Blackline Safety Corp.
Third Quarter Results
Conference Call Transcript

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Speakers:

Scott Boston
Vice President of Finance

Cody Slater
Chief Executive Officer & Chairman of the Board

Shane Grennan
Chief Financial Officer

Operator:
Welcome to the Blackline Safety Third Quarter Results Conference Call.

As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation there will be an opportunity to ask questions.

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

Scott Boston:
Thank you, Cherise.

Welcome and thank you everyone for joining us. With me today is Cody Slater, CEO and Chair of Blackline Safety Corp., as well as our 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 the call, there will be a discussion of IFRS results, non-GAAP financial measures, non-GAAP ratios, supplementary financial measures. A reconciliation between IFRS 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 hand the call over to Mr. Slater.

Cody Slater:
Thank you, Scott.

Good morning, everyone, and welcome to Blackline Safety's Third Quarter 2022 Conference Call. Today, we will be discussing our fiscal results for the third quarter ended July 31, 2022, which were issued before market opening this morning. To set the agenda for today's call, I will start by providing some high-level remarks, Shane will then discuss key financial highlights of the quarter in greater detail, and I'll conclude by providing our outlook and some closing comments before we take questions.

Our third quarter continued our strong track record of growth with revenue up 46% year-over-year to $18.6 million, representing our 22nd consecutive quarter of year-over-year annual revenue growth. This quarter's performance continued some of the trends we saw last quarter with strong regional results as we continue to garner increased traction throughout our markets. With the U.S. markets up 75%, our Rest of World markets up 64%, Canada's continued return to growth up 68%. As expected, Europe was a laggard with revenue down 6% over the prior year.

Product revenue continues to grow at a rapid pace, up 69% year-over-year to $8.9 million as past investments in our sales and marketing network and capabilities continue to drive market penetration. We are dramatically outpacing our competitors in production innovation and sales growth as we continue to increase our market share. Additionally, product gross margin improved to 17% from the prior quarter of 13% as we successfully mitigated continued component inflation and elevated shipping costs. Without one-time restructuring costs incurred in the quarter, our product gross margin exceeded 25%. The third quarter product margins represent the highest of our current fiscal year and do not reflect any benefit from the pricing increase we are implementing in the fourth quarter.

On the service side, revenue grew 30% year-over-year, and 10% sequentially to $9.7 million, including Software Services growth of 26% as our hardware-enabled software-as-a-service business model continues to deliver growing long-term recurring revenue. The 30% year-over-year service growth is the highest quarterly growth in the last two fiscal years and is consistent with the expectations we laid out on our last call for accelerated growth as several deployments associated with larger orders began implementation. Our hardware-enabled SaaS business model continues to generate strong KPIs with net value retention of 105% on a trailing 12-month basis, and ARR growth of 28% to $32.9 million, and up 7% sequentially from $30.8 million.

Additionally, our service margins have remained very healthy at 70%, unchanged from the prior year, which we consider a noteworthy accomplishment amidst broad-based inflation that is impacting all businesses.

As we have stated before but bears repeating, the majority of our lifetime gross profit for most of our products is derived from our higher-margin recurring service-based revenues and not the initial hardware sale. For example, on the G7 wearable, our line of cloud-enabled wearable safety devices, every dollar of hardware sales generates $4 in lifetime recurring service revenue. This dynamic sees the recurring service revenue deliver approximately 90% of the lifetime gross profit after the initial hardware sale.

I also want to take a moment to highlight multiple noteworthy customer contracts we announced since our last call. The first was a $2 million deal with Severn Trent Water, the second largest water company in the UK. The deal includes over 2,600 G7 devices and associated services with a three-year award and includes an option to extend for an additional five years of service that would bring the total value over $4.2 million. This deal marks the sixth water company we have won business with out of the 12 total that exist in the UK, giving us a commanding market share.

In North America, we continue to see increasing sales velocity with larger enterprise customers, resulting in three energy deals last quarter that have a total value of over $10 million. The largest of these deals has a lifetime value of almost $7 million from a Texas based oil and gas company, which is also a new customer for Blackline, validating our continued market penetration. The other two deals represent new business with existing customers and all include higher margin services, including 24/7 live monitoring by our Safety Operations Centre.

Shifting to the personnel front, I want to briefly highlight yesterday's announcement of the appointment of Jason Cohenour to our Board of Directors. Many of you may be familiar with Jason's impressive track record at Sierra Wireless where he served as president, CEO and director from 2005 to 2018, leading a business turnaround resulting in revenue growth of nearly 800% or over CA$1 billion during his tenure. His executive leadership, background in IoT, mobile communications and semiconductors experience along with his engagements as a board member of other public companies is a welcomed asset to the Blackline board. We look forward to his contributions to the company.

Lastly, I want to take a moment to thank our many existing shareholders who continue their support of Blackline through our recent successful $24.9 million capital raise, which I will discuss further at the end of the call.

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

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

As Cody mentioned, we achieved another quarter of strong year-over-year growth of 46%, yielding revenue of $18.6 million, including product revenue of $8.9 million, which represents a 69% increase from Q3 of last year. The 46% increase was driven by higher sales of our connected safety products, as well as steady growth in recurring service revenues from new hardware sales over the past 12 months, and by customer renewals of service on existing devices.

We realized a material improvement in product gross margin during the quarter, reaching 17%, an improvement from 13% in the second quarter and the prior year's third quarter, as we successfully mitigated cost inflation from shortages of certain components and higher than normal freight charges due to ongoing global supply chain challenges.

As Cody mentioned, product gross margin would have been even higher at 25% when excluding $0.7 million related to a one-time restructuring charge as we reorganized our Wearable Technologies operation.

Overall, service revenue during the quarter was $9.7 million, a 30% increase from the prior year quarter, and up 10% sequentially. As Cody mentioned, the 30% year-over-year increase represents the strongest quarterly growth over the past two fiscal years for our Service segment. Software Services revenue was one of the driving forces, up 26% year-over-year, while rental revenue increased 730% from the prior year to $0.8 million. Newly activated devices contributed growth of $0.5 million in the quarter, and service increases within our existing customer base contributed $0.7 million of the growth. This increase was partially offset by customers who renewed fewer active devices due to workforce reductions of $0.6 million, and only 15,000 from customers who declined to renew this quarter.

Our Service gross margin percentage was unchanged at 70% compared to last year, as Service revenue continued to grow, absorbing more fixed cost of sales.

The overall combined gross margin percentage for Products and Services was 45%, which was an increase from the prior quarter of 3% and a decrease from the same quarter last year of 1%. The decrease in total gross margin percentage from the prior year period is due to sales mix, with our Product revenue comprising 48% of total revenue in the third quarter of 2022, compared to 42% in the third quarter of 2021. I would note that our third quarter margins, while strong, received no benefit to the pricing increases we are implementing in the fourth quarter and would positively impact both hardware and Service margins in Fiscal 2023 and beyond.

We continue to achieve strong growth globally with U.S. revenue growth up 75% from the prior year, and 64% for the Rest of World. Additionally, Canada continued its recent return back to growth with a 68% increase from the prior year, largely as a result of increased demand in the energy market.

In Europe, revenue declined 6% from the prior year as we underwent a realignment of our operations in the region. We expect the previously announced leadership changes in Europe, including the appointment of Sean Stinson, to Chief Growth Officer, and Simon Rich to European Sales Director, along with other recent appointments of additional leaders in the European business will return the region to growth beginning in our fourth quarter of this year.

Product research and development costs were up 72% from the prior year quarter to $7.5 million as we saw additional costs associated with the final push to bring G6 to market. Salaries and wage expense increased $2.6 million compared to the prior year quarter, and we also incurred $0.4 million of incremental costs from the Swift Labs team that we acquired in the second quarter of this year. As the lion’s share of the work associated with launching the G6 moves behind us, we expect product research and development costs to trend lower in the fourth quarter.

Sales and marketing expenses increased 31% from the prior year comparable quarter to $9.7 million. The increase is primarily due to increases in headcount in Customer Care, demand generation and customer acquisition and retention teams to fuel our commercial engine. The increase in salaries and wage expense for the sales and marketing team was $1.3 million during the third quarter compared to the same period in 2021. Additionally, distributor and sales commissions increased $1.1 million from the prior year quarter due to higher product sales overall and an increase in the percentage of sales generated from finance leases through our distribution network.

General and administrative expenses increased 51% from the prior year to $6.2 million. The increase is due to a number of structural changes across the company in the last year, as well as its overall growth. Salaries and wage expense increased $1.4 million during the third quarter of 2022.

It is important to note that while our overall operating expenses increased sequentially to $24.6 million from $21.5 million at the second quarter, $1.3 million of this increase was related to a foreign exchange loss, and $0.7 million was related to one-time restructuring costs. This increase has no impact on our expectation to deliver total operating expenses in the fourth quarter that are at or below our second quarter level.

Our third quarter operating costs still reflected many of the expenses associated with our Invest to Grow strategy to scale our business, costs associated with ramping up ahead of our G6 launch, and one-time severance costs associated with our workforce reduction efforts that occurred during the third quarter.

Now, moving on to capital expenditures, which totaled $0.8 million for the quarter, primarily for property and equipment additions of rental equipment, cartridges, computer hardware, surface mount technology and manufacturing equipment. This is a decrease from the second quarter of $2.9 million, which is reflective of the fact that the majority of the investments required for manufacturing capabilities for the G6 and the scaling up of our rental fleet have occurred.

Inventory totaled $18.6 million at quarter end compared to $17.5 million at the end of the prior quarter, and $12.7 million at the end of our prior fiscal year. Over the last three quarters we have invested almost $6 million in our inventory to mitigate supply chain challenges, with approximately $2 million of the increase being attributable to preparing for the launch of the G6.

Note, we announced on August 8 plans to shift our delivery strategy away from next day fulfillment to 30 days or less, with the majority of orders being fulfilled within 10 business days. Our new fulfillment strategy still delivers best in industry delivery time. We anticipate this strategy, along with the launch of G6 to allow for lower inventory levels going forward, and therefore expect inventory to be a source of cash in the near term.

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 from finance leases with a total of $31.2 million in future contracted cash flows at July 31, 2022, which is up from $23.1 million at the end of April 30, 2022, and up from $16.3 million at the end of our prior fiscal year. These finance leases positively impact our immediate product revenues and service retention over time, but negatively impact the company's cash flows in the near term as the associated cash inflows from leasing take 1.5 to 2 years to catch up to a purchase. We are implementing some additional pricing increases to our leasing model, which we expect to improve overall margins but not significantly change the cash flow implications.

We continue to maintain an unlevered balance sheet with no debt and a working capital position of $15.6 million including cash of $10.5 million. After the end of the quarter, we completed a concurrent bought deal and private placement that raised $24.9 million in gross proceeds. We also signed a term sheet with ATB financial for a new $15 million line of credit. We believe these financial resources coupled with continued revenue growth and near-term cost reductions gives us a solid runway to fund our business through a cashflow positive inflection point.

I'll hand it back to Cody to discuss our outlook and to provide closing remarks. Cody?

Cody Slater:
Thank you, Shane.

As we discussed last quarter, we are streamlining our expense profile as we transition the company to cash flow positive in Fiscal 2023. Our third quarter operating expenses still reflect costs with our Invest to Grow strategy but as we transition to a lower-cost profile nothing has changed regarding our ability to achieve our previously communicated goal of operating costs in the fourth quarter to be at or below second quarter's $21.5 million.

I also want to be clear that while some of these cost reductions have been achieved through a workforce reduction, the majority of the reductions have been from the delayed launch of the G5, and therefore we do not expect there to be any impact on our ability to successfully launch the G6 and continue delivering robust growth and top-notch service for our customers.

In addition to these cost reductions, we also implemented an approximate 15% pricing increase for our hardware and services in the fourth quarter. This represents the first pricing increase on the G7 since its launch five years ago, and the first service pricing increase in five years. Given the market adoption of our advanced technology, global inflation and similar pricing increases from competitors, we are confident that this pricing increase will not impact our competitive positioning and will enable us to earn a more reasonable return for the world-class products and services that we deliver. This pricing increase will provide a step-change in our hardware margins and that will become visible over the next two quarters, while the service pricing increase will have a smoother uplift in margins over the coming quarters as we add new customers and renew existing customers under this new pricing model.

To give you some context for the materiality of this increase, if this pricing were in effect over our 12-month trailing results, hardware revenue would increase from $35.2 million to $40.5 million, and hardware gross margin percentage would increase from 19% to 29%, equating to a $5.3 million improvement in gross margin.

Similarly, a 15% service pricing increase would expand service revenue from $35 million to $40 million, and service gross margins percentage from 69% to 73% with a $5.2 million improvement in gross margin. And of course, these impacts give no benefit to global supply chain relief or continued revenue growth which we have a strong history of delivering on.

On the topic of continued growth, we are very much looking forward to strengthening our growth story with the upcoming launch of the G6, which is the first-of-its-kind connected personal safety device for the $240 million annual zero-maintenance gas detection market. We are launching the product in October and look forward to showcasing the G6 next week at the NSC Safety Congress and Expo in San Diego, which is North America's largest workplace safety event.

Similar to our innovation in the market with our G7 and G7 EXO products, we see a comparable opportunity to capture the zero-maintenance gas detection market that we expect will extend our competitive lead with the most comprehensive, connected safety suite of technologies globally, including our Blackline Live for Cloud based real-time reporting. Our competitive advantage is driven by our software platform that delivers tremendous value and insights for our customers who rely on our technology daily to ensure the wellbeing of their workers.

Demand and interest for the G6 continues to exceed our initial expectations, and given how early we are in the commercialization process, we have great confidence in its revenue-generating capabilities.

The last topic I would like to discuss is our decision to raise nearly $25 million in gross proceeds from a concurrent bought deal financing and private placement, which included insider participation from myself, a board member, our single largest shareholder and many existing shareholders. While we have a plan in place that we believe can achieve a cashflow positive position over the coming quarters within our existing liquidity profile, we are not ignorant to the fact that the world has many uncertainties right now, so we felt this was a prudent risk reduction move to fortify our balance sheet.

We were also able to quickly follow this equity raise with a term sheet from ATB Financial for a $15 million secured operating facility with a potential $5 million accordion feature. This new facility will have improved financial flexibility over our former facility, which we view as a highly successful outcome considering current market conditions.

Collectively, we believe our continued organic revenue growth, accelerated by our pricing increase, operating cost reductions and enhanced balance sheet provide us with a compelling outlook that we are excited to execute against and deliver value for our shareholders.

Thank you to everyone for your attention today and your continued support of 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.

The first question comes from Kris Thompson with PI Financial. Please go ahead.

Kris Thompson:

Perfect. Thanks. Good morning gentlemen.

Cody, just a question on the $2 million UK water deal that you signed with Severn Trent in July. It included a three-year service deal with an option to extend for five years. Just help us understand that agreement with the potential life when I think our understanding is the G7 might have a shelf life of four to five years before potentially its ready to be upgraded to the next version, if you will?

Cody Slater:

Sure, Kris.

The typical build use of the G7 is around a five-year timespan. As you mentioned, with Severn there's an option here to extend service contracts for up to eight years. Typical with all of our customers within that base would be a hardware repurchase somewhere along the line at the point in time when the hardware was reaching its end of life. That's not contemplated within the service structure but would be an additional revenue pickup somewhere down the line in that contract length.

Kris Thompson:

Okay. That's great. That makes sense. Just speaking of the replace cycle, the G7 was launched, call it around the beginning of Fiscal 2019, so you've got 20,000 or 30,000 units that are coming up on three-years plus in the base. Are you starting to get any indication out of your existing customers about intentions to upgrade those devices over the next four quarters or so.

Cody Slater:

We are, actually. Some of the very early adopters of the G7 and G7 EXO, we're seeing—in fact you'll probably see some announcements over the next while of a couple of scaled contracts there where they're purchasing all new hardware and then re-upping, typically for a higher level of service base. So, we think that will be an additional driver of growth over the next year on the hardware side; not so much on the service side, Kris, of course because these are concurrent service customers.

Kris Thompson:

Okay. Just a last one for me, Cody. On the service segment of the business it looking like you're monitoring over 40,000—47,000 devices now, and I believe last quarter it was 49,000. This is the first time I've seen that number actually decline quarter-over-quarter. Can you just give us some colour on what's happening there.

Cody Slater:

Yes. For clarity there, the customer count number you were seeing before was the total number of devices that our SoC team are monitoring. As part of looking at some of our cost reductions here, Kris, we did a deeper dive into that pool to find out if there were any devices in there that were not under contract, not being paid for, so the difference really is the reflection of removing those devices, which enables us to turn their sims off or turn their satellite modules off and reduce that cost base.

Kris Thompson:

Okay. That's very helpful colour.

Cody Slater:

Not reflective of a customer change, just reflective of a better discipline of removing ones that no longer had a service contract associated with them.

Kris Thompson:

Okay. That's helpful. Thanks. I'll hop back into the queue.

Operator:

The next question comes from Doug Taylor with Canaccord Genuity. Please go ahead.

Doug Taylor:

Yes, thank you. Good morning.

I want to touch on the pricing increase. It's been a little over a month since you publicly announced that initiative. Can you speak to how your conversations with your existing customers have gone in reaction to that announcement?

Cody Slater:
I'd say the general reaction is one of total lack of surprise. We're the only company in the gas detection world who hasn't increased their prices over the last couple of years, Doug. You'll start seeing the impact of that in Q4, but the real impact in Q1 as a lot of our Q4 business is already under quote and so we're not changing the quotes of current customers or quotes in the current queue, but all new customers are adopting the new price and all service renewals are starting to now happen at that newer price point. And we've had, as I said, no pushback from the customer base or the distributor RSM networks on that.

Doug Taylor:
Okay. Last quarter you had spoken to a handful of larger deals that had kind of slipped or been delayed in their deployments or implementations. Is any of that still in effect here? Some delays that have slipped into Q4, or have you caught up on all that business now?

Cody Slater:
More caught up. I would say at the end of the quarter that we were caught up, so they wouldn't be fully reflected in the numbers. The largest particular customer we're referring to there continues to deploy. They'll finish their full deployment in Q4. The amount of revenue, if you looked at their not quarterly number from them but their last month number you're getting closer to a full deployment. So a little bit more uptick in Q4 but a good portion of that happened in Q3.

Doug Taylor:
Okay. Last question from me, and I'm not trying to steal thunder from the big G6 launch next week, but maybe you can update us a little bit now that we're this close to launch on I guess what success looks like for you with that product here in the next couple of quarters? What kind of goals and what we can expect to see in terms of metrics reported on that to help us track the success of that product?

Cody Slater:

As an overview, as you know we're launching the G6 at the NSC on Monday. All the marketing material, all the webinars are starting, training is starting. Distribution channels are firing up. You won't really see much of an impact in Q4. We'll start deliveries in October but it will be small numbers in October, towards the end of the month, and with full deliveries starting in Q1.

As to the metrics we'll be providing going forward on that, much like we did with the EXO when we launched the EXO, we'll separate elements of the G6 going forward to give it a bit of an indication as to where the success in that product is. That's sort of the profile we think we'll want to take in the future, is each new product launch for a year, give some better visibility of that as it's going along.

Again, we expect it to be a significant contributor with a much faster ramp up than the G7's initial ramp up, primarily because we are already in the marketplace to a much greater degree. When we launched the G7, and as I've mentioned before with the G6, the market itself has a more rapid turnover rate with a two-year disposable product being the main competitor in there.

Doug Taylor:
Thanks. I'll pass the line.

Operator:
The next question comes from Amr Ezzat with Echelon Partners. Please go ahead.

Amr Ezzat:
Cody, Shane, thanks for taking my questions.

If I could piggyback on Doug's question, outside of North America I believe the price increases are going live tomorrow. Is there any reason where we should expect sort of a different outcome or reaction that what you're currently seeing in North America?

Cody Slater:
No, I would say not at all. The difference in the timing in Europe is distribution agreements that required a larger notice point in time for the shift in the pricing model, but our European team is seeing the same reaction as the North American in that there is generally surprise that we haven't

increased our prices over the last numbers of years and no real pushback on anything that we're talking about there.

Amr Ezzat:

Okay. That's good to hear.

If I switch my attention to operating expenses, excluding the nonrecurring expenses and stock-based comps, you look to be at $21.5 million. Just wondering, in your prepared remarks you're alluding to potentially cuts that would be reflected in the P&L going forward. Can you sort of quantify the magnitudes of these cuts, or are you guys still sticking to the $21.5 million or below?

Shane Grennan:

Hi Amr. It's Shane here. Yes, that is still the level we're looking at in terms of our Q4 operating expenses, reflective of those items that you just mentioned, to be at or below our Q2 level of $21.5 million.

Amr Ezzat:

Okay. I'll ask you again next quarter.

On the write-off you guys had on the wearable division, would we see any spillover into next quarter, or that's largely reflected in Fiscal Q3?

Shane Grennan:

That has been all reflective in Q3, Amr.

Amr Ezzat:

Okay. So when thinking about product gross margin going forward, other than the price increases that you spoke to which we'll start to see in Q1, are there other factors that we should be thinking about? You know, like obviously adjust for that write-off?

Cody Slater:

I wouldn't say anything significant. Amr, product mix is always something that does impact that a little bit. It can impact it positively in the margin if the G7 EXO has a higher percentage number towards it, but the trend we're seeing and that recovery in that margin is something you should see continue as volumes grow as well, too.

Amr Ezzat:
Okay. If you'll allow me one last one, you guys have historically been very debt averse. How should we think or how are you guys thinking about your capital structure going forward? Are there any changes there in light of the new facility?

Cody Slater:
Generally speaking, we still are debt averse. The facility will enable us to better manage some aspects of capital over the next period of time, I would say, but something that we consider to be truly part of the capital mix right now maybe to a greater degree than we have before, Amr.

Amr Ezzat:
Great. Thanks. I'll pass the line.

Operator:
The next question comes from David Kwan with TD Securities. Please go ahead.

David Kwan:
Hi, guys.

Shane, you talked about Europe, expecting there to return to growth in Q4, and obviously the Severn Trent win helps from that perspective, but can you maybe talk about what else you're seeing that gives you this confidence? I think particularly given you've got a pretty tough comp year-over-year in Q4.

Cody Slater:
Sure. It's Cody here, David.

It's really in the midst of the changes that we've done within Europe a lot of it is a different manner of managing our sales pipeline. It gives us a lot more clarity of—a lot better visibility, I would say, of what we're actually going to close within this quarter, next quarter. The strengths in that pipeline and the results to date already give us the confidence to see that we're going to see a good return to growth in Europe in Q4. Severn Trent is a good part of that, but it's a good mix of actual order intake from the whole range of the European—of our European marketplace there where we're seeing strength in nice, midsize to larger orders across the scope there.

David Kwan:
Thanks, Cody.

Maybe just more generally, can you talk about kind of what you're seeing in the pipeline and kind of the general demand environment? Are you seeing sales cycles lengthen, or any signs of slowing due to the macro environment?

Cody Slater:
In one respect we've actually seen sales cycles shorten over this last period of—last six months, shall we say? It shows a trend that's been there over the year. I think that's more about Blackline's presence in the marketplace than it is about the marketplace itself. We're more mature, customers understand us more. A lot of our business is expansion within current customer base which has a higher velocity, and I think we manage—under Sean's leadership there they're managing that whole operation to a greater degree.

We're constantly watching for elements from the macro environment as far as the context of interest rates, etc., but don't currently see those as a headwind right now.

David Kwan:
Great. Two more questions. You talked about, Cody, I guess the G6 response has been better than expected to date. As we get close to that launch next month, are you starting to see a material backlog build ahead of that?

Cody Slater:
We haven't opened the ordering book for that; that happens after the NSC. I don't expect that we'll see a truly large backlog base built up in the first 30, 60 days, shall we call it? We'll wind up with a lot of field trials. We'll line up with a lot of initial interest penetration. I'd look to seeing that number somewhere in Q1, David, to see a better understanding of what the backlog is there.

David Kwan:

Perfect. Last question.

I guess there hasn't been too much discussion on Blackline Vision kind of, say over the last year. I know it's not a big revenue driver, but could you provide maybe an update on what's kind of going on with that business and how that could be helping with the demand generation?

Cody Slater:
Sure. It's actually something—you're right, we haven't talked about it in a while. We somewhat restructured that, some of the technology group that's in that Vision team under Brian, our CTO, and have focused more on commercializing, I would say, the work that was done in that team, the work that is being done in the Vision team. Prior to this last while Vision generally did sort of bespoke work for customers. Now what you're seeing with Vision is actual more saleable platforms for different particular target markets that we're generating.

It continues to be a strong driver for customer acquisition, and I think the way it's positioned now and the team that's there now actually adds strength to that because it's now much more of a product we can sell than a sort of bespoke service.

David Kwan:
Great. Thanks, Cody. Thanks, Shane.

Operator:
The next question comes from Raj Sharma with B. Riley. Please go ahead.

Raj Sharma:
Hi. Good morning. Thank you for taking my questions. I wanted to understand, the sales and marketing and G&A expense, should we assume that once in Q4 you bring them down to $21.5 million that should we see them stabilizing after that? Have you built up the sales team enough to now be able to stabilize the expense levels on the sales and marketing and also on the G&A?

Cody Slater:
I think that's a fair comment to make, yes. The numbers we're talking about there are obviously ones that we want to see improvement over the top of, and where we're sitting right now for the

next period of time given the projections we have, you're not going to see a material shift in that number.

Raj Sharma:
Got it. Thank you. Then just on the working capital flow into cash usage cadence, I know that Q3 was a big cash user. How should we look at that sort of going forward? Are the inventory buildups done? I know the G7 you launch of course next week. There was a build up to that. Should we expect a similar cash burn in Q4/the next several quarters? How does that stabilize?

Shane Grennan:
Hi Raj. It's Shane here.

In the fourth quarter in terms of the cash burn there, you should see a significant change in that number as we implement the items that we spoke about in our press release earlier in relation to our restructuring, and that includes the change in the inventory, management strategy in terms of that. You'll see that reflected in the fourth quarter and moving forward from there.

Raj Sharma:
Got it. I guess related to that, Shane or Cody, is the cash balance that you have pro forma of the raise and now you also have significant liquidity on the line of credit. Should we view that as ample sufficient for the next several quarters?

Cody Slater:
Yes, absolutely.

Raj Sharma:
Great. Then just lastly, was there any outlook on the next quarter or the next few quarters in terms of revenues and margins?

Shane Grennan:
No, Raj. We don't publicly share outlook or forward.

Raj Sharma:

Okay, I got it. I got it. Well, I think great results again. Thank you for taking my questions and I'll take this offline.

Shane Grennan:
Thank you.

Operator:
The next question comes from Bryan Fast with Raymond James. Please go ahead.

Bryan Fast:
Good morning, Cody, Shane.

We saw a step change in rental revenue this quarter. Could you just talk a bit about seasonality of rental and what it will take to see, I guess, further investment in that vertical?

Cody Slater:
Sure. It is a seasonal business to a great degree, but with our growth right now you're not going to—that maybe won't be quite as visible. Q4, we'll see another strong quarter on the rental side. It's really right now primarily focused on the North America market, so you're looking at the plant turnarounds kind of periods of times, for us sort of Q2, Q4. What you're going to see there as far as the investment we've made to date, it's in the hardware and the people and the systems to be able to run the whole rental base. We see that with a good long runway for it as far as continued growth within the current investment.

In the future, we'll be looking at expanding that into Europe and into the Middle East. Those are totally new markets for that rental space that also should see strong opportunity for growth for us.

It's a nice business because it's one—it's a good margin business, the rental side. It introduces us to—it also has some other additional real value in that it introduces us to new customers. It's a very visible portion of the business as you're typically doing major projects with them, construction turnarounds, etc. So we look at it as both an excellent marketing tool but also an excellent revenue and margin generator for the company going forward.

Bryan Fast:

Okay, that's helpful. Does it make sense for the G6 product to be included in the rental program, or is it just, given the short nature of the product?

Cody Slater:
I think the more likely base there would be that we'd be leveraging the rental to sell the G6 to that customer for their operating aspects after the turnaround.

Bryan Fast:
Okay, fair enough.

Then understanding I guess the Rest of World still makes up a smaller portion of revenue, but growth was still up sharply year-over-year, could you just talk about areas where you are seeing success?

Cody Slater:
Certainly. On that RoW portion it's been pretty much across most of the places where we have our RSMs, or we have people sitting on the ground. I think the next really big growth area there you'll see will be the Middle East to a greater degree as we roll out the G6. That's a major market for the zero maintenance is that Middle Eastern marketplace, but we're just starting to gain some significant traction after having been in all those markets for a period of time. Across the board, as you say, a small segment overall for us but one that we see the investment to date really beginning to pay off quite well.

Bryan Fast:
Okay, thanks. That's it for me.

Operator:
The next question comes from Gabriel Leung with Beacon Securities. Please go ahead.

Gabriel Leung:
Good morning. Thanks for taking my questions.

Cody, just one for you. Just curious, based on your own research on G6, with the launch of the product do you have any concerns or should we have any concerns about potential cannibalization of G7, particularly the G7 single gas product, or do you expect it's going to be G6 will have a sort of a different customer profile, the different use case? How should we think about that?

Cody Slater:
Yes. Very clearly it's a totally different market segment, so there's no cannibalization of the G7 with the G6. I'd actually say a little bit of the opposite in the base that if you look at a lot of sites where you might have a couple of thousand zero-maintenance or disposable devices on site and you've got a few hundred multi-gas devices similar to a G7, it's easier to penetrate those sites if you can offer both products than if you can just offer one. So, different market, different use case, and I do think that it will actually help drive adoption of the G7 into some of the spaces.

Gabriel Leung:
Got it. Appreciate that.

Shane, so I have two questions for you. First, just going back to the product gross margins. Obviously there was that writedown in the quarter impacting margins by 8%. Should we think about product margin, the base level at this point being sort of 25% and then the price increases improving it from there?

Shane Grennan:
Yes, I think that mid 20s level is fair, Gabriel. There's obviously ongoing supply chain challenges around the world and our teams are working hard to mitigate those as best we can. There may be times where there's additional freight charges incurred in bringing in particular vital components, but that level of mid 20s is a good baseline to have for product margin.

Gabriel Leung:
Got you. That's helpful. Just one last thing. I know you've guided to sort of operating expenses being sort of in line to below the Q2 $21.5 million level, but looking sort of beyond that, maybe into Fiscal Q1 with the benefit of a full quarter of the restructuring, should we expect operating expenses to maybe show another sequential decline from sort of the anticipated Q4 levels?

Cody Slater:

Q4 has always got some additional significant costs built in within it, things like the National Safety Council show, etc., so I would say there'd be a natural view that there would be a shift downward from Q4 to Q1.

Gabriel Leung:
Got you. That's helpful. Thank you. Appreciate the feedback.

Shane Grennan:
Thank you, Gabriel.

Cody Slater:
Thank you, Gabriel.

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

Cody Slater:
Thank you, Operator.

I would just like to thank everyone today for their questions and their participation, and we'd like to wish you all a good rest of the day. Thank you very much.

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