

SELECTED INVESTOR QUESTIONS RECEIVED THROUGH AUGUST 17, 2020

Question

We notice that staff expenses have grown 10% while maintenance revenue went up 15% and that it led CSI to generate an improved (and maybe all-time record) margin this quarter. We were wondering if you felt that margin expansion is sustainable? I guess some employees have been temporarily furloughed while some have been permanently laid-off. Is this margin the new normal or just a temporary event due to the pandemic?

Response - Jamal

Staff expense as a percentage of revenue was 52% in both Q2 2020 and Q2 2019 so not the reason for the improved margin. Travel, Telecommunications, Supplies & Software expense declined 36% resulting in an increase in margins of 240bps. It is expected that Travel, Telecommunications, Supplies & Software expense will increase when travel restrictions related to COVID-19 are lifted. Also, \$17 million in COVID-19-related governmental assistance received in the quarter added 180 bps to margins. There can be no assurance that COVID-19-related governmental assistance to offset our costs will be available in Q3 2020 (or thereafter), and if so, whether we will qualify for or receive any such assistance.

Question

Leafing through your new AIF, I noted you'd changed one of the executive compensation metrics from ROIC to profitability, but profitability was not defined. I was wondering if you could share how the company is defining profitability when it comes to compensation?

Response - Jamal

As described in the management information circular filed on March 30, 2020, our corporate bonus plan, which compensates employees at all levels of our organization, is based upon return on invested capital ("ROIC") and net revenue growth (ROIC is calculated by dividing net income for bonus purposes for the year by the Average Invested Equity Capital for the period.). The language in the AIF was changed to reflect the fact that not all employees are on the corporate bonus plan. All senior executives are on the corporate bonus plan.

Question

Long-term plans w/ Contour? How much / what kinds of functions are you sending there, how much could ultimately go over? How does this impact M&A targets who might have concerns for employee well-being.

Early results from lowering return threshold for larger deals? Mark's worry was total company-mentality toward returns would gravitate down. Talk through what you've seen thus far. Thank you!

Response - Jamal

Less than 4% of our staff work at Contour. Contour staff assist with programming and back office functions.

Note that the lower return threshold is only for very large acquisitions. We have acquired only a handful of businesses at the lower return threshold. Mark's concern was around lowering the return threshold for all acquisitions in an effort to deploy more capital.

Question

Hi, As a long-term shareholder who plans to remain a shareholder for a long time, one of the most important metric that I'd like to have to be able to judge the health of the company is related to organic growth. You've talked about it a lot in letters and do break it out between licenses/services/hardware/maintenance, but there's another big factor under the surface of the aggregate number that is having a big influence but that I have zero visibility onto. You buy some businesses that grow over time, or at least don't shrink, but you also buy some distressed assets and turnarounds, some that are no doubt shrinking rapidly, at least at first. You even were paid to take a business off someone else's hands... So when I see an aggregate organic growth number that seems low to me, I have to wonder, is it where it is because most business units are doing poorly lately (and if so, is it temporary or a more long-term inflection in the wrong direction?), or is it because you bought more distressed and shrinking assets lately (which can still create a lot of value if you paid a low enough price for them) that mask the good results of the growing business units? So that's the problem. I don't know what the best solution is, but if I was on the board of the company, I would certainly ask for some kind of way to track what is going on underneath the surface with organic growth. Maybe just to know what percentage of businesses or revenues are in each buckets, so that I could track if the "distressed/run-off" bucket has grown lately. Something like that. I know it's complicated, but it would help shareholders understand what is going on better, and they'd better be able to make intelligent decisions about CSI as a whole. Thank you.

Response - Jamal

It should be noted that maintenance organic growth has been 4% in each of 2016, 2017, 2018 and 2019. If the mix of shrinking businesses were increasing it would be unlikely that the maintenance organic growth percentage would remain so stable. By focusing on maintenance organic growth, you should be able to flag any concerns around what's going on beneath the surface.

Question

You mentioned in a prior response regarding capital allocation that: "Moderate leverage with "friendly" debt (similar to our existing debentures) might be worth considering if our acquisition growth slows considerably." I am wondering (even outside acquisition considerations) if your current listed debt instrument is optimal for the company anymore considering the availability of extremely low cost of debt

for highly rated companies. For example, Citrix systems (which has not too dissimilar a capitalization mix) has a 10 year USD bond outstanding with a cost of capital in the mid-low 2 percent range. The redemption terms of the debentures make a refinancing awkward, but it would appear the CSI Software debentures may have a much higher longer term cost (especially if you consider the asymmetry of the range of outcomes of inflation) than what is currently possibly on offer in the market on a fixed rate basis. Given this, it would seem that a 30 year investment grade (ultra cov light) bond issue may be in the best interests of shareholders. What do you think about more traditional long debt issuance for the company? Is the redemption mechanism in the debentures too awkward to make any refinancing actually more than a ~20% probability at current rates? Since they are both stakeholders of the company, can you speak about how the board weighs the interests of shareholders against the interests of debenture holders in the context of its liability management? Thank you.

MHL Response

Jamal and I would be pleased to hear from any friendly neighbourhood i-bankers regarding the availability of 30 year ultra-covenant-light bonds.

Question

Speaking of Mark Miller making investments, he joined the board of CMG (Computer Modelling Group), which on the surface looks like a CSI type business and potential prospective CSI acquisition. Would appreciate some colour on how that went down (ie was permission sought/granted by the board). This invites question about CSI execs serving on external boards - is there a policy on this in place? Would a CSI exec being on a board nullify said company from consideration?

MHL Response

Our Operating Group managers generally check with me before going on an outside board. Some ask me for leads or ideas regarding finding a directorship. We don't have a hard and fast policy about outside board service. My advice to them is that they should serve on a board or two. It can be educational. I also warn them that the attraction of board membership soon pales unless you have a big chunk of your net worth invested in the company or are staking your career on the outcome. Only then do you pay attention, dig in, and fight over the important but frequently unpleasant issues.

Regarding acquiring a business where there is an interlocking board... I haven't seen any studies on the topic, but my initial reaction is that it might lower the risk associated with the acquisition. If the issue ever comes up, I'll check the research to see if the odds are stacked one way or the other.
