BigBear.ai Third Quarter 2022 Earnings Call Transcript November 9, 2022

Presenters
Mandy Long, CEO
Julie Peffer, CFO
Josh Kinley, Chief Corporate Development Officer
Jeff Dyer, President and General Manager of Commercial Markets
Tony Barrett, President and General Manager of Federal Markets

Q&A Participants
Louie DiPalma – William Blair
Vivek Palani – Northland Capital Markets
Harshil Thakkar – Oppenheimer & Co. Inc.

Operator
Thank you for joining the BigBear.ai Third Quarter 2022 Conference Call. This call is being recorded, and at this time, all participants are in a listen only mode, and a question-and-answer session will follow the formal presentation. If anyone should require operator assistance during the conference, please press star, zero on your telephone keypad.

And I will now turn the call over to Josh Kinley, Chief Corporate Development Officer of BigBear.ai. Thank you, sir. Please go ahead, Mr. Kinley

Josh Kinley
Good afternoon, everyone, and welcome to BigBear.ai's 2022 Third Quarter Earnings conference call. I'm here with Mandy Long, our new CEO, and Julie Peffer, our Chief Financial Officer.

During the call today, we may make certain forward-looking statements. Listeners are cautioned not to put undue reliance on the forward-looking statements, and BigBear.ai specifically disclaims any obligation to update the forward-looking statements that may be discussed during this call. Many factors could cause actual events to differ materially from the forward-looking statements made on the call. These statements are based on current expectations and assumptions, and as a result, are subject to risks and uncertainties. For more information about these risks and uncertainties, please refer to the forward-looking statements section of the earnings press release issued today and our SEC filings.

We will also discuss some non-GAAP financial measures during the call today. These non-GAAP financial measures should not be considered a replacement for and should be read together with GAAP results. You can find the GAAP and non-GAAP reconciliations within our earnings release.

Now I'd like to turn the call over to Mandy.

Mandy Long
Thank you, Josh, and thank you all for joining today's call. I'm thrilled to be here for the first time as CEO, and 30 days into the job, I can see very clearly that we have the right investment thesis, talent and technology to thrive as a software and services business.

We had a solid third quarter with total revenue of $40.7 million, our highest quarterly revenue to date, representing 8% quarter-over-quarter growth. We also made significant progress on our cost savings initiatives and expect these initiatives to result in more than $20 million in annualized savings as we move into Q4. We made some mistakes earlier in the year around how we were managing spend, and we lacked the necessary operational rigor. I'm committed to addressing these in my new role in collaboration with my leadership team.

BigBear.ai is building a better world through better choices, and our superpower is working with some of the most complex information to find and reveal what really matters. We support decisions, often in incredibly dynamic and high stakes environments, and our customers depend on our technology and expertise to achieve critical missions, from shipyards to hospitals to battlefields.

I'm focused on a comprehensive review of our talent and our portfolio, and I'm defining the path to unlock the value that exists here through focused discipline growth to drive shareholder value over the long term.

The three main objectives that we're rolling out this week to guide our path forward are as follows – Repeatable Patterns, Good Housekeeping and Find Rare Earth.

Let's talk a little bit about what each of these mean. "Repeatable Patterns" refers to how we'll leverage the assets we have today to continue to solve real customer problems. With the challenging macroeconomic environment and the geopolitical factors we face as a global society, we're going to prioritize an area of core strength, earning and maintaining the trust of our clients and partners as we solve difficult information challenges and provide decision making support in highly complex environments. We're going to be more methodical about identifying what works and replicating that with our robust prospects. We have a strong backlog, and we are going to lean in on the areas where we have established skill to drive engagement forward to success.

Our new Global Force Information Management, or GFIM, win is a perfect example of our ability to deliver value to a customer by deriving actionable insights from complex, highly divergent data to drive operational decisions based on forced readiness worldwide. The GFIM award began generating revenue in September and will be a primary driver of our fourth quarter growth.

Additionally, we're seeing opportunities with children's hospitals to provide digital twin simulation solutions to enhance decision making. For example, an early 4Q win successfully led to an implementation of our first emergency room customer in October, and we will discuss this in more detail on our next earnings call.

We are also continuing to build our pipeline in the discreet manufacturing space, focused on use cases such as optimizing process performance via increased product throughput, reducing cycle time, and right-sizing inventory levels.

With existing customers, we're looking to grow our relationships by bringing additional capabilities to the table through land and expand motion. We're establishing repeatable patterns based on lessons learned, experimenting with new concepts and put in those that validate and scale.

The second objective we're focused on is Good Housekeeping. This refers to comprehensively improving how we operate and adopting a "no shortcuts" mentality. We will continue to integrate and drive efficiencies in our core business functions. These opportunities will allow us to more closely monitor the business and pivot if necessary and will also empower our team members and create a culture of pervasive excellence and accountability.

So we're going back to the beginning, and we're doing a full review of the systems, tools and methods we're using. This includes rigorous cost and expense controls as well as financial contingency planning. It includes how we communicate and create transparency throughout the organization so that team members have the information they need to make decisions quickly and effectively. And it includes how we build and deliver technology, ensuring that we're leveraging best practices and continuously learning from our community as new methods emerge. This work never stops and will be a part of our DNA from here on out.

I'd like to note that we've made progress and that I'm grateful for the team's hard work over the third quarter in moving the ball forward. As one example, this quarter, we held a two-and-a-half-day finance transformation summit with leaders from each of our departments as well as outside advisors. The outcome of this exercise was a roadmap of objectives and actions that are designed to accelerate our close process, eliminate unnecessary redundancies, ensure that we're maximizing the value of our IT infrastructure and shorten the cycle times for our leaders to receive critical information to guide strategic decisions. We'll make future improvements to our operating efficiency in the coming quarters, and we will communicate those as we harden plans.

The third objective we're focused on is Find Rare Earth. This refers to the implementation of a continuous discovery process across the organization to encourage thoughtful experimentation by all of our creators at BigBear.ai and to establish the way we'll uncover and validate potential software and services solutions to foster a forever innovation pipeline.

This isn't just about new things. Innovation also represents the application of existing things in new areas, and we're all tilting our heads and looking at the amazing portfolio we have with new eyes as we think about servicing our markets. I'll have more information to share on our progress here as we complete an atomic level technology assessment and get to work.

By framing the work that needs to be done into these three objectives, we're organizing ourselves and our path forward. And as I shared at the beginning of my comments, our investment thesis is sound, and we have the right technology, the right people and the support of our extraordinary customers and partners. I'm confident we'll achieve meaningful, sustainable growth at BigBear.ai, and I will continue to share our progress openly and transparently. We won't be perfect, but we will learn, we will listen, and we will get better every day.

Today, we are reaffirming our financial outlook for 2022 and plan to provide outlook for 2023 when we report our 4Q and year-end financials. We're grateful for the continued support and confidence from our investors and look forward to keeping you updated as we drive towards profitable and sustainable growth.

With that, I'll turn the call over to Julie for a detailed review of our financials and specifics on our cost savings initiatives.

Julie Peffer
Thank you, Mandy. Let's turn to our third quarter results. Revenue for the third quarter was $40.7 million compared to $40.2 million in the third quarter of 2021, about 1% year-over-year growth and 8% quarter-over-quarter growth, driven primarily by the September award of the GFIM-OE Phase II contract.

Our analytics segment drove $22.7 million of revenue this quarter compared to about $21 million over the same period last year, which is 8% year-over-year growth, largely attributable to the addition of ProModel and the GFIM award in September. As we stated last quarter, we expect our Analytics segment that drives higher margins to continue to grow faster than C&E, which will improve our overall margins as our business mix shifts.

Revenue in C&E was $18 million this quarter compared to $19.2 million in Q3 of last year. The decrease was primarily the result of lower volumes on certain procurement programs. Backlog was $288 million at the end of Q3, which is down 11% compared to last quarter. This was largely driven by contracts converting in Q3 revenue as well as a few contracts with expired periods of performance at the end of the federal government fiscal year. For these time & material contracts, the customer did not spend to their contractual limits, so our backlog was reduced for any remaining funds when the period of performance was completed. This is a result of the ongoing shifting priorities we've seen throughout the year. We are continuing to review our backlog in detail to ensure we have integrated a common methodology and practical application across all of our acquired businesses as we move forward.

As a reminder, we revised our backlogs calculation methodology in the second quarter to more accurately depict awarded contracts from five categories into four: funded, unfunded, priced-unexercised options, and unpriced-unexercised options. Even with this quarter's reductions, our firm backlog, comprised of funded, unfunded and priced-unexercised options is still up 54% since December 2020.

In the third quarter, our unattested gross margin was 29%, up from 27% for Q3 2021, driven primarily by increased margins on analytics contracts. Our adjusted gross margin was 34% compared to 36% year-over-year due to the impact of less development work in Q3 2022 compared to last year. This also reduced year over year adjusted gross margin in analytics from 49% in Q3 2021 to 43% in Q3 2022. Segment adjusted gross margin for C&E was 22% compared to 21% in Q3 2021.

Now turning to operating expenses, for Q3, operating expenses were $24 million, including R&D expenses of $1.8 million and SG&A expenses of $20.2 million. We also booked $1.6 million of restructuring costs and $600,000 of transaction costs in our Q3 operating expenses that are categorized as non-recurring. Although Q3 operating expenses were higher than the same period last year, due to public company and infrastructure costs as well as integrated related expenses, when you exclude the $2.2 million of non-recurring expenses, Q3 is a sequential decrease of approximately $7.5 million, or a 25% reduction versus Q2. This reduction was largely driven by the actions we are taking to right-size our cost structure to better align expenses and cash flow with our revised revenue expectations for the year.

As part of the right sizing actions initiated in Q3, we elected to slow some of our internal investments, which required the difficult decision to execute a reduction in force at the end of August. This was a contributing factor in our sequential operating expense decline. In addition, we reassigned a significant number of G&A and R&D employees from internal projects to open billable roles, which reduced our G&A expense while fulfilling existing and new contractual obligations without additional hiring. We also reduced vendor expenses, including facilities expenses associated with reduced office space in several locations where we expect to realize additional savings in Q4.

In total, we've identified more than $20 million of annualized savings in both labor and vendor reductions. This work continues, and we expect to be operating at this new annualized run rate during Q4, which will enable us to meet our previous guidance commitment of negative single digit loss in the second half of 2022. Going forward, as Mandy described, we will continue to identify repeatable patterns that allow us to run our business as efficiently as possible, and we will continue to take a more disciplined approach to managing operational expenses and growth investments. With rigorous cost management and good housekeeping, we will efficiently deploy capital for targeted investments that yield sustainable growth.

Overall, we posted a net loss of $16.1 million for the third quarter of 2022, which included $2.2 million of stock-based compensation expense, $1.6 million of restructuring related expenses, $1.2 million of D&O insurance, and $600,000 related to transaction fees. Our adjusted EBITDA loss was $3.9 million, which is nearly a 50% improvement from Q2 with only one month of realized cost savings. Additionally, we made a year-to-date adjustment in our management bonus accrual to align with full year projected performance.

Now turning to the balance sheet, we ended the quarter with cash and cash equivalents of approximately $22 million. This represents an $8 million burn since Q2, but also includes $2.2 million of non-recurring expenses for severance and transaction fees. The structural cost reductions we have made will allow us to minimize our cash burn going forward.

Just this week, we are finalizing our credit facility amendment with Bank of America to better align with our current business needs. The revised facility will give us access of up to $25 million of liquidity upon fulfillment of the agreement covenants. As I've just described, we anticipate substantially lower cash burn going forward, and we believe our solid liquidity position enables us to target our growth investments judiciously.

Now turning to our financial outlook, today, we are reaffirming our guidance of expected 2022 revenue in the range of $150 to $170 million. We anticipate strong year-over-year growth in commercial revenues, comprising approximately 8% to 10% of second half revenue.

Following our successful cost reduction initiatives, we continue to expect adjusted EBITDA to be in the negative single digit millions for second half of 2022.

Looking ahead, we continue to expect gross margins to expand as revenue shifts towards software and our backlog remains strong. Our product strategy and go to market efforts remain core to our growth, and we will focus on driving efficiencies as we continue to find rare earth opportunities and ramp up in a sustainable way.

I'd like to turn over the call to Mandy for closing remarks.

Mandy Long
Thank you, Julie. As I shared in my earlier comments, we have the right investment thesis, talent and technology to thrive as a software and services business. We know that we still have work to do – and my leadership team and I are committed to improving how we manage our business and choosing new and existing investments that will lay the foundation for our long-term success. We shared several steps that we've already taken today, and we'll keep you updated as we implement additional measures to achieve these goals.

We're now happy to take your questions.

Operator
Thank you. We will now be conducting a question-and-answer session. If you would like to ask a question, please press star, one on your telephone keypad. A confirmation tone will indicate that your line is in the queue. You may press star, two if you would like to remove your question from the queue. And for participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Our first question comes in the line of Louie DiPalma with William Blair. Please proceed with your question.

Louie DiPalma
Hi Mandy, Julie, Jeff and Josh. Good evening.

Mandy Long
Good evening.

Julie Peffer
Hi, Louie.

Louie DiPalma
Hi. Mandy, congrats on your appointment as CEO.

Mandy Long
Thank you very much.

Louie DiPalma
For Mandy or Julie, last quarter, BigBear's FutureFlow Rx healthcare simulation platform won a significant deal, and the Shipyard AI platform also gained some traction as it relates to supply chain. Did the commercial momentum continue in the third quarter even as the macro environment has globally deteriorated?

Mandy Long
So, I'll start, and then, Louie, after my comments, I'll also ask Jeff Dyer to add a few additional pieces of color because I think there are some interesting things that we're seeing emerge. I think particularly, frankly, as a result of some of those factors that you mentioned.

We saw an early deal. We've implemented our first emergency room use case. We have an additional prospect pipeline that I think looks promising, not only from a direct standpoint, but also from an indirect standpoint as we have some great channel relationships emerging. I would say in kind of an aggregate overall, I see our commercial business having a really good outlook. But, Jeff, I want to hand it to you to add a little bit of additional color.

Jeff Dyer
Yeah. Thanks, Mandy, and thanks for the question, Louie. Good to hear from you. Yeah, she said it well. We're continuing to make investments in our sales pursuit, building a really quality pipeline and differentiating with our existing clientele with expanded offerings. Mandy alluded to our first emergency room department customer. Again, lots of exciting progress that we're making with both new clients, direct and indirect, as well as bringing new products and new innovations to our existing customer base, which is allowing us to expand those relationships.

Louie DiPalma
Great. Thanks. And for the GFIM contract that you referenced on the earnings call, this has been a contract that investors have had their eye on. You discussed in your press release about how you are partnering with Palantir. Can you provide more details in terms of what aspects of the solution you will provide versus what aspects Palantir would provide and potentially what the economic implications are in terms of you partnering with Palantir versus if you were to do the contract entirely yourself?

Mandy Long
It's a great question. So I think it probably makes sense, Louie, to set the table a little bit on the deal itself. So the GFIM contract win, it's a nine month contract valued at $14.8 million, and that award builds on the previous work, and we talked about this in other reports, and the successful delivery of a prototype platform. That's what we did during Phase I.

So where we is entering Phase II and getting into the contract phase for production, right? That's where we're headed into 2023. I think from a relationship standpoint with Palantir, we have a great relationship with them. I think the short answer is that we are frankly still doing work around exactly where some of the areas where we have superpowers, right, and where our partner does. I'll ask Tony Barrett, who runs our federal business -- Tony, do you want to add a little bit of additional color there?

Tony Barrett
Thanks, Mandy, and thanks for the question. I would say the relationship between us and Palantir is complementary. It's not competitive in this particular offering. In fact, we have several partners that we're going into this solution with, to include Appian. So what we've done is we're leading the way with a multi-member team approach, which answers all of the government's questions and allows them to get the best solution. Thank you.

Louie DiPalma
Sorry to interrupt. Mandy or Julie, I'm under the impression that, eventually when the contract shifts from the prototyping phase to the production phase, that the annual revenue will step up to around $30 million per year. Is that a good estimate?

Mandy Long
Julie, do you want to go ahead and answer that?

Julie Peffer
Yeah, I'm happy to. Yeah, I think that's a good estimate. I mean, obviously, that is not a firmed-up number completely yet, but we do expect it to be -- the estimate is it's a five-year contract, and we think it'll be roughly $30 million a year. We expect it to be a fairly quick follow on to the Phase II contract.

Louie DiPalma
Great. And final one from me - you mentioned, Julie, at the end of your prepared remarks that you're making an amendment with your Bank of America credit facility. What is the total liquidity position now with that amendment?

Julie Peffer
Yeah, so we just finalized as -- actually yesterday, our new restructured credit facility with Bank of America. The new agreement, we're going to have access to roughly $25 million of the credit facility going forward, and it's going to be related and based on our really strong government receivables. We're going to provide more of the details on the terms of that agreement within our Q, but again, we are really happy to get that locked back in. It's going to be $25 million. We don't expect to need access to that in the near term, but really happy that we were able to get this finalized and back in place.

Louie DiPalma
Okay, so with that and your cash on the balance sheet, there's about $47 million of liquidity. Is that--?

Julie Peffer
--That's right. That's right.

Louie DiPalma
Great. Thanks. That's it for me.

Mandy Long
Thank you.

Julie Peffer
Thank you, Louie

Operator
And our next question comes from Vivek Palani with Northland Capital. Please proceed with your question.

Vivek Palani
Hi, I'm Vivek on behalf of Mike Latimore. I have a couple of questions with me here. The first one is have you seen more hesitancy among project prospects given the macroeconomic environment?

Mandy Long
Thank you for the question. Yeah, I just want to make sure that I understand. Was your question in relation to the commercial pipeline that we're seeing? I just want to make sure I understand it.

Vivek Palani
Yes.

Mandy Long
Gotcha. So what we're seeing in general, right, and we talked about this in terms of, when we look at the second half of this year, we're expecting that part of our business to represent about 8-10% of our revenue. I think when we look forward into 2023, one of the initiatives that I mentioned and that we're spending a lot of time talking about internally is this idea of Find Rare Earth. And we see a lot of capabilities that we have from a technology standpoint that are certainly viable to commercial enterprises. And we need to go do the work, right, to understand and validate those use cases in the field.

But from within the portfolio that we have today, we have products today that are highly relevant that have an evangelical customer base, and we are doing more and more to make them available.

Vivek Palani
Alright. And do expect to be EBITDA positive in FY '23?

Julie Peffer
It's a great question. I think as we talked about, Mandy's been here now about a month, less than a month. But we are continuing to work toward our 2023 budget as we speak, and that process is ongoing. We haven't completed that process. But once we do, we're planning to announce our guidance as we announce our completion of Q4. So we'll let you know how that plays out, but we're not making commitments yet on 2023.

Vivek Palani
Alright, one last question. Are you forcing any enhancements in the sales strategy?

Mandy Long

I want to make sure that I understand your question there, Vivek. So you asked whether we were forcing any enhancements in our sales strategy. Are you talking about in terms of how we do our mix of go-to-market, or maybe you could help me understand a little bit more?

Vivek Palani
On the go-to-market part.

Mandy Long
Gotcha. So when we think about -- and I'll focus on the commercial business because I think that's probably based on where some of your questions have been, but we can certainly expand to talk about more. Within the commercial side, we have a -- and over the course of 2022, we brought in a really high caliber enterprise sales team. That's part of Jeff Dyer's organization. We are seeing that really bearing fruit as it relates to both direct and indirect channels. So I talked a little bit and alluded to some of the things that we're doing from an ecosystem standpoint and with partners. That's something we see a lot of opportunity for on a go forward basis, and we're spending some cycles there.

I think the mix and approach of how we go to market, more of kind of our focus right now in terms of our messaging and otherwise is to frankly create additional clarity and make it easier for customers to discover and quickly understand the products that we have available in market today for the personas that we service.

Vivek Palani
Alright. Thank you. That's it from my side.

Julie Peffer
Thank you.

Mandy Long
Very welcome. Thanks, Vivek.

Operator
And as a reminder, if you would like to ask a question, please press star, one on the telephone keypad.

Our next question comes from the line of Ittai Kidron with Oppenheimer. Please proceed with your question.

Harshil Thakkar
Hey, guys, this is Harshil on for Ittai. Thanks for taking the question. I just wanted to ask about the cost cutting program, just how far along are you and how much more in terms of savings do you think you still have to realize?

Mandy Long
Thank you very much, and, Harshil, it's lovely to meet you, by the way. So we have made a ton of progress on our cost savings initiatives. I'm actually -- I'm incredibly proud of the work that we did in the third quarter. When we look out, being able to achieve more than $20 million in annualized savings as we go into 4Q is I think a big step forward.

From a go forward basis, is there more to do? I think the honest answer is that, 30 days into the role, I'm still going through and doing the type of comprehensive analysis that you would expect, not only from a tools standpoint, a spend standpoint, talent, kind of just how we operate. I think the kind of short answer is that, wherever we can look for opportunities to be more efficient, we will. I think we've done an effective job of managing and stabilizing the near-term liquidity challenges we had that we talked about. Julie, do you want to add any more color?

Julie Peffer
Sure. Let me just elaborate on some of the cost savings initiatives just to give you a flavor for what we've done and what's coming. So, in total, we've identified more than $20 million of annualized savings are coming from both labor and vendor savings. So we really focused on both areas. We started that effort in August and September, but basically, we've got essentially one month of the cost savings initiatives as benefit in Q3. So you'll see a full quarter's worth of that when you get to Q4, so that helps you with your run rate.

During our call in August, we committed to going through and doing a comprehensive review of all of our expenses. And as part of that process, I think I mentioned in the script, we had to make a difficult decision to do a reduction in force. That was executed at the end of August. In addition to that, we were able to also reassign some of our really talented team members across both G&A functions and R&D functions into billable roles for both existing and new contracts, so that reduced our need to go out and actually hire additional people into the company. So that really helped mitigate our operating expenses, as well.

And then in addition, we found some significant opportunities to reduce vendor spend, including a reduction of several of our office locations. Those cost reductions, they're going to, all across the board in our vendors spend, help us to really meet that guidance commitment that we made about negative single digit loss in the second half of the year. And if you take that and kind of move that forward into what does that mean for 2023, as I mentioned before, we're developing our full year budget now, but we of course expect to leverage the savings we've already achieved this year as we move forward. There's going to be areas for sure that we're going to need to invest in and make really key areas of focus, but we will continue to be very prudent in terms of our investment areas and then focusing on driving additional efficiencies, all of this through the lens of Good Housekeeping and Repeatable Patterns.

So thank you for the question. Really appreciate the opportunity to really give you some color on what we're doing to save -- cost savings in the company.

Harshil Thakkar
Got it. Yeah, no, that was very helpful. Thank you.

Mandy Long
Thanks, Harshil.

Operator
There are no further questions at this time. And now I would like to turn the call back over to Mandy for any closing remarks.

Mandy Long
Thank you, John. I just wanted, in conclusion, to say a big thank you to everyone who joined today. We are incredibly fortunate to have a group of customers, partners and investors who believe deeply in the mission of this organization and the path that we're on. I have no doubt that we are right now on the path and at the beginning of what is going to be an incredibly successful transformation. We are frankly sitting on one of the most exciting things I've seen in my career, and it's a privilege to be able to be the CEO. We are excited about talking to you about some of the things that we're going to be doing in the coming quarters, and we appreciate the questions. I hope that everyone has a wonderful rest of their day. Take care and stay safe.

Operator
This now concludes today's conference. Thank you for joining the BigBear.ai earnings call. Have a great rest of the day.