Deveron Corp.

First Quarter Fiscal 2024 Results Conference Call

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Length: 20 minutes

CORPORATE PARTICIPANTS

Philip Linton
Deveron Corp. — Vice President, Corporate Development

David MacMillan
Deveron Corp. — President & Chief Executive Officer

Akshay Shirodker
Deveron Corp. — Chief Financial Officer

CONFERENCE CALL PARTICIPANTS

Steve Hansen
Raymond James — Analyst

Nick Boychuk
Cormark Securities — Analyst

PRESENTATION

Operator

Good morning, ladies and gentlemen, and welcome to the Deveron Corp. First Quarter Results Conference Call. At this time, all lines are in listen-only mode. Following the presentation, we will conduct a question-and-answer session. If at any time during this call you require immediate assistance, please press star zero for the operator. This call is being recorded on November 22, 2023.

I would now like to turn the conference over to Philip Linton. Please go ahead.

Philip Linton — Vice President, Corporate Development, Deveron Corp.

Thank you, operator. As we conduct this call, various statements that we make about future expectations, plans, and prospects contain forward-looking information. Certain material assumptions were applied in making these conclusions and forecasts; therefore, actual results could differ materially from those contained in our forward-looking information. Additional information about these factors and assumptions are contained in our current quarterly report to shareholders, as well as our most recent annual report, MD&A, and annual information form filed with the Canadian Securities Commission.

Joining us today are Mr. David MacMillan, President and CEO, and Mr. Akshay Shirodker, CFO. I will now turn the call over to David MacMillan for opening comments before we take your questions. David?

David MacMillan — President & Chief Executive Officer, Deveron Corp.

Good morning and thank you, everyone, for joining us this morning on Deveron's fiscal Q1 earnings call.

Before we begin discussing Deveron's results and the Company's outlook for the rest of the fiscal year, I want to detail some of the challenges and opportunities Deveron have experienced in the market. As our field teams execute post harvest, helping our customers make their input decisions for the following year, we are seeing record fertility numbers come through our lab network, which continues to speak to the value of the growing platform. We're processing more than 10,000 samples a day. Deveron's fertility business continued to perform, with its sample volume growing 21% year over year. This is a unique opportunity to capitalize on the operational leverage within the lab assets and adding incremental margin. There continues to be a substantial growth opportunity within our current and trusted customer base, specifically in the US where testing services is fragmented and lacks the technological standardization.

The agriculture industry continues to expand, with farm needs, social, and economic factors driving new users to our data. With respect to carbon, we've been very early to the market, signing some extremely large customers. We've built infrastructure to collect and test and the volume has not met our expectations in the quarter. We believe over time this will be a growing segment of Deveron, but for now allows us to focus on fertility and other ancillary services. Additionally, it allows us to focus on streamlining our US collection network and lab operations to improve profitability. We're looking forward to providing a more specific measurement to this improvement in operating costs as we work through the remainder of the year. Another note on cost management and optimization is our continued integration of our Canadian and US lab network. We are now utilizing technology and process from our Canadian lab network, which we expect will create $900,000 in run rate savings effective December 1, 2023.

Turning to our results, we were able to deliver quarterly revenue of $7.7 million, which was a 7% increase year over year. Gross margins were up at 65%, improving 5%. This was supported by the execution of cost synergies through our acquisition strategy, strong fertility growth, and operational leverage within the lab assets. As our business evolves, we think this positive volume trends in fertility are strong indicators of the underlying value our customers see in our business.

Agriculture is extremely regionally organized industry. Deveron has a unique advantage of first-mile field service that can help accelerate soil testing for our customers. By removing the labour constraint, we are seeing our customers test more and interact within our platform. As we free up some resources and reallocate more focus to fertility testing, we feel confident in our ability to deliver continued and growing value to our customer base.

As we continue into the rest of the fiscal year, we have started to build a foundation of a valuable business that provides incredible, independent, and mission-critical information to the North American farm community. Agriculture soil testing offers significant returns to the users of this information. This value is evidenced in the growing density of testing in conjunction with a growing appetite for more information outside of the historical and base testing parameters of N, P, and K. While our testing services are not limited to fertility, we believe it offers the best place to focus and can help our teams prioritize the expansion of fertility testing with new customers and up-selling current customers into more valuable offerings.

With that, I'd like to hand it over to our CFO, Akshay, to speak more directly to our results. Go ahead.

Akshay Shirodker — Chief Financial Officer, Deveron Corp.

Thank you, David. Hello, everyone, and thanks for taking the time to join us on today's call. As you can see from our results, we continue to grow sales and improve on our margins and I think we have started to work on a few other realization of synergies that will continue to provide improvement in our results over the coming quarters.

In reviewing our results, Deveron was able to achieve growth, despite headwinds in our ancillary carbon business. In fiscal Q1 the Company achieved 7% growth in top-line revenue, up from $7.1 million to $7.7 million year over year. Data collection revenue grew 63% to $1.2 million thanks to growing demand for field services. Data insights revenue increased to $6.5 million from $6.4 million. This slowdown in growth was due to dampened volumes in the carbon business as adoption of carbon programs slowed in the market. Also, we are still seeing some headwinds in our tissue testing programs in Canada, but it does look like volumes have started to rebound, so we are cautiously optimistic here.

This quarter was also highlighted by improvements in gross margin percentage, an improvement in the Company's EBITDA profile. The key driver to this improvement was increased demand for the Company's fertility products, driving improved margin profile. Gross margin percentage increased 5%

year over year to 65% for the quarter while EBITDA margin percentage increased 11% year over year for the similar period. We, as a company, have a very exciting opportunity ahead as we reset focus around fertility and focus more on this up-sell to our current customer. Once we reach scale, testing volume becomes a driver to the bottom line, which is why we are focusing on this in the coming months.

Dave already discussed some of the cost optimization opportunities we have implemented, but over the last two months, in my review of the business, we have identified other opportunities to manage costs, specifically around field services. You can see an increase in quarterly operating expenses as we have onboarded full-time staff to service volume. In the other regions of our service network, there is a more flexible model, leveraging third-party collection staff, which can be tied more directly to revenue. I'll be working with our teams over the coming quarters to assess market demand and manage margin more closely in real time.

With continued focus on prioritization for the team, we can continue to grow while delivering better cost management. We started to realize some synergies across standardization of technology and process across our lab network, but we are just scratching the surface. I'm looking forward to working through our busiest season with our team and pushing a renewed focus on volume as a key operating metric for the Company.

With that brief overview, I'll hand it back over to Dave for closing remarks.

David MacMillan — President & Chief Executive Officer, Deveron Corp.

Thanks, Akshay.

We see a great opportunity to concentrate on our growing fertility business and leverage our vertically-integrated lab and soil collection networks. Historically, our strongest sales numbers come following the harvest in Q2, which should continue to illustrate the value of the network we are in the very early innings of building. Soil is one of the most important data layers in the agriculture industry. The provision of field collection and testing is fragmented and lacks standardization, which we believe gives Deveron a unique position to grow from. With a continued focus and evaluation of the drivers of our business in the quarters ahead, we believe our mission of becoming the world's soil bank creates significant value for our customers.

With that, Phil, let's open the call for questions.

Q & A

Operator

Thank you. Ladies and gentlemen, we will now begin the question-and-answer session. Should you have a question, please press star followed by the one on your touchtone phone. You will hear a three-tone prompt acknowledging your request and your questions will be polled in the order they are received. Should you wish to decline from the polling process, please press star followed by the two. If you are using a speakerphone, please lift the handset before pressing any keys. One moment for your first question.

Your first question comes from Steve Hansen with Raymond James. Please go ahead.

Steve Hansen — Analyst, Raymond James

Good morning, guys. Dave, just on the carbon side, it sounds like it's been soft, as you've described. How flexible is your cost structure on that side as well? It sounds like it's related to the field services you've spoken to, but maybe just describe the magnitude of the headwind and how quickly you think you can adjust to that softness you've described.

David MacMillan — President & Chief Executive Officer, Deveron Corp.

Thanks, Steve. Maybe I'll address a bit of the market and then I think Akshay can also talk a little bit to the flexibility of the cost structure.

So, what we're seeing in carbon, obviously we were one of the first companies, especially in the US, to be out there, working with some of the largest global companies in their sustainability programs and carbon testing. I think what we've started to see come through the pipeline from, one, a science side that's creating some headwinds, is that MRV protocols are not completely standardized yet, so I think large companies are struggling with determining what their SOP should be. And as they firm up those protocol measurements, we're starting to see a differentiation on like how much physical soil is needed to verify those credits. So that's creating a little bit of a headwind from the standpoint of like how much base level. You know, someone was saying, well, we needed 20,000 points previously. I think the science now is suggesting that, with good practices, they can half that number. So I think that's one thing that's creating a bit of a headwind.

I think the other, which is probably more real in terms of, I think, long term, is just grower demand is still struggling a little bit. I think what we're hearing from all our partners is companies are full bore on the importance of sustainability and creating these carbon programs, whether as loyalty rewards for their customers or real ESG offsets within their businesses. The issue is that the grower still doesn't quite know what the direct value is to them. Obviously, there's been a lot of flexibility in how carbon credits have been priced and, depending on the program that growers are participating in, I think there are still some unknowns in what they're signing up for, whether it be 100-year leases and how do you transfer land values.

So I think those are two things that, at the end of the day, are going to get sorted out, and as programs scale it's kind of helpful to us if we can be taking less samples per farm, because it means more customers can participate, and at the end of the day all of those samples can start flowing through our laboratory ecosystem. But that's been a driver on one side. And I think as we start to see government participate a little bit more in standardization and growers having a little bit more visibility into the actual value that they're getting out of participating in these programs, we'll see a ramp up again. But I think those are two things that, just over the next couple quarters, the industry needs to solve and, as they work through it, that's going to help us.

With respect to flexibility of our operating costs, I think this is some of the things that Akshay has been working very deeply with on our side since he started. And Akshay, maybe I'll hand it over to you just to give Steve and everyone a better overview of where you see some of the flexibility moving forward.

Akshay Shirodker — Chief Financial Officer, Deveron Corp.

Yeah. So, with regards to servicing the carbon business in general, you've got a bucket of costs on the lab side and on the field services side, and on the lab side it's extremely flexible. We haven't made any significant capital expenditures to service the business, as we are using existing lab equipment. And the biggest driver for costs, being lab technicians, that can be scaled up or down as the business group. But on the field services side, that's where we have real cost synergies here and, highlighting what we had mentioned before, which we had a full-time collector staff in anticipation of growing volume in the carbon business, we can significantly reduce our overhead and reduce the number of full-time staff that we have to service the carbon business and start switching over to a third-party service contractor seasonal-type model. That's where I think the real flexibility is.

And in terms of timing, at the end of the season we can move away and restructure our costs and that's, you know, the November/December timeframe. So pretty quickly and we have a lot of flexibility in terms of aligning costs with revenue.

Steve Hansen — Analyst, Raymond James

Okay. That's great. That's very helpful. And if you guys are thinking about the margin profile on the lab business or the insights business looks pretty fantastic, but I'm just, I'm trying to get a sense for sort of the balance of the year. You're into your busiest season now. It sounds like that cost challenge will linger into the fourth quarter a little bit on the field services side and then, as we get into next year, it'll improve. Is that the way to think about it, the next calendar year, sorry, that is?

Akshay Shirodker — Chief Financial Officer, Deveron Corp.

Yeah, sorry, if you're talking about this quarter, yes, the costs will linger, you know, two thirds of the remaining quarters, so up until the start of December. And starting January 1st, yes, there will be a reset in terms of how we deliver this revenue across both lab testing and field services.

Operator

Your next question comes from Nick Boychuk with Cormark. Please limit yourself to one question and one follow up. Thank you.

Nick Boychuk — Analyst, Cormark Securities

Thanks. Coming back to the carbon angle, Dave or Akshay, can you guys expand a little bit on how much growth you're expecting from that business into 2024 relative to what you're going to be able to recoup in the fertility side of business?

David MacMillan — President & Chief Executive Officer, Deveron Corp.

Yeah, I think what we've done is, as we've seen volumes be a little light through this quarter, we've gone back to our partners and said, okay, where are you guys at in your selling cycle with respect to these programs heading into next year. And the way it sort of works, as everything in agriculture, which is sometimes seasonally frustrating, is when folks are doing a ton of work in the field, there's not much selling that's happening. So we really have to kind of get through the tail end of the season, so two or three more weeks, before we can kind of sit down with all the groups and say, okay, how are we thinking about demand, given, A, the fact that MRV protocols are sort of constantly changing and, B, the sign-ups that you're forecasting moving ahead. I do think that there is still quite a bit of opportunity in how we've initially, I think, won business in this market and, as we mature as a company, can go forward and negotiate, I think pricing tied to volume discount, and kind of play a more partnership angle where, again, as the business grows, there can be volume reductions. And it will give us more flexibility, I think, in the way we plan for things versus, you know, you can imagine in the very beginning of carbon, where it was quite a wild west, people were rolling out maps of all of the United States and saying, you know, we're going to have credits to sell left, right and center. And although I think everybody believes that will be the case, it's just taking a little bit more time, again, to ramp up and to get, I think, grower sign-ups.

We've been going everywhere we can. We've had teams going as far as Montana, working in the mountains from pasture land to corner Iowa. It's just, I think, everybody needs to reset a little bit with respect to where the network can focus. And we're having those conversations with our partners. So probably by maybe the end of the year I can give you a little bit more, I think, direct expectation on how to think about carbon, but we're still going to have to sit down with our groups and, as Akshay mentioned, kind of go through what next year looks like given the demand being driven by their underlying programs. If that answers your question.

Nick Boychuk — Analyst, Cormark Securities

Yeah. And also just a quick follow up on the balance sheet. Can you kind of comment how comfortable you are with the current cash balance? Just speak to the debt profile and how you're planning on managing that into the back half of the year.

David MacMillan — President & Chief Executive Officer, Deveron Corp.

Sure. Akshay, maybe I can hand that one over to you?

Akshay Shirodker — Chief Financial Officer, Deveron Corp.

Yeah. So we feel very confident that we have enough to operate through this busy season and build up a cash surplus as we exit this season. And with our planned refocus and alignment with revenue, we feel as if we can extend that cash surplus into the coming year, at least midway through calendar year 2024 or covering all of Q4 2024.

David MacMillan — President & Chief Executive Officer, Deveron Corp.

And I think just to add to that, Nick, like obviously, where our balance sheet is, it's a little bit complicated from the standpoint of where debt lives. Like we've got debt living at a secondary entity, which we're the majority shareholder of, and then we have convertible notes at the public company. We feel like we've got great sponsorship with our lending partners, our underlying businesses where the debt sits, and we have covenants outperforming and we're on side with everything. So, from a standpoint of moving into next year, it's really about continuing to optimize costs and realign to an operating model tied to volume.

Over the last three years, we've built a pretty robust entity that's been focused on acquiring over ten companies. We're now doing the hard work of integrating everything in and getting everyone to one metric, which we think is tied to volume. We think being able to communicate that externally is going to help with everybody in how they think about the business and, to Akshay's point, tie margin a lot more closely to revenue profile. And I think over the coming quarters you're going to see a lot more emphasis from us on that cost optimization side. We obviously announced an additional $900,000 in savings from technology process that's real right to the bottom line, which will be effective as of December 1st on a run-rate basis. So there are lots of opportunities here. Again, we feel a little bit sideswiped by what's happened in the macro carbon business, but the bet that we made that this market is going to be really important for us, which we still believe, it's just going to take a couple of quarters to sort out, and moving forward we're pretty excited about the opportunity to focus around fertility and service, again, this very large North American market.

Nick Boychuk — Analyst, Cormark Securities

Thanks.

Operator

Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.