Blackline Safety Corp.
Second Quarter 2024 Results
Conference Call Transcript

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Speakers:

Elisa Khuong
Vice President, Accounting and Finance, Corporate Controller

Cody Slater
Chief Executive Officer and Chairman of the Board

Shane Grennan
Chief Financial Officer

Sean Stinson
President and Chief Growth Officer

Operator:
Welcome to Blackline Safety's Fiscal Second Quarter Results Conference Call.

The conference is being recorded.

I would now like to turn the conference over to Elisa Khuong, Vice President, Accounting and Finance, Corporate Controller. Please go ahead.

Elisa Khuong:
Welcome, and thank you for joining us.

Today, we will be discussing our fiscal results for the second quarter ended April 30, 2024, which were issued before market opening this morning.

With me today is Cody Slater, CEO and Chair of Blackline Safety Corp.; as well as our CFO, Shane Grennan. I will turn the call over to Cody in just a moment for an overview of our second quarter. Following that, Shane will discuss the financial highlights of the quarter in greater detail. Cody will close with our outlook and some additional commentary before we take questions.

I'd like to remind everyone that an archive of this webcast will be made available on the Investors section of our website.

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 risk and uncertainties. Actual results may differ materially from those set forth in such statements. For a discussion of these risks and uncertainties, please 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.

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

Cody Slater:
Thank you, Elisa.

Good morning, everyone, and welcome to Blackline Safety's second quarter 2024 conference call. Building off the consistent momentum we have seen over the past 18 months, I am pleased to share today Blackline's second fiscal quarter results.

We delivered the highest revenue in the Company's history at $31.6 million, a 31% increase over the same quarter last year, coupled with record gross profit of $18 million, up 44% from the prior year. This quarter marks our 29th consecutive quarter of year-over-year revenue growth, a track record that few companies can match. These results demonstrate the strength of our robust, hardware enabled, software-as-a-service business model and the steadily increasing demand we are seeing in the market for our unique connected safety platform.

We continue to achieve greater scale with our service revenue, growing 30% to a record $16.8 million for the quarter. This enabled us to deliver a 33% year-over-year increase in our ARR, or annual recurring revenue, now reaching $56.5 million. The increase was driven by new customer sales, as well as maintaining our exceptionally strong net dollar retention of 130%. This impressive NDR demonstrates the powerful value customers see in the Blackline platform, our industry-leading hardware and software connected safety solution.

We're seeing our land-and-expand strategy pay off, with an increasing number of customers upgrading their initial deployments with additional hardware and services, many moving to adopt Blackline as their enterprise-wide solution.

Our highest ever service margin of 77% generated $13 million of gross profit compared to $9.6 million in the prior-year quarter. Our hardware segment generated $5.1 million of gross profit, up 76% year-over-year, delivering a margin of 34% in the current quarter, up from 26% in the prior year. This lift in margins stems largely from increased volume as our scale absorbs more fixed costs, and also from manufacturing operational efficiency, alongside our updated pricing strategy. The strong contributions from both hardware and services, we were able to see an increase in our gross margin to 57% from the 52% in the prior-year quarter, delivering a record gross profit of $18 million.

On the expense side, total operating expenses for Q2 were $21.8 million. It's important to note that as a percentage of revenue, each category of expenses decreased year-over-year, demonstrating efficiencies as we scale. The Company's ongoing disciplined cost management, together with our past investments in our sales and marketing and research and development efforts, will continue to drive robust results.

As we look to the remainder of the year, our continued margin expansion and disciplined cost focus and top line growth put us in a strong position to deliver on our goal of achieving Adjusted EBITDA profitability as we exit the fiscal year.

Looking at our cash position, we ended the quarter with total cash and cash equivalents on hand of $13.2 million, with our cash used in operations decreasing 78% year-over-year. With our improving margins, growing ARR, and a major decrease in cash burn, we exited the quarter in a strong financial position.

In 2017, Blackline introduced the industrial world to connected safety, as we brought the G7 connected wearable to market. We integrated our hardware offering with unique, value-added services, including real-time connectivity, push to talk, and 24/7 live monitoring of workers, making Blackline's solution far superior to the existing gas detection products on the market. Today, seven years later, Blackline has achieved its greatest quarterly revenue ever, as customers upgrade their outdated, conventional gas detection fleets to Blackline's industry-leading hardware and software platform.

Looking ahead, we at Blackline remain focused on disciplined execution of our proven business model. With our strong financial foundation, dedicated team, and award-winning solutions, we are well-positioned to capitalize on growing market demand for our connected safety solutions while delivering sustained value to our shareholders.

I will speak to the bought deal financing and concurrent private placement later in the call, but before I do, I will now turn the call over to our CFO Shane Grennan to discuss our fiscal second quarter results and financial position in more detail.

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

As Cody mentioned, we achieved our 29th consecutive quarter of year-over-year revenue growth of 31%, generating total revenue of $31.6 million. This includes $14.8 million in product revenue, which increased 32% year-over-year. The increase in the current year reflects the efforts and past investments in Blackline's global sales team and channel distribution network, as well as continued targeted demand generation and sales development activities.

Product gross profit of $5.1 million improved 76% in the second quarter as a result of the growth in product revenue, which increased our gross margin percentage to 34% from 26% in the prior-year period. Consistent with the prior fiscal year, we expect additional improvements in our product margin through 2024, in line with the Company's traditionally stronger second half of the fiscal year, with the Company benefiting from increased volume of product sales, pricing increases, and manufacturing line efficiency, which will continue to push our product margin higher and unlock incremental margin expansion.

Service revenue during the quarter increased 30% to $16.8 million for the eighth consecutive quarter, with greater than 25% growth in this segment. Software services revenues were a major contributor to the growth, up 28% year-over-year, which also drove ARR growth of 33% to $56.5 million.

Newly activated devices contributed year-over-year growth of $0.5 million in the quarter, and net service increases within our existing customer base contributed $3.2 million. This resulted in a net dollar retention of 130%, as we maintained our highest ever net dollar retention for the second consecutive quarter. Our expansion of active customer devices and the efforts of our client success team to increase the penetration of higher value services such as Blackline Safety operations centre, personnel monitoring, two-way voice, and push to talk all contributed to this impressive peer number.

Our quarterly rental business reached an all-time high, generating revenues of $2.2 million, resulting in 42% year-over-year growth. We expect to continue to see strong growth in remaining fiscal 2024 quarters, with the expanded rental team now covering Europe and the Middle East regions where there is substantial potential for our connected area and wearable devices for three-to-nine-month projects.

Our service gross margin percentage of 77% generated over $13 million of gross profit for the quarter, representing a 34% year-over-year increase. We expect continued margin improvements through fiscal 2024 as we continue our penetration of value-add data and communication services for our customers. Our total gross margin percentage came in at 57%, yielding $18 million of gross profit, our sixth consecutive quarter of 40% year-over-year growth. This growth in total gross margin is due to a combination of higher sales volume and continued discipline across our business.

In terms of our geographical mix, we are pleased with our performance, as each one of our key geographic markets improved from the prior-year comparable period.

Our European market represented our largest growth region, improving 69% from last year's Q2, as our sales team saw success across the industrial safety sector.

Our Canadian market saw strong growth of 34% compared to the prior-year quarter, benefiting from a four-year, $8.5 million deal with a major North American midstream energy infrastructure company.

Our U.S. market also saw strong growth of 20% compared the prior-year quarter, with an upgrade of an additional $1.7 million to our previously announced $2.7 million contract with a major upstream energy company to protect over 800 workers, and a $1.5 million deal with a major U.S. utility provider based in Southern California for 1,000 devices.

Additionally, our rest of world markets were able to see year-over-year increases, with a new deal announced in the quarter valued at $1.4 million with a water and utility provider based in Australia.

Shifting now to operating expenses, our total expenses for the quarter were $21.8 million, which was up $2.6 million or 13% compared to our expenses of $19.2 million in the prior year's comparable quarter. Despite the year-over-year increase, the Company's total expenses as a percentage of revenue decreased from 80% to 69%.

General and administrative expenses remained flat from the prior-year quarter at $6.7 million, where as a percentage of total revenue, decreased to 21% of revenue compared to 28% in the prior year.

Sales and marketing expenses increased 22% from the prior-year quarter to $10.5 million. A major contributor to this increase was sales commissions incurred as a result of the growth in our product sales, and higher distributor commissions, as some of our larger lease contracts were referred through our distribution channel. However, it should be noted that sales and marketing expenses as a percentage of total revenue decreased by 4% from the fourth quarter of fiscal 2023 where we recorded our previous highest total quarterly revenue. In the current quarter, we were able to surpass that revenue achievement by 5% while lowering our sales and marketing expenses.

Product research and development costs remained consistent compared to the prior-year quarter at $5.1 million and decreased as a percentage of total revenue to 16% from 21% in the prior-year period.

Overall, salaries and benefits were lower, as the Company continued to review its team composition and make changes as necessary throughout the past 12 months.

Our development teams remain focused on the next generations of our core products and services as we look forward to the impact these innovations will make as these products and services come to market in the future.

The Company had no significant capital expenditure commitments in the quarter other than the manufacturing of rental equipment and owned modular cartridges used in the G7 connected suite of technologies, which generate service revenue.

Inventory totalled $16.6 million at the quarter-end compared to $17.1 million at the end of the prior year as we effectively managed our supply chain and continuously worked towards improving inventory turns.

At the quarter-end, we had total cash and cash equivalents on hand of $13.2 million. Our net cash used in operations decreased 78% in the second quarter year-over-year, with an 87%

improvement in cash used in operations in the six-month year-over-year comparable period. Improvements in our trade and other receivables collections and growth in deferred revenues from the timing of payment of device service plans ensured that these working capital metrics continued to improve in the current fiscal year.

The Company has over $9.4 million of borrowing base availability on our two-year senior secured operating facility with ATB Financial. This facility, based on the Company's monthly recurring revenue, has a capacity of $25 million, of which the Company had access to $22.3 million at the end of Q2. As our monthly recurring revenue continues to grow, we should have access to the full $25 million by the end of the year.

Our lease program had a total of $46 million in future contracted cash flows at April 30, 2024, up from $39.6 million on October 31, 2023. During the quarter, we submitted our funding request to our lease securitization facility with CWB Maxium for proceeds of $0.5 million which were received post quarter-end. We made repayments of $1.5 million in the second quarter in accordance with our lease repayment schedule. Post quarter-end, the Company announced the renewal of the lease securitization facility with CWB Maxium for an additional year to March 31, 2025.

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

Cody Slater:
Thank you, Shane.

Blackline's strategic plan, led by continued top line growth, healthy margin expansion, and disciplined cost management, is focused on driving sustainable profitability for the Company. The strength and scalability of our business model is evident in our Q2 revenue, as we ended with our highest ever quarterly revenue figure at $31.6 million. Our Blackline platform continued to drive growth in our second fiscal quarter, as we saw annual recurring revenue reach $56.5 million, up 33% compared to the prior-year quarter and 83% growth over the last eight quarters.

In addition, the Company announced several major contracts during and post quarter-end, which, combined with the strength of our business model, will only push Blackline further as we continue to lead the transformation of the gas detection and the low worker industries to a connected future.

Subsequent to the quarter-end, the Company announced a bought deal financing offering and a concurrent private placement for gross proceeds of $34.6 million. These deals successfully closed yesterday morning. The Company intends to use the proceeds to provide a source of funding for our leasing program for those contracts which are not financed through the lease securitization facility; to accelerate the application of artificial intelligence across the corporation's data, providing customers with valuable operational insights; as well as for other general corporate and working capital purposes. The deal represents a strong signal of competence from new and current investors in the Company's successful track record and the strength of our business model.

We are confident that we have the resources required to execute our business strategy through continued growth and disciplined cost management, putting Blackline in a position to generate positive cash flow following the Company's seasonally stronger latter half of the fiscal year.

I am immensely pleased with the success Blackline has attained during the first half of 2024. Our commitment to fostering both top and bottom-line growth remains our priority as we enter the second half of the year. Blackline continues to drive success across all geographies and verticals, a testament to the strong foundation we have established over time. Our focus on cost management and scalability will drive further improvements in our gross profit, reinforcing our trajectory towards exiting fiscal 2024 with positive Adjusted EBITDA, marking Blackline as a Rule of 40 company, the gold standard for a SaaS business.

It is truly an inspiring time for Blackline. I want to thank all our customers around the globe for their loyalty to the Company. Thank you to the entire Blackline team for their commitment to our purpose and for their drive in delivering strong results to ensure that every worker has the confidence to get the job done and return home safe.

Thank you for your attention this morning. I will now turn it over to the Operator for questions.

Operator:
We will now begin the analyst question-and-answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two.

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

Doug Taylor:

Yes. Thank you, and good morning. Let me start with a question about what remains a very strong top line growth profile. The sequential uptick in services revenue this quarter was one of the, if not the most, meaningful on record, which is great to see. I just wanted to drill down on that a bit on the underlying drivers here and what we would attribute to the pricing increases still rolling through; feature uptake, I think you spoke about PTT and other new add-ons; and what might be characterized as rental or more short-term services revenue in nature versus the timing of new hardware activations. If you could shed some light on the drivers there, that'd be helpful.

Cody Slater:

Sure, Doug. It's Cody here. Certainly, as you say, the growth in the service side from Q to Q was excellent. Rentals had a good performance of that, for sure, but you're entering the more seasonally strong rental periods, so we're going to see a little bit of that as it goes forward, so it was one of the major contributors. Really, the rest has been looking at that ARR—sorry, the net dollar retention numbers, and that being driven by a large amount of expansion in our current customer base. We saw that from some of the announcements and some of the awards that were out there. As well, Q2 winds up seeing a lot of the Q1—sorry, the Q4 services start to pile in as well too, so it often takes 60, 90 days before we're really seeing the impact of the larger sales from that Q4 number, so a mix of those things; the Q4 really rolling in, the net dollar retention driving new unit count into the field, and the stronger rental period.

Doug Taylor:

Thanks for that. Let me ask you a question on the EBITDA positivity threshold timing. You're more or less reiterating the objective of exiting this year profitable and as a Rule of 40 company, I think previously you'd said at some point during the second half, so I guess my question is, is there a change at all in the spending priorities against the growth trajectory, particularly now that you've got a more comfortable balance sheet position to invest with against maybe a more receptive growth opportunity in the current market?

Cody Slater:

No, the short answer to the question about changing expense profile is no, Doug. We have no planned changes anywhere across the board. You're going to see pretty flat throughout, though, the standard sort of increases. I think a couple of things we've seen that are a little bit different than maybe at the beginning of the year is a higher velocity of our leases going through our distribution channel, which drives some expense on the commission line, as that's how those are compensated, and we're seeing—I shouldn't say—we're seeing a higher than normal or higher than historical average of leases coming through the distribution channel, so I think that's just a element of the maturity of the distribution channel, so that's probably one of the only differences that we're really seeing across the board. So, we're still looking at the same kinds of things, but with the real focus being on that Q4 number. You've seen the EBITDA numbers tighten every quarter. You'll see that again in Q3 and then into Q4 into that positive territory.

Doug Taylor:
Okay, and just to clarify, then, on the leasing, a leased device, I mean, you're taking more of the cost related to that upfront, and therefore, it has a near-term impact on the margin, and then it releases in the quarters and years ahead. Is that the right way to think about an increased mix of that type of adoption?

Cody Slater:
Yes, it's a good way to look at that, Doug. The leases tend to generate a higher level of—they generate a higher margin overall for the Company. If the leases sold through our own channels, then it looks like a standard sale pretty much from the cost profile, but if it's sold through a distribution channel, then the distributor's getting a commission on that lease, so there's an additional cost recorded in our commission structure there.

Doug Taylor:
And upfront, though...

Cody Slater:
Exactly. (Multiple speakers 24:11), I mean, not getting too much paid over time, but it's recorded up front.

Doug Taylor:
Understood. Maybe last question for me, you spoke about some of the new capital you've got being used in part to accelerate an AI development or artificial intelligent tools. Can you maybe talk or shed a little bit more light on how we should expect that to manifest in terms of not the cost

profile, but also, I mean, as a product announcements, we should anticipate to package that kind of functionality, or how else should we expect that to show up?

Sean Stinson:

Yes, Doug, it's Sean Stinson here. AI is something that we've been thinking about for quite some time, so we've been building a foundation to build upon, so through the rest of 2024, we don't expect to incur any expenses related to that. That's really a 2025 plan, so we'll build up the team in 2025. What we're working on now is really strategy, and that way you'll see is later in the year of 2025, you'll see some of the first AI products come to market, and those will be split between real-time analysis and data and then analysis of historical data, and those will be offerings that we can take directly to our customers. There's things that our customers have been asking for, so we have a good idea of what that offering will look like, but you'll see that later in 2025.

Doug Taylor:

Thanks for that, Sean, and congrats to the team, and best wishes to Shane as you move on to your next chapter. I'll pass the line.

Operator:

The next question comes from John Shao with National Bank. Please go ahead.

John Shao:

Hey. Good morning. Thanks for taking my question. Congrats on the strong quarter. My first question is, if I just look at the historical performance in the past, Q2 was a seasonally light pre-summer quarter, but for this one, we actually saw the highest sequential growth, so my question is how should we model Q2 seasonality going forward?

Shane Grennan:

John, this is Shane here. I think you're correct, John. Maybe I would break it into two parts. I think referring maybe to the product side of it as opposed to the services side of it, you're correct that at the first half of the year, our Q1 and our Q2 are seasonally lower than what we achieve in terms of our product revenues compared to quarters three and four. Purely from a modelling and an expectation perspective, that's an assumption or consideration you could carry forward to future years in terms of the product revenue side of things. As Cody mentioned, when it comes to some of our services revenue, there's seasonality with our rental segment and when those rentals take place during the year, and then from a general software services revenue perspective, that's a continued build in terms of the appreciation each quarter will continue, but that does have less—there is seasonality, with some of our Q4, as Cody said, coming on later in Q1 and Q2, but less an element of seasonality for software services compared to the product segment.

John Shao:
Okay. Thanks for the colour. For the second half of the year, sounds like it's going to be strong as usual, so could you just maybe talk about your sales pipeline? At this point, how much visibility do we have right now?

Sean Stinson:
Yes, it's Sean here again. The team globally uses CRM, and I would say that probably upwards of 75% of what we are working on goes into that CRM, and we've got good visibility out. Some of the opportunities that we work on can take up to a year to close for a very large opportunity, so we've got visibility out that far, and our forecasting accuracy continues to improve, so the sales team, their execution continues to increase, and so our accuracy continues to increase, so I'd say I've got—within the quarter, I have very, very good visibility. One quarter out, it's still reasonable, and then past that, we can see opportunities, but maybe it's harder to predict the exact close date on things that are three or four quarters out.

John Shao:
Okay. Okay, got it. How should we think about your production capacity at this point?

Cody Slater:
Sure. It's Cody here, so more including resting capacity is really not a limitation for us at this point in time. We have expanded the facility over this last year. We've expanded the equipment lines there for our surface mount, etc., so if you look forward for the next couple of years of growth, we're pretty comfortable with the production capacity, along with some tweaks to facility size and other things, but nothing that's dramatic during that time.

John Shao:
Last question from me, for the European market, do you think it's fair to say the growth when we saw last year was totally behind?

Sean Stinson:

John, do your mind repeating that question again, please?

John Shao:

Yes. For the European market, do you think it's fair to say the growth headwind we saw from last year was totally behind us?

Sean Stinson:

Yes, I would say so. We didn't feel a headwind in Europe this quarter, and I don't expect one, so in Q2, I don't think we felt one. We don't anticipate one in Q3. Things look good right now, so what we saw in the results was, I guess, a combination of a removal of headwind, but also significantly improved execution ability from the European sales team. That team hasn't grown in headcount over the past two years, but their sales have increased, so we're seeing improved performance on a salesperson headcount basis.

John Shao:

Thanks again for the colour. I'll pass the line.

Operator:

The next question comes from David Kwan with TD Cowen. Please go ahead.

David Kwan:

Hey, guys. Thanks for taking my call. Wondering, on the pipeline, just following up on John's question, you obviously had quite a few larger wins, including the record $8.5 million follow-on. Do you get a sense that the pipeline's maybe been a little bit drained here, or do you still feel confident that there's lots of good-sized opportunities, both kind of the singles and doubles, but also some of these larger ones that you've probably got on the go?

Sean Stinson:

Yes, definitely not drained. Very strong pipeline. What we saw in Q2 was an acceleration from one specific client, which was a significant acceleration, and it had a decent impact, but still a very strong pipeline. I would say it's the strongest in the Company's history. Not only is it strong, but the visibility's improved, and our ability to predict when things close and to manage deals, again, continues to increase quarter-over-quarter, so I'm very confident in the pipeline right now.

David Kwan:

Well, that's helpful. Thanks, Sean, and on the $8.5 million follow-on contract win, how much of that, I guess at least from a hardware perspective, was filled in Q2 and how much is left to be—will get realized in Q3?

Sean Stinson:

Yes, the hardware was fully fulfilled in Q2, but a lot of that contract, obviously, is service revenue, and that'll be fulfilled over the next few years.

David Kwan:

Great. That's helpful, and as it relates to the leasing activity, it sounded like it was elevated again this quarter. I recall, I think it was Q4, where you guys called out, I think it was like $400,000 in the sales commissions to distributors. Can you say how much that was this quarter?

Cody Slater:

Sure. It was a pretty similar profile to the Q4 numbers, actually, at the end of day.

David Kwan:

Okay, perfect.

Cody Slater:

A little bit lighter, but similar kind of percentages overall, and really, that's higher, as mentioned before. I think that's actually—although it changes a bit of the expense profile there, it's actually a positive in it's saying that those distributors' channels—distribution channels are starting to be more active in contributing to larger deals.

David Kwan:

No, that's great to hear, Cody, and then just one last question on the rental revenues, obviously a great quarter there. I know that there were some deals that had slipped from Q1 due to cold weather. How much of a factor were those slipped deals versus just a stronger pickup in demand in Q2?

Sean Stinson:

I would say that the bulk of the growth here was really just the seasonal demand in Q2. Some of the projects that slipped in Q1 haven't actually started yet. It was a further slip than anticipated, and that's completely on the client side. That's not something that we have any influence over. If the rental job is moved because of weather or some other issue, we just have to try to find another client for those assets that we have in the pool. So really, what we see there is Q2 and Q3 are strong quarters for rentals because of the turnaround season.

David Kwan:

That's great. Thanks, guys.

Operator:

The next question comes from Sean Jack with Raymond James. Please go ahead.

Sean Jack:

Hey. Good morning, guys. So just quickly, you spoke in the release how you're seeing more clients that are looking to standardize your product and solutions across their whole business. Just wanted to ask, is there anything left to do from a product or a software capability standpoint to get more companies to upsize on this front?

Sean Stinson:

There are, but the gap, I guess, between our vision and what we are executing continues to narrow, so there are definitely more innovative things that we have to bring to market, but what I find now versus, say, four years ago is we have an excellent offering for enterprise clients on the product side. There's always something else. Regionality or regionalized data storage is something that we hear more about now. Private LTE is something we hear more about now, but in terms of the general offering, I think we've got an excellent solution for enterprise clients, so no issues there. We've never not been able to close an enterprise client because of a gap in the offering.

Cody Slater:

I'd just add that what we're sort of seeing there, what we feel we're seeing there is that those enterprise clients that Sean's referring to are—they're better understanding the overall value of the software, the visibility, the workforce of other elements of the whole Blackline platform, and that's where you start to see the shift from a site-based decision on gas detection and safety to an enterprise-based decision, and that's something we're—as we've said, we've mentioned that with a couple of the clients lately where we've seen that happen. We do see that as an accelerated trend going forward.

Sean Jack:
Right. Okay, perfect. Thanks, and then just on the product margin front, can you give us a bit of a sense of what's possible going forward maybe for the basis of the year for margin expansion on that line? I know you guys are working hard on that, and also maybe give some details on what tools you're using to flex that higher?

Cody Slater:
Sure. We're still targeting to see that number move up. It's always impacted a little bit by product mix, because different product lines have different margin profiles, but the underlying growth in that number is really being driven by the scale of the business as we start to—as we fully absorb labour and other elements of the production facility, different efficiencies we've put in place, pricing arrangements with supply channel changes from the development side, so all those elements are contributing to that strong growth in the product margin. Still targeting to get ourselves into the high 30s by the end of the year, and I think we're more confident looking into 2025 to be talking about a 40% gross margin again in that year.

Sean Jack:
Right. Okay, perfect. I'll pass it on.

Operator:
The next question comes from Rogan Ananth with ATB Capital Markets. Please go ahead.

Rogan Ananth:
Hi, guys. Good morning, and thanks for taking my question. I just had a question just on the distributor commissions. You guys mentioned how you guys have seen the elevated number of leases going through those distributor channels, and so based on that, is it fair to say on an absolute dollar basis, that we'll see some of the elevated sales and marketing expense numbers throughout the fiscal year?

Cody Slater:

I mean, not as a dramatic element. It does impact the overall number, but there's lots of moving parts in that whole base, so I wouldn't want to model something that would significantly change the profile there.

Rogan Ananth:

Got it, and just in terms of geography, I know you guys have called out Europe being a strong growth driver for the rest of the fiscal year. Are there any other drivers that you guys see? I know you guys talked about the Middle East, but is that a 2024 second half story, or more into 2025?

Sean Stinson:

Yes, the Middle East opportunities are continuing to progress very well. There's a lot of strength there, but the bulk of the delivery of that will land in 2025. We would expect to potentially close a contract in 2024, but it's a large roll our and would progress into 2025.

Rogan Ananth:

Got it. Perfect. Thanks. I'll pass the line.

Operator:

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

Cody Slater:

Thank you, Operator. I'd just like to thank everyone for their attention this morning and wish you all a good day, and we'll see you again in another quarter. Thank you.

Operator:

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