

FINAL TRANSCRIPT

DATA Group Inc.

Second Quarter Results

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PRESENTATION**Operator**

Good morning. My name is Sarah (phon), and I will be your conference Operator today. At this time, I would like to welcome everyone to the DATA Group Incorporated Second Quarter 2013 Results Call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks, there will be a question-and-answer session. If you would like to ask a question during this time, simply press *, then the number 1 on your telephone keypad. If you would like to withdraw your question, press the # key. Thank you.

Michael Suksi, President and Chief Executive Officer of the DATA Group, you may begin your conference.

Michael Suksi — President and Chief Executive Officer, DATA Group Inc.

Thank you, Sarah, and good morning, everyone. Thanks for joining us to review the DATA Group's financial results for the second quarter of 2013 and the year to date.

Paul O'Shea, our CFO, is with me, and Paul will be discussing DATA Group's performance from a financial results point of view, and I'll be giving some broader comments.

Before we begin, I'll remind you that our remarks and our answers to your questions today may contain forward-looking information. This information, by its nature, is subject to risks and

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uncertainties that may cause actual events or results to differ materially from any conclusion, forecast, or projection contained in our remarks or answers.

Certain material factors or assumptions were applied in drawing the conclusions, forecasts, or projections included in our remarks and answers, and additional information about the applicable risk factors and assumptions are contained in the DATA Group's annual and quarterly continuous disclosure filings available on SEDAR.

Also, please note in today's call all references to the DATA Group will mean its various business divisions and affiliated entities.

The DATA Group continues its profound transformation as we focus on dramatic cost reduction, new revenue growth, and aggressively reducing our debt. I'll give you highlights of those key points.

Cost reduction. Our multiyear transformational cost reduction program that we began in late 2012 is intended to reduce our annual costs by approximately \$28 million by the end of 2015. We're well on our way. We succeeded in reducing our costs by \$12.1 million on an annualized basis in the first half of 2013, and we recorded \$6 million in associated restructuring charges in the first half of the year as a result.

New revenue growth. We have launched a variety of new digital products and services to transform DATA Group into a business process outsourcing provider and to offset declines in our legacy print business, which are occurring because of technological change.

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As a result, we have won several large new outsourcing contracts, and have recorded approximately \$5 million in new revenue from these specific categories in the first half of 2013. We will be launching additional new products and services in the second half of 2013. DATA has a very strong list of blue chip clients to whom we will continue to market these services.

Third point is debt reduction. We expect to accelerate the pace of debt reduction as our cost reduction initiatives gain momentum. In the first half of 2013, we reduced our total debt by \$2.5 million.

Our net loss in the second quarter and year to date is primarily due to the restructuring expenses associated with our successful cost reduction initiatives. The secondary reasons for our net loss are a reduction in revenues in our legacy business, as I mentioned, due to technology, investing in our growth strategy as we continue to invest in new products and services, and we had a smaller deferred income tax recovery in the first half of 2013 than we did in the first half of 2012. All of those negative impacts have been partially offset, of course, by our cost reductions beginning to take effect.

I'll now turn it over to Paul to go over the specific financial results for the second quarter and year to date.

Paul O'Shea — Chief Financial Officer, DATA Group Inc.

Thanks, Michael. Revenues for the quarter ended June 30, 2013, were \$77.8 million, a decrease of \$4.8 million or 5.8 percent compared with the same period in 2012. Revenues for the

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six months were 160.7 million, a decrease of 8.6 million or 5.1 percent compared to the same period in 2012.

Revenues for the three months and six months ended June 30, 2013, decreased from the prior period due to orders which did not repeat in 2013, and to change in product mix. We continued to experience revenue gains from new business, particularly from the start-up of a new contract in the United States, which partly offset declines in revenue from existing customers due to technological changes and competitive activity.

Gross profit for the second quarter of 2013 was \$19.8 million or 25.4 percent of revenues compared to gross profit of 21.1 million or 25 percent of revenues for the same period in 2012. Gross profit for the six months ended June 30, 2013, was \$41.5 million or 25.8 percent of revenue compared to gross profit of 44.3 million or 26.2 percent of revenues for the same period in 2012.

Adjusted EBITDA for the second quarter of 2013 was \$5.8 million or 7.4 percent of revenue compared to adjusted EBITDA of 6.2 million or 7.5 percent of revenues for the same period in 2012. Adjusted EBITDA for the six months ended June 30 2013, was \$13.2 million or 8.2 percent of revenues compared to adjusted EBITDA of 13.9 million or 8.2 percent of revenues in the same period in 2012.

Adjusted EBITDA decreased from the prior year due to the continued investment in our growth strategy, and a decline in revenues, as previously stated, and was partially offset by cost savings realized as a result of our cost saving initiatives.

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We declared total dividends to shareholders during the second quarter of \$1.8 million or \$0.075 cents per share, which represents an annualized rate of \$0.30 per share and reduced our debt by \$500,000, which is consistent with our previously announced plan.

DATA Group declared total dividends to shareholders during the first six months of 2013 of 7.6 million or \$0.325 a share, and reduced our debt by \$2.5 million. All of our dividends and debt repayments during the second quarter of 2013 and the first six months of 2013 were funded from cash generated from our operations.

I'll now turn it back to Michael for some closing remarks.

Michael Suksi

Thanks very much, Paul. Well, let's be clear: we are without question in the midst of a multiyear and profound transformation of our business.

We believe in the longer term this will benefit our valued shareholders, customers, and employees. Our revenue and adjusted EBITDA results year to date, which we are not satisfied with, confirm that this strategic plan is absolutely necessary because we are seeing gradual, but steady declines in our legacy business due to technological change.

Therefore, we will continue to aggressively reduce our cost and our debt while continuing to also drive new revenue growth from new sources, as we invest in new products and services and expand our market share. That's why we have highlighted today the success we are having in these critical areas.

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Cost reduction is moving forward rapidly, debt reduction is happening, and the pace is expected to increase. Revenue from new products and services is growing, and our intent is to accelerate that growth by offering these new capabilities to our enviable list of blue-chip clients with whom we gratefully enjoy strong relationships.

I'd like to thank you for joining us today, and I'll turn it back to Sarah to open it up for any questions.

Q&A

Operator

At this time, I would like to remind everyone in order to ask a question over the phone, please press *, then the number 1 on your telephone keypad. We will pause for just a moment to compile the Q&A roster.

And your first question comes from the line of Stephen Hamer with CIBC. Your line is open.

Stephen Hamer — CIBC

Hi, Michael. Hi, Paul.

Michael Suksi

Hey. Good morning.

Stephen Hamer

How are you today?

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Michael Suksi

Great, thanks. How are you?

Stephen Hamer

Very well, thanks. Can you talk a little bit in a little more detail about some of the growth initiatives you guys are working on?

Michael Suksi

Sure. Anything in particular? Or...

Stephen Hamer

You were talking about the transformation of the business, so I know last year you were talking about the business in Chicago and the telecommunication company in Canada. Those were the two that you highlighted...

Michael Suksi

Yeah.

Stephen Hamer

And it was the more complete offering of the marketing and so on. So I'm just wondering how that is evolving and if you've been able to get more customers for that? And any other initiatives that you guys are working on at the moment?

Michael Suksi

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Sure. So I'll first give sort of a quick synopsis of what we're doing, and I can comment a bit as well on results. We are launching new products and services that are by definition, this is our criteria, they have to have growth inherently in them...

Stephen Hamer

Mm-hmm.

Michael Suksi

So we're looking for things that are naturally growing. That's why we refer to digital and e-solutions. We are also in many cases looking at professional services that support those solutions. The solutions have to be obviously complementary to what we're doing right now and what our legacy businesses have been doing.

So as a result of that we've launched over the last few years really I would say three key specific products or product categories. There's a range of marketing solutions that are all supporting direct marketing. That's where the future of marketing is going away from mass marketing towards specific targeted direct marketing. So as you may know, we did an acquisition of FSA almost two years ago now, which is a direct marketing company. They also have a sister company called Datalytics, which specifically provides data analysis around understanding what motivates consumers to make purchase decisions, and therefore how to inform an effective direct marketing campaign. So we acquired them.

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We launched what we call cross-channel direct marketing, which supports our direct mail legacy business by adding electronic or digital direct marketing solutions, such as e-mail, mobile messaging, webpage building, things of that nature. And we launched professional services, such as creative design and copyrighting to go with those solutions.

We've also launched a separate marketing digital solution, which is a software solution that allows clients to automate and outsource the process of developing a marketing campaign by using our software, and then that of course complements our ability to fulfill the process. So it's essentially a workflow automation document process outsourcing solution for our marketing campaigns.

And then in a different space, Stephen, away from the marketing part of our business and more on the side of the business that supports administrative functions within our clients, we've launched what we call a document process management solution, which is really focused on using technology, software, hardware, and consulting services to automate and outsource document-intensive functions that a client may have.

So for example, a credit application that a client may have where in the past we would have printed the credit app and sent it off to our customer for use and that would have been all we would have done with it; now with this document process management solution we would still do that printing, but we'd also do the mailing, receive the returned product back to us, scan it, archive it, and based on business criteria that our customer would have supplied to us, we could even be

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making decisions for them in terms of who gets approved and who doesn't. So it's an outsourcing of the entire process rather than us simply doing the printing.

Stephen Hamer

Mm-hmm.

Michael Suski

So that's a real quick—am I answering your question? I'm giving you a real...

Stephen Hamer

Yes.

Michael Suski

Of what we've done.

Stephen Hamer

Right.

Michael Suski

Correct me if I'm wrong, but I don't recall you being on one of our calls before?

Stephen Hamer

Well, actually I used to be at another company. I've moved over. So yeah, I was at a call—on one of the calls, I guess, probably about a year and a half or two years ago.

Michael Suski

Okay.

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Stephen Hamer

Yeah.

Michael Suski

So that's what we've done. And then in terms of go forward strategy, I alluded to the fact that we're launching additional new products in the second half of this year.

Stephen Hamer

Mm-hmm.

Michael Suski

So I won't go into detail about that. You'll see announcements coming out in Q3, but it'll be a category that complements what we're already doing in the marketing space.

Stephen Hamer

Mm-hmm.

Michael Suski

And simply augment what we're able to offer our marketing-related clients.

Stephen Hamer

Right.

Michael Suski

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We then took those solutions, that range of solutions, as well as our legacy offering; a very important point that it's a bundling offering of all of our solutions, old and new, and packaged that together under a broad business process outsourcing solution.

Stephen Hamer

Mm-hmm.

Michael Suski

We call that within our company, we refer to it as managed business communications solutions, but the more generic concept is it's a business process outsourcing solution that focuses on documents and related functions. That offering, that broad BPO offering, is what we've begun going to market with in the second half of last year, so it's been roughly a year since we started doing that.

That's where we won that significant new contract that brought us into Chicago that you alluded to, as well as expanded our relationship with that financial institution in Canada.

Stephen Hamer

Right.

Michael Suski

And as a result of that, it has taken some time to launch that and get it up and running because the size was so significant that there was some work to do to get it up and running, but we

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are now up and running. The client is quite satisfied, and we're seeing revenue growth coming from that that's...

Stephen Hamer

Mm-hmm.

Michael Suski

So far this year in the range of I'll say between 3 million and \$5 million so far this year. We expect that to continue to accelerate.

The other new products and services that we've launched are also generating new revenues, not frankly as fast as I'd like to see, but we're on target this year to do, I'll give you a range, between 2 million and 5 million in revenue from those new products that I mentioned so far this year. And we've landed a couple of other smaller managed business communications clients that are starting to generate revenues for us now, including that telecom client that you mentioned, but they're really just getting ramped up about now.

Stephen Hamer

Right.

Michael Suski

Does that answer your question?

Stephen Hamer

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Yeah. So how has the uptake been from current customers and prospects of these new products?

Michael Suski

Well...

Stephen Hamer

Or have you not really gone into—I guess the question I'm asking is, are you—have you fully started to market these new products? And what kind of reception are you getting?

Michael Suski

Apart from the results I just mentioned, if I think about sales pipeline, I think that's what you're getting at?

Stephen Hamer

Sure.

Michael Suski

And how things are coming, the marketing has begun. It has begun within, depending on which product specifically, some as recently as the last six months, and some over the last year and a half, but it has begun. And the feedback from clients has been actually very encouraging. And it's why we're continuing to focus on new product development, and we're launching more because the feedback has been excellent.

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The sales cycles are longer than I'd like, frankly, but we are really pleased with the feedback we're getting. We're getting clients' comments about they believe we're going in the right direction, the solutions are relevant and meaningful to them, and they see value in them, and they're complementary about the thought leadership we're displaying in terms of where our industry needs to evolve, not just to address the issue that we face in terms of technological change, but also from a customer point of view to deliver value to them.

So it's been quite positive. I want to just see that turn into revenue faster.

Stephen Hamer

Yes. I can understand that. One last thing, I noticed the inventories were up slightly. Any particular reason for that?

Michael Suski

Paul?

Paul O'Shea

That would be the implementation of the new contract in the US affecting the revenues.

Stephen Hamer

Okay. Okay.

Paul O'Shea

As we take on inventory to supply the US market, US customer.

Stephen Hamer

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Okay. So that's inventory taken on for a new customer?

Paul O'Shea

Yeah.

Stephen Hamer

Okay. That's great. Thanks very much.

Michael Suski

Thanks for your questions, Stephen.

Stephen Hamer

You're welcome.

Operator

Your next question comes from the line of Vern Cushenbery with Cush Capital. Your line is open.

Vern Cushenbery — Cush Capital

Hi, Paul. Hi, Michael. Thanks for taking my question. I appreciate it. I wanted to ask you a little bit about the legacy business, and if you could parse that out between lost customers and decreased volumes, and maybe comment a little bit on the pace of change? I would expect printing to be a long-term business that's not going to decline to zero, so the rate of decline should begin to flatten at some point. Are you seeing any of that? Or do you have maybe thoughts you could share?

Michael Suski

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Sure. It's a question, Vern, that really does to answer you properly needs to be broken down a little bit. It's—I think it's actually dangerous, in my opinion, to throw general numbers out about rates of decline because it's analogous to buying a car and saying how much does a car cost? Well, are you talking about a Rolls Royce or are you talking about a budget car? So I will break it down a little bit.

The digital part of our business where we do digital printing using the latest digital technology, the colour part of that is growing; the black and white part of that business is in decline. Direct marketing and direct mail is roughly flat. Traditional business forms are more in decline. The commercial pieces, which is the brochure printing and annual report printing, is declining faster. The label part of our business is growing.

So I realize I'm not giving you specific numbers, but I'm just giving you a flavour for the—we have quite a broad mix, and some pieces are growing; some are in decline. If I averaged it all out, the rate of technological impact and decline I would estimate to be 3, 4 percent a year in the traditional part of our business; some parts declining as fast as 7, 8, 9 percent, but others growing, but if I average it out, 3, 4 percent, I would say, per year.

I also think, by the way, quite frankly your comment about eventually it'll flatten out, I don't believe it will. I think we're in a fairly steady decline in the traditional part of the business, and that's why it's critical that we reinvent the offerings that we have because there will be, I think, for the foreseeable future that steady decline happening.

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Vern Cushenbery

Okay. That's helpful. Are you losing clients or transitioning the business away from the, I guess, (unintelligible) and the new growth initiatives?

Michael Suski

Yeah. Our track record—the answer to that is our track record overall over the last two, three, four years is we have lost very few clients. In 2012, we did have two that were, I would say, reasonably significant that we lost, and represent on an annualized business in the neighbourhood of 10 million, 12 million, Paul?

Paul O'Shea

Yeah.

Michael Suski

In total sales. So we have had a hit that is showing up in the first half of this year from some loss, and if that helps you understand our numbers somewhat, there is that baked into our decline this year. But if I was—my comment would be if I was assessing our business from an investor point of view and overall how things have gone, and if you looked at us over the last two or three years, the impact of lost customers would be not very significant at all. The vast majority of the decline is revenue—or sorry, technology-related...

Paul O'Shea

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And I'd just add to that. It's not usually a lost customer. It's sometimes a lost application within the customer. So we still have the customer relationship. It's just that an application may change.

Michael Suski

That's a fair point.

Vern Cushenbery

Okay. That's helpful too. Thanks, guys. I appreciate that. A quick question on restructuring costs. Six million in the first half. What do you expect for the second half of the year?

Paul O'Shea

That's the bulk of the restructuring. We expect some further restructuring in the second half, but it won't be near that amount...

Vern Cushenbery

Okay. Great.

Paul O'Shea

In the second half of this year. But looking forward into—we've said that the plan goes out to 2015. We may anticipate further restructuring charges in 2014, 2015, which may be significant.

Vern Cushenbery

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Okay. And then last question. On your comprehensive income there was a \$3 million adjustment for post-employment benefit obligations. I imagine that's partially driven by lost accounts and partially driven by interest rates. Can you break that out for us?

Paul O'Shea

It's driven by the discount rate increasing on the defined benefit pension plan; all of it.

Vern Cushenbery

All of it. Okay.

Paul O'Shea

Yeah.

Vern Cushenbery

Okay. Thanks much.

Paul O'Shea

(unintelligible)

Michael Suski

Thanks, Vern.

Operator

Once again, if you would like to ask a question over the phone, please press *, then the number 1 on your telephone keypad. Your next question comes from the line of Bill Chisholm with MacDougall. Your line is open.

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Bill Chisholm — MacDougall

Good morning.

Michael Suski

Good morning, Bill.

Bill Chisholm

(unintelligible) probably I guess the restructuring charge, restructuring activities to take 28 million out of your costs in like three years would be an ambitious program it seems to me. Obviously that 12, you've cut nearly half of it already. Is this mainly a reduction in the headcount? Or is there physical plants going to be closed?

Paul O'Shea

It's physical plants. We closed our plant in Brockville and we closed a warehouse in Anjou, and we're moving our FSA facility to our Ambassador Road. So it's plant, so we're taking out space, and it's also headcount, of course.

Bill Chisholm

Okay. And I guess the question was asked, but is most of that \$6 million a cash cost? Or is it a write-down of...

Paul O'Shea

That's—most of that represents lease obligations out to 2016. So the cash will still go out over the period of time.

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Michael Suski

The secondary piece...

Paul O'Shea

Is the severance.

Michael Suski

But it's the same point. It will go out over time.

Bill Chisholm

Okay. And are you in the process of discontinuing any product lines or businesses? Or is this just sort of condensing your footprint to some extent?

Michael Suski

At this point, we have not discontinued any product lines, but part of our overall multiyear plan is we are looking at that option, and there is that possibility. Anything we would do in that regard would be some of our products that have become—if we judge a product to be no longer viable from the point of view of the changes that are going on in technology then we may look at discontinuing some of those products.

Bill Chisholm

Okay. I guess the other comment you did make that you had quite an enviable list of clients. Are these basically the clients you've been dealing with over the last number of years? Or have you had any clients because of the new products that you are developing?

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Michael Suski

Our strategy, Bill, has been to go to our existing clients and market the new services because that's where we have these relationships. So the majority of what we're doing in terms of the success that we've had in that regard so far and even what we're working on is more related to expanding the relationships that we have.

As an illustrative example, the financial institution that we had the success with last year and that we've been implementing even into this year, that relationship, which was already a long-standing good one, will roughly speaking double in size as a result of the expanded services. The telecom client that we also had some success with, same story. So that's where the majority of it is coming from, and it just seems to make good sense to us if you've got a good relationship with the client, good reputation, and because of the new offerings that we have there's a significant opportunity to increase the relationship, then that's the first place we're going to do that.

So we've had some new clients as well. One of the other new contracts that we won in the managed business communication space and that we're just implementing now is a brand new client, but the majority of the focus is on the existing clients.

Bill Chisholm

If I recall, you—one of your new expansions has been through a client down in the US where you had to put some feet on the street down there. Is that still dedicated to strictly one client? Or is there any opportunity to broaden that out and service more than the one client?

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Michael Suski

It is still dedicated because the—again, as I mentioned earlier, the amount of time it takes to implement something of this size and do it right and make sure that customer is bang on satisfied, which they are, means you've got—these are not small relationships that we're launching out.

So at this point the answer is yeah, it's still dedicated to that client. However, I would anticipate that as we move forward, likely late this year, we'd be in a position to start marketing to other clients as well.

Bill Chisholm

Okay. Very good. That's it.

Michael Suski

Thanks, Bill.

Operator

Your next question comes from the line of Dror Shaham with National Bank Financial. Your line is open.

Dror Shaham — National Bank Financial

Yeah. My question, can you talk a little about the dividend policy and the sustainability?

Michael Suski

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Well, our dividend policy hasn't changed. I think the key point, Dror, is as we've said in the past, we continue to look at our dividend and balance that against the other needs of our business, which are specifically the need to continue to invest in our growth strategy and the need to pay down debt. So those two things, growth and debt, combined with the dividend we are constantly balancing, and of course, stating the obvious, I realize, but one of the really fundamental key influence into that that we look at every quarter with our Board is our financial results and our ability to continue to manage those three things.

So we look at that every quarter. We continue to do that, and we will continue to do that. And we'll scrutinize that carefully going forward.

Dror Shaham

Okay. Thank you.

Michael Suski

Thank you.

Operator

And once again, if you would like to ask a question over the phone, please press *, then the number 1 on your telephone keypad.

And we have no further questions at this time. I turn the call back over to the presenters.

Michael Suski

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Thanks, Sarah. So thanks for your calls—or for your questions today and for your time. And we look forward to talking again when we have our Q3 results ready to be released. Thank you.

Operator

This concludes today's conference call. You may now disconnect.

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