



Magal Security Systems Ltd.
Second Quarter 2021 Earnings Call
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C O R P O R A T E P A R T I C I P A N T S

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C O N F E R E N C E C A L L P A R T I C I P A N T S

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Sal Deturris, *Private Investor*

Fred Ehrman, *Private Investor*

P R E S E N T A T I O N

Operator

Greetings, and welcome to the Senstar Technologies Second Quarter 2021 Earnings Conference Call.

As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Brett Maas with Hayden IR. Thank you. Please go ahead.

Brett Maas

Thank you, Operator. Welcome to Senstar's Second Quarter 2021 Earnings Conference Call. I'd like to welcome all of you to the conference call and thank Senstar Technologies Management for hosting this call.

With us on the call today is Mr. Dror Sharon, CEO of Senstar Technologies, and Tomer Hay, CFO. Dror will summarize key financial and business highlights, followed by Tomer, who will review Senstar's financial results for the second quarter. We'll then open the call for questions-and-answer session.

Before we start, I'd like to point out that this call may contain projections or other forward-looking statements regarding future events or the Company's future performance. These statements are only predictions and Senstar cannot guarantee that they will, in fact, occur. Senstar does not assume any obligation to update any information. Actual events or results may differ materially from those projected, including as a result of changing market trends, reduced demand and the competitive nature of the security systems industry, the unanticipated and unknown effect of the coronavirus, including on our

operations and our clients as well as other risks identified in the documents filed by the Company with Securities and Exchange Commission.

In addition, during the course of the conference call, we will describe certain non-GAAP financial measures, which should be considered in addition to and not in lieu of comparable GAAP financial measures. Please note that in our press release, we have reconciled our non-GAAP financial measures to the most directly comparable GAAP measures in accordance with Reg G requirements. You can also refer to our website at www.senstar.com for the most directly comparable financial measures and related reconciliations.

With that, I'd like to now hand the call over to Dror. Dror, please go ahead.

Dror Sharon

Thank you, Brett. Thank you for joining us today to review Senstar Technologies' second quarter 2021 financial results.

For the sake of clarity, while Senstar Technologies is the name chosen for the Company following the divestiture of its Integrated Solutions division, the Company's legal name remains Magal Security Systems Limited until the name change will be formally approved by the Israeli Company's register, which we expect will take place later this month.

In the second quarter, Senstar delivered 30% revenue growth, along with an improvement of 270 basis points in gross margin and an EBITDA increase of 95% to \$2.5 million. The strength of our financial results in the quarter demonstrate the results of executing well against our growth strategy and the benefit of our strategic decision to divest the project division. We are now singularly focused on developing Senstar's highly scalable business model, having completed the divestiture of the Integrated Solutions division on June 30, 2021.

At the shareholders' meeting on August 15, the Company name of Senstar Technology Limited will be submitted to a shareholders vote, and we are confident that it will pass. Afterwards, we will work with NASDAQ to change the stock symbol. As the Integrated Solutions division was considered a related party of Senstar till June 30, 2021, our reported consolidated revenue exclude Senstar sales to the Integrated Solutions division of \$112,000 or 1% of consolidated revenue. As of the third quarter and on, sales to former Integrated Solutions division will be included in our revenue like any other customer.

In the second quarter, many business activities returned to standard procedures following several quarters of disruption caused by COVID. Borders are reopening, people returning to workplace and offices and the resumption of trade shows are improving the business climate and facilitating Senstar's ability to grow its pipeline. Based on our pipeline and closing ratio, the outlook for Q3 and the remainder of 2021 looks very positive. We hope that the COVID Delta variant will not undermine the positive business atmosphere evidenced in the last quarter.

Senstar gross margin in the second quarter was 69%, on par with last year's second quarter and up nicely from 62% in the prior year quarter. However, the industry has been impacted by various supply chain dynamics, and for the remainder of 2021, some material costs may increase, particularly for semiconductors, but not only. We have long-term procurement agreements in place and are working to secure necessary components and mitigate further price increase. However, supply chain challenges may affect gross margin in the second half of 2021 and potentially the first half of 2022. Anyhow, Senstar's gross margin is expected to be above 60% for the full year.

With the launch of our new Fusion's hardware and software offering in the second half of 2021, we anticipate software sales to increase post-launch and result in raising gross margin over time. We expect that main impact will be evident during 2022.

Senstar EBITDA margin in the second quarter was 25%, an increase of 800 basis points from Q2 2020. One factor contributing to the higher EBITDA margin was the subsidies received from the Canadian government in the quarter. But even without those subsidies, the EBITDA was in the range of 19%, which is better than last year's results.

Looking out into the second half of 2021, we anticipate continued revenue growth with Q4 typically being our strongest quarter. Operating expenses are expected to remain relatively stable for the remainder of the year. Our Public Company expenses and amortization are expected to be stable or lower for the total (phon) entity each quarter, thereby improving our record operating performance by the second half of 2021. We anticipate positive net income through the end of the year.

Now with the divesture being behind us, we are focused on driving growth across each of our key verticals. We're executing our tactical plans to achieve this, including further improvement of our solution along with strengthened sales structure. We have transformed the Company image into—with the Senstar Technology branding, which has deeper connection with technology innovation. This allows us to leverage Senstar's strong industry standing to bring an enhanced technology offering to the market later this year. In addition, we plan to cross-sell and upsell to our existing customer base. Lastly, we intend to continue growing the business pipeline with new distribution channels by leveraging OEMs, system integrators and value-added retailers.

As I stated last quarter, the drivers for growth for 2021 are growing sales in our four key verticals, broadening our sales and sales distribution, leveraging our R&D investment into new sales, making acquisitions to provide technology and expertise. This quarter, we increased revenue from each of our four key verticals, Energy, Corrections, Logistics and Critical Infrastructure. The most significant contribution to this quarter was our multimillion dollar contract with a major Asian airport for an integrated Perimeter Security system.

Our revenue growth is attributable to our product strategy and our technology-rich fees (phon) solutions. This paired with our software offering delivers a high-value solution to thousands of Senstar customers in over hundred countries. Changes made this year to leadership in key regions and the implementation of new KPIs are working as evidenced by the growth in the second quarter. Today, half of our employees are customer-facing. This close relationship with customers is an evidence that improves our ability to land new customers and enhance our ability to upsell to existing customers.

In the second quarter, we enjoyed success with both new and existing customers. Our sales team is growing our pipeline in all regions and is successfully converting new opportunity into booking. In the second quarter, bookings increased year-over-year, laying a strong foundation for future revenue growth. The investment we are making in R&D gives Senstar a competitive advantage in the market, by extending the advantage with the recent launch of Version 8 of our Symphony Common Operating platform.

Symphony 8 is an SMS, a security management system, with functionality beyond a traditional VMS platform. Symphony 8 includes AI analytics, access control, video integration and inputs from our fees products. What sets Senstar Symphony apart from the competition is the Senstar fusion engine. By intelligently combining Senstar data with video analytics, the Senstar fusion engine delivers performance significantly above that of individual devices.

Senstar fusion combines the input from our traditional paid products into solutions that enhance the intelligence gathering for end users. The Senstar product development team is working on a new product to further develop the performance of our current offering. In early 2022, we plan to release a new FiberPatrol, a short-range and optimized solution.

Our product technologies, cross-platform analytics are components that leverage data to improve the analytics of our Symphony 8 Common Operating platform. This improved platform puts us in a solution provider category by combining our SMS capabilities with our first-in-class feed for system integrators and end users. With this strategy, we are targeting new customers, higher contract value and stickier revenue streams.

The divestiture of Magal Integrated Solutions closed on June 30, 2021. Now the transaction is completed, we have a cash of \$50.5 million with no debt. We have funds budgeted for ongoing R&D investments and targeted M&As. Our pristine balance sheet gives us a leeway to pursue our M&A strategy. We are selectively considering opportunities to acquire innovative technology and essential expertise that will support our brand leadership. Senstar has an attractive economic profile that generates free cash flow.

We remain careful in how we allocate our capital. We prioritize our uses of cash for internal investment R&D to drive future growth, target technology acquisitions and returning cash to its Shareholders when there is an excess beyond what is needed for R&D investment. Presently, we are engaged in active discussions for potential acquisition of a company that has sophisticated technology applicable to several key verticals. Ideally, any acquisition we pursue will allow the Company capabilities to increase sales with existing clients and attract new clients. We are negotiating certain elements of this particular transaction and the timing is uncertain, but we are optimistic and highly engaged with this target.

Lastly, in proxy statement that filed on July 16, we are asking shareholders to approve a dividend distribution not to exceed \$40 million with the final amount to be decided by the Company's Board. The vote will take place next week on August 15 at our Annual General Meeting. Afterwards, we will issue a press release with details of any dividend-related decision by the Board.

In closing, I'd like to thank all of our employees worldwide for their commitment and the excellent work. Collectively, we are working to deliver growth, improve our profitability and ultimately deliver shareholder value. I would like also to thank the employees and leadership of the Magal Integration Solutions Division for their hard work during the years and wish them lots of success. I'm sure Magal, Senstar—Magal and Senstar will continue to work together as partners for many years to come.

Lastly, I want to thank my dear friend, Kobi Vinokur, our former CFO, for his excellent contribution to the Company and wish him lots of success in his new role.

Now I will pass the call to Tomer who seamlessly took over the CFO role as a natural replacement for Kobi. Tomer worked closely with Kobi during his tenure with the Company and bring years of excellent experience, especially as Magal, VP Finance for the last 10 years. Tomer, please go ahead and review the financial results.

Tomer Hay

Thank you, Dror.

First, I would like to join Dror in wishing Kobi lots of success in his new role. In more personal note, I would like to thank Kobi for his mentorship, professionalism, friendship and for being there for me whenever I needed.

As Dror mentioned, we are reporting this quarter the results of continuing operations, based primarily on Senstar's standalone revenues and of the corporate entity containing the cost of a public platform. In addition, we show, in a separate line on our P&L, the net results of Magal Integrated Solution operation and divestiture defined as income or loss from discontinued operations.

As a reminder, up until completion of the divestiture, which occurred at June 30, 2021, the Integrated Solutions Division was still a controlled operation and therefore, was considered as a related party. This means that Senstar sales to Magal were eliminated from the top line in this quarter. With the completion of the divestiture, Senstar sales to the Integrated Solutions Division as an unrelated external customer will be included in the reported revenues starting July 1.

Our reported revenues for the second quarter of 2021 was \$10.1 million, an increase of 30.9% compared with reported revenues of \$7.7 million in the second quarter of 2020. The increase was primarily due to increased sales across all geographic regions. The geographic breakdown as a percentage of revenues for the second quarter of 2021 compared to the year ago quarter are as follows: North America, 47% versus 54%; Europe, 22% versus 24%; APAC, 28% versus 19%; and Latin America remains flat at 3%.

Second quarter reported gross margin was 69.8% of revenues versus 67.1% last year. The increase in gross margins was primarily due to increased sales and a shift in sales mix towards high-margin products. Our reported operating expenses were \$4.8 million, a 16.1% increase from the prior year second quarter operating expenses of \$4.2 million. The increase in operating expenses is due primarily to an increase in business and sales expenses such as travel and marketing, offset by the benefit of payroll subsidies granted by the Canadian government.

Our reported operating income for the second quarter was \$2.2 million compared to \$1 million in the year ago period. Our reported income from continuing operations was \$0.7 million in the second quarter of 2021 compared to \$0.5 million in the year ago quarter. The Company's reported EBITDA from continuing operations for the second quarter was \$2.5 million versus \$1.3 million in the second quarter of last year. Financial expenses was \$0.2 million compared to \$0.5 million in the second quarter last year. This is an accounting effect we regularly experience due to the adjustment of our monetary assets and liabilities denominated in currencies other than the functional currency of the operational entities in the Group.

As Dror mentioned, thanks to our operating leverage and with the anticipated ramp-up in quarterly revenues, we expect to report improving operation performance. We also anticipate that we will continue to produce positive net income for continuing operation during the remaining of 2021. Net income attributed to Senstar Technologies' shareholders in the quarter was \$11.8 million or \$0.51 per share versus \$0.2 million or \$0.01 per share in the second quarter of last year.

The reported net income includes \$11.1 million in income from discontinued operations versus a net loss from discontinued operations of \$0.4 million in the same period last year. The net results from discontinued operations included the net loss of the Integrated Solutions Division in the quarter, certain transactional expenses as well as the expected capital gain impact of the divestiture completed on June 30, 2021. Added to Senstar operational contribution is the public platform expenses and amortization of intangible assets from historical acquisitions. For both the second quarter of 2021 and 2020, those expenses were \$0.9 million.

Cash and cash equivalents as of June 30, 2021, were \$15.5 million or \$2.18 per share. As of June 30, 2021, assets attributed to discontinued operations were \$4.8 million, with liabilities attributed to discontinued operations of \$5.3 million as compared to assets attributed to discontinued operations of \$49.6 million and liabilities attributed to discontinued operations of \$25.2 million as of December 31, 2020.

That concludes my remarks. We are happy to take your questions now. Operator?

Operator

Thank you. Our first question is coming from Sam Rebotsky of SER Asset Management. Please go ahead.

Sam Rebotsky

Good morning, Dror or afternoon.

Do we have—of the \$40 million, are we looking at any acquisitions? How close are we to an acquisition? How much of the \$40 million do we expect to give as a dividend and when would this happen?

Dror Sharon

You asked a few. First, as I mentioned, we are negotiating now an acquisition. I don't know yet when it will be—when we'll be able to close it, mainly due to the other party; this is one. We are on top of it, but I don't know yet what will be the date of closing, if it would be closed.

Second, we asked the AGM to vote on distributing up to \$40 million in dividend next—actually, it's going to be next week. Then the Board will take a decision what will be the amount of money that is distributed.

Sam Rebotsky

But what—do we want to submit—distribute a significant amount of cash? Or do we want to hold most of it back and run the Company with the extra cash that we have?

Dror Sharon

We have excess cash above this—again, I don't know yet what will be the amount that the Board will approve. But we have excess cash above the \$40 million. On top of it, Senstar generates cash as well. I don't see any problem of using this cash generation to acquire companies.

Sam Rebotsky

Okay.

Do we have—can you discuss at this time what a range these potential acquisitions are for the use of the cash? I assume we expect to use part of the cash for an acquisition and not stock?

Dror Sharon

Okay. There are things that are—it's under NDA, so I cannot elaborate too much on this opportunity. But usually, we are looking between \$10 million to \$20 million—investments of \$10 million to \$20 million.

Sam Rebotsky

Okay, well good luck. Hopefully something works out and good luck. Thank you.

Dror Sharon

Thank you, Sam. Good to hear you.

Operator

Thank you. Our next question is coming from Sal Deturris, a Private Investor. Please go ahead.

Sal Deturris

Good morning, gentlemen, and congratulations on an outstanding quarter.

I had a question that I asked before and I'm just trying to catch the status of this. On the foreign tax that was withheld on the Magal dividend in December 2020, it was noted that there would be an instruction letter posted on the Magal website to see if one could qualify for an exemption or a lower tax rate. I have not seen anything on that yet. Can you give me a status on that instruction letter?

Dror Sharon

Thanks for the question and for (inaudible) this quarter.

Regarding this, unfortunately, we are stuck in the same position we were at the previous quarter that tax authorities in Israel, working slowly on that because of COVID. We are waiting for some kind of document to support. We are pushing month after month. Hopefully, it will be solved in the upcoming weeks. We are also frustrated from this situation. But again, hopefully, we are pushing. Our consultants are pushing and we hope to get it.

Sal Deturris

Okay. When that comes out, would that be announced in a press release do you think?

Dror Sharon

We will do whatever it takes. Yes, we will make sure everyone will get the message.

Tomer Hay

We can do it a press release, in order to update everyone.

Sal Deturris

Okay, I appreciate that. Thank you very much for your response.

Dror Sharon

Thank you.

Operator

Thank you. Our next question is coming from Fred Ehrman, a Private Investor. Please go ahead.

Fred Ehrman

Good afternoon. Dror and Tomer. Tomer, nice to make your acquaintance.

Tomer Hay

Thank you.

Fred Ehrman

I also want to add my thanks to Kobi, who was just a pleasure to deal with as an investor and wish him the best of luck as well.

My question also has to do a little bit with the previous question. We've been asking for quite a long time to get this tax ruling and I know you've been frustrated as well. Possibly, since there may be another dividend coming shortly, is it possible that maybe the authorities will combine both dividends into one ruling?

Dror Sharon

Look, we will wait first for the decision of the AGM and then the decision of the potential distribution. For sure, if that will happen, we will try to approach by using our consultants again and try to see if we can take it as one and not need to wait a few more months for the second one. But we don't have the answer now. We didn't approach it. We are still waiting for the decision of the AGM and then the Board of Directors. Then we will approach the tax authority for sure.

Fred Ehrman

Okay.

My second question has to do with the potential acquisition you've mentioned and you commented that the ball is in the court of the other side. They're apparently the ones that have been holding up any closing of it. Are the problems potential other buyers that are competing or are the terms more or less agreed upon, at least from your point of view or are there still a lot of open issues?

The Company has been involved in merger discussions over the last few years, some of which have not been completed. Just wondering what the possibilities are for this one closing? I know you can't answer that question because it's not up to you. But could you give us, the shareholders, at least an indication of how it looks?

Dror Sharon

First, as far as we know, there are a few other competitors on this target, but I think we are in a good position basically. The main stop or the main issue over there is they are dealing with some kind of litigation. We want to acquire a clean company. Once it will be resolved, hopefully, we'll be able to close it. But again, things can be changed any day. It's not in our pocket. We'll have to wait. We are doing everything to be able to close it, but now it's not only up to us.

Fred Ehrman

All right. Okay. Again, congratulations on the quarter and good luck in the coming periods.

Tomer Hay

Thank you very much.

Dror Sharon

Thank you very much, Fred.

Operator

Thank you. At this time, I'd like to turn the floor back over to Management for any additional or closing comments.

Dror Sharon

Thank you, Operator. On behalf of the Management of Senstar Technologies and Senstar, I would like to thank you for your continued interest and long-term support of our business. I look forward to updating you next quarter, and have a good day, and keep safe. Thank you very much. Bye-bye.

Operator

Ladies and gentlemen, thank you for your participation. This concludes today's event. You may disconnect your lines at this time, and have a wonderful day.