

# EQUITY RESEARCH

August 11, 2022

Earnings Update

## DIALOGUE HEALTH TECHNOLOGIES, INC.

Margins Expand While Sales Cycles Get Stretched

### Our Conclusion

Dialogue posted mixed Q2 results with revenue that was slightly below expectations, but strong gross margin expansion that was boosted somewhat by one-time benefits. While a deeper focus on operational efficiency led to better-than-expected margins, Tictrac contributed less ARR than expected and Tictrac sales cycles in core international markets appear slower than anticipated. Management reiterated the timeline to positive EBITDA and operating cash flow by year-end 2023, as investments are focused on revenue generating and patient facing roles. We retain our Neutral rating as the macro-outlook puts pressure on HR budgets and the move upmarket lengthens sales cycles and slows pipeline conversion. A slight increase to our target multiple to reflect peer performance over the last month offsets the decrease to our estimates, keeping our price target at \$4.00.

### Key Points

**Macroeconomic Uncertainty Limits Growth Upside:** While Dialogue continues to see growth in total members and member service units, we view the uncertain macro environment as a limiting factor to any significant upside to our growth forecast. We expect that HR budgets will see minimal growth in the short to medium term as enterprise customers with exposure to elevated cost inflation look to manage expenses. While management noted it has yet to see a notable trend in budget cuts for health services, there have been isolated discussions with clients around cost savings. Management anticipates longer sales cycles as it moves up-market and targets enterprise customers with longer journey from signing to onboarding.

**Margin Lift A Positive This Quarter & Path To Profitability On Track:** Q2 gross margins of 49.7% were up 730 bps Q/Q. The Tictrac acquisition contributed 40 bps of the expansion, while a retroactive price increase at a legacy Optima client added 80 bps and lower Optima utilization also benefitted margins. While client migration off of the Optima EAP will continue to benefit margins, larger customer migrations are progressing slowly. Overall, CARE remains on track to reach positive EBITDA by year-end 2023 and we are encouraged to see improving margins in the quarter

**Tempering Our Tictrac Expectations:** Tictrac added \$2.5 million of ARR in the quarter, well below the \$4.5 million ARR levels Tictrac was doing at the end of 2021. The decline was due to a large insurance customer moving from a white labeled version of the product to an API. Management does not consider the ARR to be permanently lost, but will recognize the ARR as the customer rolls out the API by region. International sales cycles are longer than expected. Thus we adjusted our 2023 Wellness forecast from \$20 million to \$10 million. Management's initial ARR expectations of \$13 million by 2022 and ~\$27 million by 2023 seem out of reach, and we see it as unlikely that the business will meet the ARR threshold of GBP 9 million required for the \$32 million earnout by March 31, 2023. Dialogue is seeing some traction with its initial Wellness efforts in the Canadian market and is hopeful that the Canadian strength can offset international weakness.

*All figures in Canadian dollars unless otherwise stated.*

Please see "Price Target Calculation and Key Risks to Price Target" information on page 4. For required regulatory disclosures please refer to "Important Disclosures" beginning on page 5.

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Neutral

CARE-TSX, Sector: Information Technology

Current Price (8/11/22): C\$3.71

Price Target (12-18 mos.): C\$4.00

### CIBC Estimates and Valuation

(Dec. 31)	2020	2021	2022	2023
Revenue(mln)	35.80A	68.05A	97.46E	137.47E
Prior			102.55E	148.87E
Adj. EBITDA(mln)	(16.9)A	(21.3)A	(19.7)E	(3.1)E
Prior			(19.2)E	(2.4)E

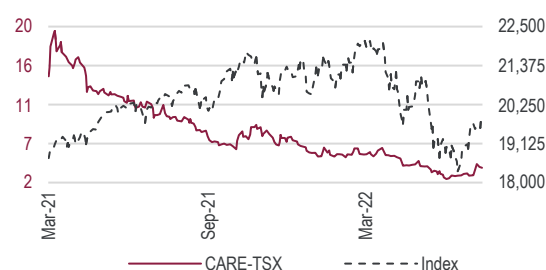
Revenue(mln)	Q1	Q2	Q3	Q4
2023	30.46E	33.18E	35.77E	38.05E
Prior	33.15E	35.81E	38.64E	41.26E
2022	20.69A	23.04A	25.56E	28.18E
Prior		24.24E	26.92E	30.71E

Valuation	2020	2021	2022	2023
EV/Sales	4.2x	2.2x	1.5x	1.1x

### Stock Performance and Key Indicators

Avg. Dly. Vol.:	48K	Shares O/S:	65.9M
Market Cap.:	C\$245M	Float:	36.2M
52-wk Range:	C\$2.41 - C\$10.01	Div. / Yield:	C\$0.00/0.00%

### TSX Composite Index vs. CARE-TSX



(Source: FactSet)

## Dialogue Health Technologies, Inc. (CARE-TSX) — Neutral

Price (8/11/22) C\$3.71 12-18 mo. Price Target C\$4.00

Sector: Information Technology

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Key Financial Metrics	2020	2021	2022E	2023E
Sales Growth	254.9%	90.1%	43.2%	41.0%
Per Share Data	2020	2021	2022E	2023E
EPS	(1.87)	(4.48)	(0.40)	(0.15)
Diluted EPS	(1.87)	(4.48)	(0.40)	(0.15)
Wgt Avg # of Shares	11,157.1	56,109.0	66,032.6	66,858.9
FD Number of Shares	11,157.1	56,109.0	66,032.6	66,858.9
Income Statement	2020	2021	2022E	2023E
Revenue	36	68	97	137
Cost of Goods Sold	21	39	52	67
Gross Profit	14	29	45	70
Gross Margin %	40.20%	42.33%	46.67%	51.28%
SG&A	30	44	60	66
R&D	5	10	10	12
Tot Operating Exp	35	55	72	80
OpEx (% of Revenue)	98.30%	81.45%	74.24%	58.22%
EBITDA	(18)	(249)	(23)	(6)
EBITDA Margin	(51.67%)	(366.52%)	(23.90%)	(4.14%)
Adj. EBITDA	(17)	(21)	(20)	(3)
Adj EBITDA Margin	(47.3%)	(31.3%)	(20.2%)	(2.3%)
Net Income	(21)	(251)	(27)	(10)
Net Margin	(58.4%)	(369.4%)	(27.3%)	(7.1%)
Cash Flow Statement	2020	2021	2022E	2023E
Net CFO	(19)	(23)	(25)	(6)
Net Cash Flow	17	62	(52)	(16)
Free Cash Flow	(20)	(25)	(27)	(8)
Balance Sheet	2020	2021	2022E	2023E
Cash & ST Investment	42	104	52	36
Total Current Assets	55	-	-	-
Total Assets	66	135	116	109
Tot Curr Liab	11	11	17	19
Total Liabilities	98	15	19	20
Shareholders' Equity	(31)	120	96	89
Tot Liab & SE	66	135	116	109

Source: Company reports and CIBC World Markets Inc.

## Company Profile

Dialogue is a B2B provider of virtual health and wellness solutions. Through its Integrated Health Platform, Dialogue offers a variety of services including primary care & mental health, EAP, OHS and iCBT.

## Investment Thesis

1) Dialogue's Solid Strategy & Operational Execution, 2) Virtual Benefits Becoming A Standard Employee Benefits Offering 3) Acquisition Add Additional Capabilities And Move Into New Geographies

## Price Target (Base Case): C\$4.00

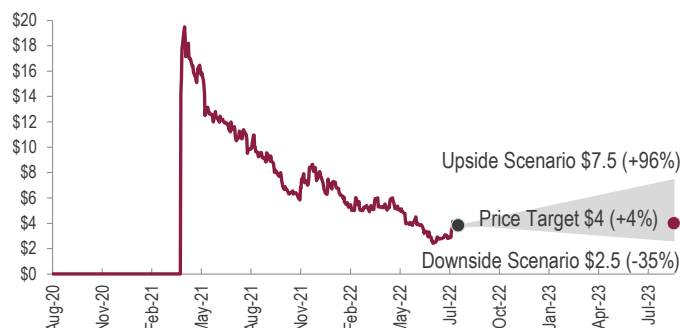
Our price target is calculated using a 1.5x EV/Sales multiple on our 2023 estimates. The target multiple is a one turn discount to B2B providers of virtual care, health and wellness.

## Upside Scenario: C\$7.50

Our upside scenario is calculated using 55% revenue growth in 2023 and a 2.5x EV/2023 Sales multiple.

## Downside Scenario: C\$2.50

Our downside scenario is calculated using 25% revenue growth in 2023 and a 0.5x EV/2023 Sales multiple.



## Financial Summary

**Q2 Results:** Dialogue reported Annual Recurring Revenue (ARR) of \$97.1 million, up 39% Y/Y and up 8% Q/Q. Revenue in the quarter of \$23.0 million was up 38% Y/Y and was a touch below consensus and our estimate (\$23.4 million/\$24.2 million). The adjusted EBITDA loss of \$4.8 million was above the Street and our estimate (-\$5.4 million/-4.8 million). Gross margins in the quarter were 49.7%, better than consensus (44.4%) and our estimate (46.1%).

**Segmented Results:** Primary Care & Mental Health revenue was \$15.0 million, up 46% Y/Y and in line with consensus and our estimate (\$14.7 million/\$15.3 million). EAP revenue of \$6.8 million was slightly above the Street and our estimate (\$6.5 million/\$6.4 million) and OHS revenue of \$1.2 million was slightly below consensus and our forecast (\$2.0/\$2.6 million).

**Reporting For Net Retention Ratio Changed:** CARE is changing its NRR disclosure from quarterly NRR to rolling 12 months (118%). There was some customer churn this quarter (1,500 members) given price increases rolled out in the quarter. However, churn was primarily smaller low-margin customers using a single product. Despite the churn, the quarterly net retention was still above 100% as price increases more than offset the churn.

### Exhibit 1: CARE – Financial Summary – Q2/F22

	Q2-F2022			Q2-F2021	Y/Y%	Q1-F2022	Q/Q%
	Actual	CIBCe	Cons.				
Consolidated							
Revenue (\$MM)	23.0	24.2	23.4	16.7	38%	20.7	11%
Primary Care & Mental Health	15.0	15.3	14.7	10.3	46%	13.8	9%
EAP	6.8	6.4	6.5	5.6	22%	5.8	17%
OHS & Other	1.2	2.6	2.0	0.8	58%	1.1	9%
Adjusted EBITDA	(4.8)	(4.8)	(5.4)	(5.6)	-14%	(5.7)	-15%
EBITDA Margin	-21.0%	-19.9%	-23.1%	-33.9%	-38%	-27.6%	-24%
Gross Margin	49.7%	46.1%	44.4%	41.5%	20%	42.3%	17%
Annual Recurring Revenue (\$MM)	97.1	104.5	NA	70.0	39%	90.3	8%

Source: Company reports, FactSet and CIBC World Markets Inc.

**Changes To Our Model:** We have updated our model to reflect Q2 results and our lowered expectation for Tictrac. The majority of the decline in our forecast is Tictrac-related as the remainder of our model saw minimal adjustments. We continue to forecast breakeven Adjusted EBITDA in Q4/23E.

### Exhibit 2: CARE – Changes To Our Model – 2021 - 2023E

	Revenues (\$MM)	Adj. EBITDA (\$MM)	Gross Margin (%)
<b>2021A</b>	68	-21	42.3%
<b>2022E</b>			
CIBC est. – new	97	-20	46.7%
CIBC est. – prior	103	-19	47.3%
Consensus	100	-19	45.3%
<b>2023E</b>			
CIBC est. – new	137	-3.1	51.3%
CIBC est. – prior	149	-2.4	52.7%
Consensus	142	0.2	50.7%

Source: Company reports, FactSet and CIBC World Markets Inc.

## Price Target Calculation

We derive our price target of \$4 based on 1.5x EV/2023E Sales. Our target multiple is based on a 25% discount to an average of virtual healthcare providers whose business models include B2B sales. We view the discount as reasonable given Dialogue's smaller size and the smaller Canadian market which make up a majority of revenue and growth.

## Key Risks To Price Target

The primary risks to our price target include the following: 1) faster-than-expected margin expansion as a result of operating leverage and price increases, 2) faster-than-expected expansion in attach rates resulting from new services, 3) competitive pressure, leading to compressed PMPM rates, and 4) changes to the regulatory environment, which may impact service delivery.

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None	NA	Sector rating is not applicable.

Note: Broader market averages refer to S&P 500 in the U.S. and S&P/TSX Composite in Canada.

## CIBC World Markets Inc. Price Chart

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