in the fourth quarter, as revenue increased 81% to $9.4 million. As we've announced previously, we've also added facilities in France, Houston and the UAE to better access our global sales opportunity and service our existing customer base. I want to highlight the location in Houston, as this will serve as a base for the sales operations and customer support team that we've built throughout the fourth quarter to focus on the rental market opportunity, as well as field servicing of our devices in the United States.

Expanding the European sales team also continues to demonstrate strong results, as total revenue grew 80% compared to the prior-year quarter. I would also note that for the Fiscal Year 2021, European revenue grew to $15.7 million from $8.3 million, up 88% year-over-year. We continue to see encouraging returns from our channel investments in the rest of the world, with revenue outside North America and Europe growing 62% quarter-over-quarter to $715,000. Revenue from these geographies exceeded $2.5 million for the 2021 fiscal year, a 96% improvement from 2020.

We had record service revenue of $8.2 million driven by recent product sales and strong retention and renewal activity. Service level increases to current and new customers contributed growth of $382,000 in the quarter. This increase was offset by customers who renewed fewer active devices due to workforce reductions of $193,000 and only $25,000 from customers who declined to renew this quarter. Overall, total service revenue was up 22% this quarter over the prior year's quarter, with software services revenue up 20%. Our service margin percentage improved to 69% from 67% excluding the Canada Emergency Wage Subsidy, or the CEWS, as we continue to add to our revenue base each quarter while maintaining the same cost structure.

Product gross margin for the quarter was negatively impacted by global supply chain shortages causing increased cost of inputs for the Company's manufactured devices. We were able to navigate this with a product gross margin of 30% for the quarter compared to 37% in the fourth quarter of 2020, excluding the impact of CEWS, as we delivered more devices than ever. Our procurement team worked diligently throughout the quarter to maintain the required inflow of components to sustain our manufacturing operations. Despite these challenges, the Company was able to improve product gross margin to 24% from 17%, excluding CEWS, over the full year. We see these challenges continuing through Fiscal 2022. However, we are confident that we will be able to support our sales growth, including bringing G6 to market this summer as expected.

The overall combined gross margin percentage for product and services was 47%, which was lower than the same quarter last year, driven by a sales mix that was more heavily weighted on the product side versus service.

When looking at the Company's expenses for the quarter, I will draw your attention to the table in our MD&A, which details the amount of CEWS for the quarter and year and their comparative periods. No CEWS funding was recorded in Q4 2021 compared to $0.9 million in Q4 2020. With the conclusion of the program in October 2021, Blackline recorded $1.4 million of CEWS for the Fiscal Year 2021 compared to $2.9 million recorded in Fiscal Year 2020.

Product research and development costs were up 60% to $4.7 million for the quarter. Excluding the impact of CEWS and our new subsidiary, Wearable Technologies, the total product research and development cost increase was 21%. The team is continuing to work to ready G6 for market this coming summer, as well as enhancing the Blackline Live portal to offer many new services to our customers and handle all the data that our products generate.

Wearable Technologies continues to work under the guidance of our CTO, Brian Sweeney, developing prototypes and features for the G5, our entry into the construction and light industrial markets early in 2023.

On the sales and marketing expenses side, we saw an increase of 173% to $9.8 million. Excluding the impact of CEWS and additional cost for Wearable Technologies, the increase was actually 144%. One of the major contributions to this increase was higher commissions of $1.2 million compared to the same period last year, which were paid on the hardware from the large deals we secured in the quarter. We were also able to return to business travel and trade shows including the National Safety Council in Orlando during the quarter, which resulted in an incremental cost of $688,000. There was also a $486,000 bad debt charge in the quarter, as we settled the last of our severely COVID impacted receivables.

Throughout 2021, we have made preparations to handle significantly increased volumes with the upcoming launch of G6. We've invested in our operations team with an even greater emphasis on product quality and manufacturing efficiency. This has contributed to the increase in general and administrative expenses of 131% quarter-over-quarter. Excluding operational and admin personnel at Wearable Technologies and the impact of CEWS, the increase was 78% in the fourth quarter compared to the fourth quarter of 2020. Also included in the overall increase is the operations team in France, as well as the initial hires for operations in Houston. Our People Services and Enterprise IT functions have also expanded to serve our increased headcount which nearly doubled during the year. We've also increased our Finance team to meet the additional reporting requirements associated with being listed on the TSX. As a final note on expenses, we have invested $4.3 million overall in Wearable Technologies since acquisition as we integrate their team into our operations and move them forward at pace for the go-to-market strategy.

The Company continues to maintain a strong balance sheet with no debt and a solid working capital position of $62 million, including cash and short-term investments of $54.5 million. This follows our capital raise in October which brought net proceeds of $37.6 million. Our cash position reflects our $1 million investment in additional Surface Mount Technology equipment. This will allow us to double our production capacity in the upcoming year. This was largely prepaid at the end of the fiscal year and was fully installed and operational in early November. Capital expenditures and lease payments for the quarter also impacted cash by $2.2 million, primarily due to revenue generating cartridges sold during the quarter.

For inventory totals, $12.7 million at October 31, 2021 compared to $13.6 million at the end of our third quarter and $10.8 million at the prior year-end. Of this total, materials/parts inventory represented $7.2 million and finished and packaged units $5.5 million. During the quarter, our inventory levels were drawn down to deliver our product sales in the period and then fully replenished to ensure proactive management on material levels considering current global supply chain challenges and to be able to supply anticipated future orders. The impact to our cash in the quarter was $8.4 million, as we renewed our inventory during the quarter and delivered a record number of devices to meet demand.

With the onboarding of our new CMO and CTO during the year, we had ended several large external contract arrangements for marketing, public relations and product development consulting services and brought these in-house through the expansion of our internal teams in these areas, with $2 million in final payments for these services reflected in the year-end cash outflows.

Blackline provides the option to our customers to purchase outright our devices or to lease through our G7 Lease Program, with this customer decision affecting the timing of our cash inflows associated with that sale. We have expanded the number of customers opting for finance leases, with a total of $18.9 million in future contracted cash flows at October 31, 2021, an increase from $7.2 million at the prior year-end. These finance leases positively impact our immediate product revenues and service revenues over time but negatively impact the timing of associated cash inflows to Blackline. Generally, it takes one and a half to two years for a finance lease contract to catch up to a purchase agreement with service in terms of the cash flows. During the year ended October 31, 2021, we added 100 new leases with a total contract value of over $16 million. This, factored together with us working with certain customers to accommodate payment terms as they face further waves of COVID-19, saw a build of $10.1 million in our total accounts receivable balance for purchased outright and lease sales at the current year-end compared to the prior year-end. Blackline will continue to proactively deliver its **Invest to Grow** strategy while maintaining prudent management of working capital and associated cash flows.

I would like to take this opportunity to announce that our 2021 environmental, social and governance report will be published on February 17. As we have grown operationally and financially over the last year, we recognize that we have a duty to continue to improve our impact on our environment, people, communities, investors, customers and partners. ESG will always be core to what we do as we save lives and get people home safely, and in doing so, enhance our customers' own ESG goals.

I will hand it back to Cody to discuss our outlook and provide closing remarks. Cody.

Cody Slater:
Thank you, Shane.

Looking back, 2021 was a transformational year for Blackline, as we executed on our **Invest to Grow** strategy. We are proud to have achieved 19 consecutive quarters of year-over-year quarterly revenue growth. However, our revenue growth was only part of that story. We nearly doubled our headcount during the year as we continue to expand our sales channels and accelerate our product road map.

As part of these additions, we grew and realigned our leadership team, with the appointment of two excellent new executives, Christine Gillies, as Chief Marketing Officer, and Brian Sweeney, as Chief Technology Officer, who have brought deep experience in high growth SaaS, software-as-a-service enterprises and have already made great contributions. On top of this, we added two new directors to our Board, Cheemin Bo-Linn and Barbara Holzapfel, who have also extensive experience leading technology businesses.

2021 also saw Blackline secure access to a $15 million financing facility, supported by our recurring revenue. In June, we graduated to the Toronto Stock Exchange and became one of Alberta's largest publicly listed companies in the technology sector. At the end of the fiscal year in October, we completed a bought deal financing, adding net proceeds of nearly $38 million to an already strong debt-free balance sheet.

We also completed the first acquisition in the Company's history. We are excited about our future entry into the light industrial construction markets with the G5, which would be the first device to—to bring connected safety to those industries.

Throughout the year we secured new facilities in France, Houston and Dubai, further extending our global reach. Our business is a global one and we have affirmed our commitments to the environment and our communities and all of our stakeholders in our first ever ESG report. Recently, we were proud to be announced among Deloitte's Enterprise Fast 15 as the ninth fastest growing enterprise company in Canada with 230% revenue growth over the last three years. It's remarkable to look back on these accomplishments, and I would like to acknowledge all the hard-working people at Blackline that have made them possible.

As impressive as these accomplishments are, Blackline will not rest on its laurels as we seek to transform industrial workplaces through connected worker technologies. 2022 will see the launch of G6 to the compliance focused market, opening Blackline's connected offering to hundreds of thousands more industrial workers. This monitor will be the first connected product designed specifically for this space. We see G6 as a true disruptor to the unconnected legacy products that currently dominant this market.

In 2023, we will introduce our new flagship product, the G8, which will provide enhanced data and monitoring capabilities particularly for site supervisor and remote service personnel. The G8 will enable workflow management software to help coordinate the work done by distributed field technicians while enhancing workplace safety for world-class enterprise industrial operators. In addition, G8 will drive a suite of services expanding Blackline's offering to our customers in markets ranging from industrial maintenance to high value construction to service technicians and utilities markets globally. G8 will focus on market industrial—making industrial workforces more productive while saving money and keeping work on schedule for customers.

2023 will also see us launch our first product under the WTL brand, the G5. This will allow us to begin to realize returns on the investments here as we enter the global construction, rail, ports and light industrial markets. The G5 will ship with customer access to predefined productivity enhancing reports and upsell access to additional services that provide money saving insights to customers taking it beyond the pure safety value proposition.

In addition to the significant investments we've made throughout 2021 in our product development team and its road map, we have grown our sales and marketing team globally and our infrastructure to support our growth and our customers. Our **Invest to Grow** approach has now begun to pay significant dividends and we see the opportunity to leverage the investments we've made across the business as we accelerate our growth trajectory through 2022 and into 2023 towards the next phase of Blackline as a leading provider of connected worker safety solutions.

Thank you to everyone for your attention today and your support for Blackline Safety. I'll leave it there and we'll turn the call over to the Operator and open it up for questions.

Operator:
Thank you. We will now begin the question-and-answer session.

Our first question comes from Amr Ezzat with Echelon Partners. Please go ahead.

Amr Ezzat:
Good morning. Thanks for taking my questions, and very impressive growth. Probably very hard to quantify, but maybe you could take a shot at it. Can you give us a sense of how much of the product growth is due to pent-up demand from previous quarters? You guys mentioned that some growth is due to your ability to regain access to customer sites and obviously the procurement processes recommencing for clients. Just hoping to get a sense of what you guys would deem as one-off sales related to previous quarters.

Cody Slater:
Really if we're talking about the Q4 sales pipeline, I'd say everything within the pipeline there was something that we've been working towards building on over the past period of time. Certainly the access to customer sites in Europe and in the United States started more like—a number of months ago, so that's what's been helping drive that velocity. Plus, also just the entry into new market spaces. You saw that with the water/wastewater in Europe, where having one, the first business in that space, it becomes easier and easier to win more within that and I think we're going to see the same in utilities within the North American market.

Amr Ezzat:

Okay. There's obvious seasonality in your numbers with Q4 usually being a very strong quarter. My sense from your answer is you feel that you could sort of deliver on a strong Q4 like that again and exceed it. Is that a fair statement?

Cody Slater:
Certainly, in Q4, I mean, to your point, seasonality is definitely part of our business. Q1 is always the weakest quarter for the year. It winds up being—with our October year-end, Q1 winds up being during the holiday Christmas period, etc. But as we look forward to the growth during this year, without a single doubt, our Q4 will distinctly outstrip the Q4 we just posted.

Amr Ezzat:
That's great to hear. Okay, maybe one for Shane. On your gross margins for the products, it's actually improved from the last few quarters despite the tapering off of CEWS and the supply chain issues that you spoke to. I'm just wondering how should we think about your gross margins on the product side for the new fiscal year. We're seeing inflation in input costs. Are you guys able to pass that on to customers?

Shane Grennan:
Thanks, Amr. Yes, we concluded our product margin at that 30% range for Q4 2021. As we look forward to Fiscal 2022, we see that level being maintained through that period, noting that there is an inflationary pressures through the period. But that would be reasonable through the period.

Amr Ezzat:
Okay. Maybe you could speak like in broad terms on your manufacturing capacity. You had that PR recently. Then Shane, you spoke to your new SMT and increased capacity. How do we think about your maximum manufacturing capacity? Can you maybe give us utilization rates and what that sort of translates into potential sales?

Cody Slater:
Really it's—it's Cody here, Amr. The manufacturing capacity—our intent is to ensure that the manufacturing capacity here obviously meets our demand. We're looking to be able to produce more than double what we produced in volume in Q4 as we go through this year as far as a capacity level. The investments in the Surface Mount is sort of the core to that because we build all of our own board level products here but it's also investments in quality, particularly as we hit volume products,

like the G6. So, it really varies a lot on the mix of the kind of product we have, whether it's EXO, which is a bit more labour intensive but a higher dollar volume product, G7's range depending on what the sensor mix within them. The G6 will be a very light manufacturing impact. In other words, a higher volume product, lower overall manufacturing timelines per device.

So, we're comfortable with where we're at right now with the manufacturing level. We also have capacity to add chips here as well too. So we really don't see that as a constraint to growth. It's one that our teams are working very hard to make sure it's not a constraint on our growth.

Amr Ezzat:
Fantastic. Congrats again. I'll pass the line.

Cody Slater:
Thanks very much.

Operator:
Our next question comes from Doug Taylor of Canaccord. Please go ahead.

Doug Taylor:
Yes, thanks, good morning and congrats on a nice close to the fiscal year. A couple of exciting new product line extensions that you've mentioned here I'd like to ask some questions about. First, the G6. You're very specific now with your timetable for launch there. So I wonder if you'd just talk about what the remaining hurdles are development-wise, regulatory or anything like that are to complete there to get that product ready for launch so we can get some additional confidence that that type of table is going to remain static.

Cody Slater:
Yes. As you point out, Doug, we're talking about a July launch for the product, really. That means volume, July we'll get the product into customers' hands, we'll need a month or two of customers utilizing the product to start seeing the volume demands build. So, it's a Q4 story for us as far as revenue for the year. Challenges, certainly, they're always there in things like approvals. We feel we're well in hand with that. That's often one of the biggest difficulties in our product range, given the intrinsic safety nature of what we're doing, but again on the G6 we feel we have that well in hand. Technology-wise, we're far down the path. The biggest risk realistically on the G6, our supply chain.

It's a volume product. We can't be—we need to be able to have a supply chain that will cover tens of thousands of devices, not thousands or hundreds, in the case of the G7 or the EXOs, and that's something that we feel we have well in hand. But if there's any risks within the whole base, I would say the core risk is supply chain for us, but we think we are managing that well. You will see some inventory build with that as we bring parts in and materials to make sure that the G6 is ready to launch on time.

Doug Taylor:
Okay, and shifting to Wearable Technologies, which is now the G5. Can you spend a little time—it seems to be taking shape here. Can you spend a little time talking—the market for that, the competitive set and perhaps maybe the envisioned business model for those initial products that are going to come out of that acquisition?

Cody Slater:
Yes, sure. If you think—I mean, I like to think about Wearables in the base of think about workers in the kinds of spaces we're talking about, whether it be construction, ports, railroads, good markets for this, they're all wearing a safety vest, this is the device that gets attached into that vest. We've changed the design and structure of the devices we're beginning to get closer to deciding how to commercialize that. A lot of the work we're doing right now is getting in and understanding, qualifying the market space, ensuring we're delivering the right product when we bring that out in 2023. It's really more of a productivity and workforce maintenance kind of product than it is a safety product. It's definitely got the core safety element but if you think about the majority of the applications it's really going to be around the data and the software that drive the device and bring those value-adds to the customer base. Construction sites are looking to be more efficient and effective. Same with railroads, ports, all those kinds of places. You're talking about large volume applications. Business model very similar to everything we're talking about.

From a technology standpoint, it's really—aside from the form pack, you're talking about technology very similar to the G6 but not including the gas detection as a standard from the context of the business model. Again, pretty similar base. It's a service and really primarily a service driven product. The hardware will just be sold as part of that service plan into that space. Again, so, higher volume, even than in the G6 market, but a new market space. One thing I'd qualify in the whole base with G5 compared to G6. G6 we're replacing a legacy market, the legacy products that's almost 20 years old that we believe we will be a true disruptor in an already established market. In the G5 this will be new value to the kinds of customers you're going into. So although we see a good, strong introduction in 2023, I think you have to look at a different kind of a ramp-up based on the fact that it's a new product in that market space, so no direct competition realistically.

Doug Taylor:
Do you expect for G5 the current $1.5 million per quarter investment in bringing that product to market to be sufficient or a good level to model through 2022 until you get to that point?

Cody Slater:
Yes, I think it'll shift—if anything, there'll be some—it won't be increasing from that, Doug, I would say. We're going to—we're primarily focusing on the development side with some of the—now with the alignment better, as we've begun the integration with the alignment between the companies, more of that load is being shared between the businesses. So, I would see it being pretty similar to what it is now until such time as 2023 when the product pops out.

Doug Taylor:
Okay. Now one last question, more of a clarification for me. The $7.8 million large transaction you announced in November, I wonder if you'll just remind us to what degree some of that was recognized in Q4 or is going to be recognized in the upcoming quarters, that'd be helpful. Thank you.

Shane Grennan:
Hi Doug. The majority of the product was realized during the quarter and the associated service revenues will be realized over the term of the contract.

Doug Taylor:
So for deals that have been announced since quarter end, it's the $4.3 million that you'd recently announced that is still product revenue which is still to be recognized outside of your regular cadence of new customer signings. Is that correct?

Shane Grennan:
Yes, that $4.3 million isn't relating to Fiscal 2021, Doug.

Doug Taylor:

Right.

Cody Slater:

And again, it's a hardware and service.

Doug Taylor:

Okay. Yes.

Cody Slater:

Depending on the particular deal, the hardware can be 20% to 30% of the order. In the case of the one from Q4, it was a very heavily serviced weighted order, so you'll see a lot of service come kicking in. One thing I'd point out with that too, Doug, is that large deals like that typically we're talking about three to five months before we're fully deployed and that's when the service starts to kick in. So you'll see maybe some—the real bump up in service on that order you'll see in Q2 not in Q1.

Doug Taylor:

Okay, thank you very much. I'll pass the line.

Cody Slater:

Thanks very much.

Operator:

Our next question comes from Kris Thompson of PI Financial. Please go ahead.

Kris Thompson:

Great. Thanks guys. Fantastic quarter. Shane, really good disclosure and MD&A. Thank you for that. Just circling back to the G6 product launch, do you guys have a backlog of orders right now? How should we think about the average order size in terms of units? Cody, you mentioned hundreds of thousands of units as an opportunity. What do you think the annual kind of volume opportunity is for you guys?

Cody Slater:

Well, that was out with the—at a one end—without giving forward-looking information as to how many units we think we're going to sell, Kris, but I would say first to start off with the overall, we won't have a backlog of orders at this point in time. We won't start building a backlog until we can get demos and devices in front of customers, which is still a few months away. We don't really want to get into the market until we have a product to market.

So, the G6 market though itself, I'll just make a couple of points on that. It's a very different market than the G7. G6 tends to be large volumes. Most of our customers, if you look at a large facility site, when you're talking about a multi-gas, they may have three or four suppliers in multi-gas, but when you talk about the single gas, what's called the disposable market, they'll only have one supplier. So, the other thing to keep in mind in this market is it's a market that turns over every two years. All those devices get replaced every two years. Typically, for four gas, like a G7, it's four to five years. So, there's a higher frequency of turnover so there's easier access to the market than there is in the four gas market space and they're larger single unit order bases. I'd point out this is a market we know really well. This is a market, BW, my old business really built. We understand the value adds we can bring with the G6, so we see a pretty high uptick at the beginning stages. To put it in perspective, the market on an annual basis is in the range of close to a million devices per year are sold in this space. So, even a reasonable penetration into the market is a pretty big impact for Blackline.

Kris Thompson:
Okay, that's exceptional colour. Thank you. Just circling back again to the contract you've announced. In Fiscal Q4 there's a lot of big ones. In Q1 I think I've seen the one $4.3 million. Can you just remind us on any given quarter the typical amount of your product revenue that would be product refresh from your existing customer base from expansion of headcount, etc., versus new wins, just so we can kind of get a sense of your cadence of press releases and how we should think about are they going to miss or beat Q1 consensus because I know it's tough for us to model the product component of your business.

Cody Slater:
Sure. I'd say first is really if you want to say refresh, it's a very small portion of our business. The G7's only really been out for four years now going on. So, it's at that four-year cycle you start to see a refresh in the product so that's really not a significant base. A lot of our sales structure comes through expansion within the customer, but it's typically not what you're saying—I wouldn't think about this as an expansion of a site adding more personnel. It's a particular customer with multiple sites and we're now taking one site, then the next site, then the next site. That's where sort of our

internal customer growth comes from. So, when we talk about service growth with inside our current customer base, that's really not because they're adding more devices for a particular site or area, it's because we're taking on more sites and more areas from that particular customer.

Q1's always a light cadence—when you're talking about those large major orders, November, December, January, these are not times—in December everybody's away for holidays, January the first thing they're doing is not necessarily buying their connected worker solutions. So, typically, a light quarter. If you look at—I won't say there's—it is a little lumpy. Q4 was definitely heavy weighted in some of the larger orders. You saw that in the cadence in the press releases. But in typical bases those orders should make up 20%, 25%—20%, 30% of the business, shall we say.

Kris Thompson:
The large orders should be 20% to 30%.

Cody Slater:
Something—I mean, again, saying typical is a little hard when you're growing at our rates.

Kris Thompson:
Got it.

Cody Slater:
So you have some, definitely, variability in there. But the base business—one thing that's really been, I would say from my standpoint, has been very, very positive to see, when we had a much smaller sales force we were very dependent on those large orders. Miss one large order and you miss significantly. Now that we've expanded our sales, regional sales managers, expanded our geographic markets, you're starting to see a lot more of that midsized business come in. We don't press release any of that. That's actually some of the nicest business because that growth is the real fuel to get us to where we want to be.

Kris Thompson:
Okay, that's really helpful. I've got lots more but I'll hop back into the queue. Thanks so much.

Cody Slater:
Thanks very much.

Operator:

Our next question comes from David Kwan of TD Securities. Please go ahead.

David Kwan:

Hey guys. Obviously, a very strong quarter from a revenue standpoint. I was curious if you could talk about what the shape of the pipeline looks like right now given the relative flurry of large deals you had announced over the last six months.

Cody Slater:

Sure, David, I'll chat to that. I will say talking to—looking at our pipeline in North America and in Europe—well, I'll touch on three different areas, North America, Europe, and what we call the rest of the world. North America, the pipeline is stronger than it’s ever been and that's I think indicative of the fact that, particularly in the U.S., we were able to get people back in front of customers and start things moving forward again. So, we have—when we look at our full year here, we have a very, very strong pipeline in North America, strong pipeline as well in Europe. Particularly Europe, in the past has been a bit more of a U.K. story, and now it's becoming more of a mainland Europe story and that's really positive. That was part of the reason of putting things like the location in France there to better support that growth in that space.

An interesting one, even though it's very small numbers right now, is the rest of the world though. We put people in there really just pre-COVID and that was pretty difficult—mostly in areas that were exceptionally difficult to actually see sales within. But I'll point to—you'll start seeing some real significant traction in those spaces. We have some excellent people and each of those markets in areas has different hurdles you have to get over between regulatory, between telecommunications and others and it’s taken us a couple of years. But we're really at a point now where I think you can start to see some actual significant growth and contributions from that rest of the world market.

David Kwan:

That's helpful, thanks, Cody. Curious with Omicron, to what extent you might be seeing that impacting your business. Are you seeing sales cycles slowing in certain areas and to what extent that might be impacting your supply chains?

Cody Slater:

Yes, I think there's a series of impacts. It's certainly impacted some of the different markets we're in. Again, some are geographically based. The U.S., not so much. Europe, more so. The rest of the world really mixed. I think that the other side it's impacted, which is something Shane commented on, we're working towards is, is the finance side. Your receivables side can be lengthened out because you've got a lot of companies that are—it's remarkable how many companies you call up and half the people you're normally dealing with they're now out for whatever period of time. That's the same on the supply chain a little as well.

The supply chain is one of those undercurrent kinds of things that people—everybody talks about, but understanding the real scope of it, we have an exceptionally strong team here and we've leveraged our very strong balance sheet to make sure that that doesn't cause us problems that will keep us from getting the product out the door. If you look at Q4, we had all those problems in Q4 on supply chain and we looked through the different particular materials and elements, but the team there rose to the challenge and shipped more hardware and more individual devices and more dollar value by far and away than we ever have and we're able to replenish the materials so that we're able to keep the cadence up going forward.

So, it's one of those things we're all, everybody is always tired of talking about at the end of the day, but I do think, from my view, one of the points we're trying to make in the call today is that Q4 really for us signals that entry into that new normal, where we have an Omicron or other things like that coming up, we do really see that they're not going to be nearly as disruptive as this has been in the past.

David Kwan:
That's great. Last question for me. Maybe a little bit more for Shane. The sales and marketing spend, there's a big jump there. Some of that is, I guess, non-recurring at least from a quarter-to-quarter basis. With NSC I think you had mentioned was about close to $700,000 there. How should we be looking at this expense line going forward?

Shane Grennan:
Thank you, David. As you note, as Q4 did have some one-time items there, we talked about the bad debts and some of those that were impeded by COVID. So, there will be more one-time items. Going forward, the trajectory, normalizing for those items that we highlighted, we'd be looking in the

range—as a proportion of revenues, we were 51% for the fourth quarter. We would see that declining right through the period of Fiscal 2022 into more a 30% mid to low range, David.

David Kwan:
Okay, that's helpful. Thanks, Shane.

Shane Grennan:
No worries.

Operator:
Our next question comes from Bryan Fast of Raymond James. Please go ahead.

Bryan Fast:
Thanks. Good morning guys. I just want to circle back on the large contract win with the U.S. utility announced in November. Is there any parallels you could draw between your success with the U.K. water and wastewater space and what you see in the U.S. utility space?

Cody Slater:

Really, very much so, Bryan. It's Cody here. What I'll point to is each of these markets are very—each of these businesses, industries, markets are unique in how they handle safety, large contracts, all these different types of base. If you look at the water/wastewater, the impact of the first win there was—I'm trying to say, if you think about the first win in the water/wastewater, that would be the one where we'd spent the most time learning the business, understanding how to market to and understanding what their particular value proposition was and everyone after that has been cleaner, easier, lighter to do, because we better understand and are better focused on that business.

Same in the U.S. utility space. It's a very complicated, different kind of business. It's about things like your rate case for what your charges are back into the utility exchange itself. It's about understanding what their real value propositions are between the workforce management sides of our business, the communication sides and the safety sides. I think that first major win in an industry like that just positions our—it's something we learn from very well, it's something we focus the teams on very well, focus the marketing, focus the sales on. We see that—I look at that market as the similar opportunity, larger scale than the water/wastewater. There's more of them. It's a bigger overall market in that space. But over the long term it's certainly a market we intend to be—we believe we can have a similar success to what we've had in the water/wastewater markets in the U.K.

Bryan Fast:
Okay, great. That's good colour. This one's for Shane. How should we think about the cadence of product development costs over the next year?

Shane Grennan:
Thanks, Bryan. So, looking at Q4 as a proportion of overall revenue, we were at that 24% level. I would say through Fiscal 2022, I would probably have that at a higher point at the start of the year for some of the developmental work that we'll be doing on the G6, as Cody outlined, but it would have that tapering through the remainder of the period to a similar or potentially slightly lower number at the end of the fiscal year compared to what we were for Q4 2021.

Bryan Fast:
Okay, that's it for me. Thanks.

Operator:
Our next question comes from John Shao of National Bank Financial. Please go ahead.

John Shao:
Hey guys. Congratulations on a strong quarter. I think in your press release you mentioned the next-generation of Blackline Live. I'm just curious, compared to current generation, what improvements should we expect from a new release.

Cody Slater:
Really, one of the things you'll see with, Brian, now running a research and development group is the sort of more, a more regular cadence of releases both on hardware and on software. In hardware we're looking at now doing a three times per year release of upgrades to things like the G7 and the current product base. When you talk about the software side, Blackline Live's really are what we call our portal, it's the customer access point. It's things like single sign-on. The other feature sets that are built around GDPR and security are part of the initial things you're seeing right now come out on our Blackline Live. The biggest changes you're going to see over term are the ability to manage

more data, particularly other people's data, so that we can actually bring more value at that business efficiency and process end.

So, I wouldn't look at it as a single new element coming out but just as a much more rapid evolution of the Blackline systems.

John Shao:
Okay, thanks. My other question is, I think the article mentioned that the Company's entering into the product rental market. I'm just curious about the market opportunity in that market and also the gross margin relative to other services revenue you have.

Cody Slater:
Sure. Talking about the market opportunity, rental is—we started this off in the North American space, and you can see that it was very—I mean, we had massive growth in this last period of time. Again, I'll point to it as a cyclical business. Our Q4 and our Q2 will be our strongest rental quarters, typically. It's the market we think has a lot of value to it. One, these are typically construction, plant turnarounds, these kinds of things. It gets us onto sites that we haven't been onto before. It gets customers exposed to our product. It's driven primarily right now by the area monitors, but the G7s will come along with that in many of the applications. Margins are, for the rental contracts, are more similar to our service margin than to our hardware margins. You're looking at a very different kind of a business. We're more modeling it here that we'll probably see rental device in field for about 50%, 60% of the year. But at the price points its at, if you look at that over a three-year period life of it, you'll be looking at a similar kind of a margin to what we see on our service. Maybe a little bit lower but not dramatically.

John Shao:
Okay, thanks. My last question is—maybe this is more to Shane. Just trying to understand the 30% gross margin for the hardware this quarter. So, how much of this 30% is actually coming from higher mix towards G7 EXO and how much of it is coming from operating leverage?

Shane Grennan:
It's really a combination of both. I would say, John, the EXO certainly helps. It's a higher margin point than the G7 suite of devices. So, that certainly contributes to that. Also, the large volume that happened in the fourth quarter, is certainly a large contributor to that as well as—really a combination

of the two is really the growth from what was a lower point of 13% back in Q3 to a more stable 30% in the fourth quarter.

John Shao:
Okay, thanks. I'll pass the line.

Cody Slater:
Thanks, John.

Operator:
Our next question comes from Raj Sharma of B. Riley. Please go ahead.

Raj Sharma:
Hi. Good morning guys. Great results. I just have a couple of questions. On the SG&A, I wanted to just kind of understand—it's gone from $6.6 million in the first quarter of the SG&A expenses to now $14 million a quarter. I understand there's a huge increase, a substantial increase in headcount and in other areas there's also an increase in commissions. How do we look at that going forward? I know that Shane, you mentioned that as a percentage it goes below 30s. Is that—as a dollar figure, do you expect to have more headcount increases or are you kind of—should the costs here stabilize? Is the low 30s percent, is that a result of higher increases, increasing sales, or is that a—and your number, your SG&A expense sort of staying flat? Can you give some colour on that and help us model that going forward?

Shane Grennan:
Raj, Shane here. Raj, maybe I'll take that in two parts because I know for our public disclosure we do split the lines into two items. I think where I spoke earlier in relation to the sales and marketing and the couple of ones of that and certainly an increase in revenues through Fiscal 2022, is a factor in that percentage declining through the period. When it came to the question in relation to headcount, as Cody mentioned earlier, we did almost double headcount through the year. There will be additional headcount coming on earlier in the fiscal year but certainly at a lower, a greatly lower pace than we had previously. As a component of revenue, our G&A finished Q4 at a 22% of overall revenue. For our view of going through 2022, earlier in the year, as we bring on more individuals as part of our overall scaling, our operational management focus, that number as a proportion of revenue, noting the cadence of revenue in the earlier part of the year also, maybe at a higher point

than Q4 was, but that normalizing and decreasing through the remainder of Fiscal 2022 for G&A specifically.

Raj Sharma:
Got it. Then, I have a question on—I wanted to understand the recent deal that you just announced of $4.3 million. It seems to have a lot more bridges than we would normally have expected. Is that sort of a one-off type of a situation where you had one-on-one for the number of bridges to the devices? Obviously, it increased—also there's a service component to those bridges. Is that a one-off sort of a project or has something changed about the dynamics of the attach rates for service contracts and for bridges?

Cody Slater:
Sure, Raj. It's Cody here. I'll take that. Just this particular type of market, this is more of what you'd look at as a lone worker market. So, this is a particular customer that has a large number of field service people and in their case it's a one-to-one relationship with their vehicle kind of thing, so it's one bridge, one device. We have other customers like that, a lot in the field services market space. So, it's one of the market applications for the bridge type product, I'd say. To your point, typically with our bridges you see three to four people connected on it, it's sort of smaller teams working around the bridge device. But there are applications out there, particularly in North America that are solely focused one-to-one and that's really where this one is. It helps because as you say a nice order because there's lots of—there's a nice service component with the bridge. But it's not unique in the base, it's just one aspect of that overall market.

Raj Sharma:
Right. Thank you. Then, once the G6 launches in July, so there are a couple of things that are happening here. I sense one is that there were more blended sales of products and now there are outright purchases. is that right? How does the dynamic—did the dynamic change with respect to the change in how it's purchased or it's leased? Also, would that change with the G6?

Cody Slater:
Yes, it's really a bit of a mix. I mean, as Shane mentioned I think before, we offer customers a different, multitude of ways to purchase our product. We've seen a little more pickup in the pure lease-like kind of application, which as you mentioned is—the leases are great, they're a four-year contract, their net retention, good margin, but the impact to cash flow upfront. We've got a purchase

model where customers can purchase the device and the service upfront. The blend is probably—is really not something we can predict exceptionally well. It really depends on the particular customer. Some markets like to pay capital upfront. Some markets like to spread it over a longer period of time. The G6 will be a bit more like the leased kind of product where you're just seeing a monthly rate of revenue for the G6 with the hardware blended into it over a longer period of time, in most cases.

Raj Sharma:
Got it. Thank you again for answering my questions. I'll take this offline. Great results. Thank you.

Cody Slater:
Thanks very much, Raj.

Operator:
Our next question comes from Gabriel Leung of Beacon Securities. Please go ahead.

Gabriel Leung:
Hey, good morning. Thanks for taking my questions. I just have one follow-up for you, Cody. Just focusing on G6 for a second because I think that's going to be an important growth catalyst this year. Based on your early discussions with the prospects, how are you thinking of pricing the G6 relative to the incumbent products out there? I think single gas detector's about $150. I'm just wondering how you're thinking of pricing. Number two, do you expect it'll be less of a missionary sale vis-à-vis the G7 just because of sort of a lower price point expected on the G6, which would—might make it a shorter sales cycle, perhaps?

Cody Slater:
Yes, for sure. I mean, I'll start with the sales cycle. Definitely, with what we're doing on the G6, we're really—again, in my mind we're disrupting a market that's pretty stale and old. I do see the velocity—like there isn't as much missionary work here at all. The G7, you're selling a lot of additional value-adds and services and things like this. It's new. How do I think about that? What does that really mean? With the G6, it's really just a better product. There's obvious value-adds from the second you take a look at it. They're both—from a competitive nature, there's certain things we don't want to get into in too, too much detail, but at the end of the day, one thing I'd keep in mind on the price point is

you're talking about a two year product. You're right, $150, $175, something like that, but it's rotating out every two years.

The G7 is a four-year product. So you're now talking—simply the device itself is—you're competing against is $300 and change. If you look at over that period of time, the G6 is going to be about a $450 product to the customer over the period of time. Call it about a $10 a month number. But there's other aspects in that that are—we've talked about before with the G7, you're saving costs on your compliance costs as far as understanding that people are using the device, if they're bumped, if they're tested you're saving costs actually on deployment of the device, you're saving costs on—in actual fact, the way we designed the G6, you're actually saving costs on the gas you use to bump test it and operate the devices.

So, we believe the value proposition is really clear, customers know it very well. Again the nice thing about it when you talk about cadence is that typically you're more like 1,000, 2,000 devices when you're talking about a G6 order. Also, this is a product that has the opportunity to sell through channels, such as more of the catalog houses, larger safety houses, so we can broaden our distribution very rapidly. You can't do that with a complicated product like a G7, but with a G6 you can. So, you're right, we look at this as a big impact. We'll have it out only for a quarter this year, but the cadence moving into 2023 I think will be exceptionally strong.

Gabriel Leung:
Cody, just to clarify, that $450 product cost over the life, does that include the service line?

Cody Slater:
Yes. If you think about it, $200 for the product, $250 for the service, something like that would be a way to look at it. But really, for most of the customers this one we will be more—yes, we'll offer a variety of ways you can purchase it, but basically you'll be telling people it's $10 a month.

Gabriel Leung:
Got you. That’s helpful feedback. Thank you very much.

Cody Slater:
Thanks very much.

Operator:

This concludes the question-and-answer session. I would like to turn the conference back over to Mr. Slater for any closing remarks.

Cody Slater:

Well, thank you everyone for your questions and for your attention today and participation. We wish you all a good rest of the day.

Operator:

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.