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Information Services Corporation Third Quarter Results 2016
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P: Michael Urlocker; GMP Securities; Analyst
P: Justin Keywood; GMP Securities; Analyst

+++ presentation
Operator^ Good morning, ladies and gentlemen, welcome to the Information Services Corporation Third Quarter Results Conference Call.

I would now like to turn the call over to Mr. Jonathan Hackshaw. Please go ahead, Mr. Hackshaw.

Jonathan Hackshaw^ Thank you, Chanel, and good morning, ladies and gentlemen. Welcome to ISC's conference call for the third quarter ended September 30, 2016. With me today are Jeff Stusek, President and CEO; Shawn Peters, Vice President, Finance, and Chief Financial Officer. Also in attendance is Kathy Hillman-Weir, Vice President of Corporate Affairs and General Counsel.

Jeff will begin the call with a review of some of the highlights of the past quarter. Shawn will then provide a summary of our financial and operating performance before handing the call back over to Jeff. After the formal remarks, we will conclude the call with a Q&A session where Jeff, Shawn, and Kathy will be available to answer any questions you may have.

Before we begin, we would like to remind everyone that we will only summarizing results today. ISC's consolidated financial statements and management's discussion and analysis for the third quarter ended September 30, 2016, have been filed on SEDAR and are also available in the Investor section of our website. We encourage you to review those reports in their entirety.

I would also like to remind you that any statements made today that are not historical facts are considered to be forward-looking statements within the meaning of applicable securities laws. The statements may involve a number of risks and uncertainties that have been described in detail in the company's filings, in particular, in ISC's Annual

Information Form dated March 15, 2016, and ISC's audited Consolidated Financial Statements and Notes and Management's Discussion and Analysis for the quarter ended September 30, 2016. Those risks and uncertainties may cause actual results to differ materially from those stated. Today's comments are made as of today's date and will not be updated except as required under applicable securities legislation.

Today's conference call is being broadcast live over the Internet and will be archived for replay shortly after the call on the Investor section of our website at www.company.isc.ca.

I will now turn the call over to Jeff.

Jeff Stusek^ Thank you, Jonathan. Welcome, everyone, and thank you for joining us today. Our performance this quarter was solid, even though we continue to face a challenging economic environment. Both our segments performed well, given the economic climate, and in fact, our Services segment completed the third quarter with a better than expected performance. This resulted in an adjustment to the contingent purchase price consideration for ESC, which had an impact on our overall EBITDA and EBITDA margin for the quarter. That said, the increase in the contingent consideration speaks to the performance of ESC and the diversity this segment brings to our overall business. This becomes even clearer when you look at our results for the first nine months of 2016. Year-over-year on a consolidated basis, our revenue was up 20.5%. Our net income was up by $1.2 million, and our EBITDA margin was in line with our expectations for the year overall.

In addition to our financial performance, last year, we set about reviewing our brand with input from internal and external stakeholders to articulate our current state as well as accommodate our future direction. This morning, we revealed the culmination of that work with our new brand, logo, and tagline, which we expect to roll out over the course of the next 12 months. You can have a look at our new brand in action in the Company Information tab on the homepage of our website at www.isc.ca.

With that, I'd now like to ask Shawn to summarize our financial and operating performance for the third quarter in 2016.

Shawn Peters^ Thanks, Jeff. Revenue for the third quarter of 2016 totaled $22.9 million, an increase of 16%, compared to $19.7 million for the same period in 2015. For the nine months ended September 30, 2016, revenue was $67.2 million, an increase of 21%, compared to $55.7 million for the same period last year. Our revenue growth year-over-year was largely driven by the addition of our Services segment, which we acquired in October of 2015.

EBITDA for the third quarter was $7.3 million compared to $8.2 million in the same quarter of last year, which resulted in an EBITDA margin of 32.1%, compared to 41.5% for the same period in 2015. As Jeff mentioned, our EBITDA and EBITDA margin for the third quarter were reduced year-over-year due to a $1 million adjustments in the third quarter of 2016 for the contingent purchase price consideration related to the purchase of ESC Corporate Services. The increase in contingent consideration reflects the better than expected performance of ESC through the third quarter.

EBITDA for the nine-month period was $22.7 million with a margin of 33.8% compared to $20.2 million and 36.2% in the same period last year. Adjusted EBITDA for the third quarter was $9.5 million compared to $9.6 million in the same quarter last year, with ISC generating an adjusted EBITDA margin of 41.5% for the quarter compared to 48.6% for the third quarter of 2015. For the nine months ended September 30, 2016 adjusted EBITDA was $26.1 million compared to $21.8 million in the same period last year, which resulted in an adjusted EBITDA margin of 38.9%; nearly identical to the 39% margin in 2015.

Our net income and total comprehensive income for the third quarter was $3.8 million or $0.22 per basic and diluted share. In the third quarter of 2015, net income was $4.7 million or $0.27 per basic and diluted share. Net income and total comprehensive income for the nine-month period was $12.6 million or $0.72 per basic and $0.71 per diluted share. Compared to the nine months ended September 30, 2015, net income and total comprehensive income was $11.4 million or $0.65 per basic and per diluted share.

Turning to our registries. Revenue for our registries segment was $19.5 million for the third quarter, a decrease of $0.1 million or 0.6%, compared to the three months ended September 30, 2015. For the nine-month period, revenue was $56.4 million, an increase of $0.7 million or 1.2% compared to the same period last year. Our results were higher primarily due to increased revenues from the Corporate Registry and the Personal Property Registry.

In our Land Registry, Land Registry revenue was comparatively flat for the first three quarters of 2016. Revenue was $15 million for the three months ended September 30, 2016, decreasing just slightly by 0.2% compared to the third quarter of 2015. Revenue for the land registry was $41.9 million of the nine months ended September 30, 2016, a modest decrease of $0.2 million or 0.4% compared to the same period in 2015.

The majority of the revenue generated from the Land Registry is from the Land Titles Registry, where the bulk of our fees are value-based, where we've seen a decrease in average land value. Land Titles Registry revenue for the three months ended September 30, 2016 was $14.1 million, a rise of 0.4% compared to the three months ended September 30, 2015. For the nine months ended September 30, 2016, revenue was $39.1 million, a decrease of $0.1 million or 0.4%, compared to $39.2 million in the same period of 2015.

Overall transaction volumes climbed by 2.1% for the three months ended September 30, 2016, compared to the same period last year, primarily due to an influx of resource sector interest transactions. Regular land transactions or land transfers in the third quarter of 2016 fell by 4.9% compared to the third quarter of 2015. Year-over-year, the volume of mortgage registrations and title searches has declined by 12% and 4.5% for the third quarter, respectively. The uptick in overall transaction volumes offset the decrease in average land values, which contributed to the stable revenue results.

Revenue for the Personal Property Registry for the third quarter was $2.7 million, which represents a decrease of 3.6% or $0.1 million from the same period in 2015. For the nine months ended September 30, 2016, revenue was $7.7 million compared to $7.6 million for the same period last year, up 1.3%.

Transaction volumes of the third quarter of 2016 increased slightly by 0.7% compared the same period last year, primarily due to an increase in our search volumes, up 2.1%, and maintenance volumes, up 10.1%, which more than offset the 4.4% decrease in personal property security setups in our registration volumes.

Revenue for the Corporate Registry for the three months ended September 30, 2016, was $1.9 million, flat compared to the third quarter of 2015. For the nine months ended September 30, 2016, revenue was $6.8 million, up 12% compared to $6.1 million for the same period last year. There was a number of factors influencing revenue for the Corporate Registry this quarter.

On July 11, 2016, ISC launched its sew system for the Saskatchewan Corporate Registry. In addition to the new technology, some permanent changes to the services and fee structure were implemented at the same time as the launch of the new system. The new fee schedule results in structural changes to how volumes are recorded. The system transition also included some temporary fee adjustments and resulted in some planned transition downtime at the start of July, affecting revenue and volumes in the quarter.

As a result, revenue from the filing of annual returns and renewals, classified as maintenance transactions, declined by 11.3% compared to the third quarter of 2015, largely due to the temporary fee adjustment. Revenue from the incorporation and registration of new business entities decreased 14.4% compared to the third quarter of 2015. These declines were offset by the registry fee changes made in July, as well as new revenue from the operating of the Common Business Identifier program and Business Registration Saskatchewan program.

Turning to our Services segment, revenue for the third quarter was $3.3 million. This is a decrease of $0.3 million or 8.4% compared to the second quarter of 2016. For the nine months ended September 30, 2016, revenue was $10.2 million. As always, please keep in mind that the results for this segment are primarily provided by our wholly owned subsidiary, ESC.

Revenue from search and registration services was $1.4 million for the third quarter, representing 43.6% of the total revenue of our services segment. For the nine months ended September 30, 2016, revenue was $4.5 million.

Revenue from Know Your Customer services for the three months ended September 30, 2016, was $1.2 million or 34.8% of total revenue. For the nine months ended September

30, 2016, revenue was $3.4 million. The remaining 21.6% of revenue for the quarter comes from our corporate supplies and accessories.

On to expenses. Consolidated expenses were $16.9 million, an increase of 31.4% compared to $12.8 million for the same period of 2015. Expenses for the nine-month period were $49.7 million compared to $39.5 million for the same period of 2015, an increase of 25.7%. The increase in the expenses was the result of the additional salaries in our Services segment, which was partially offset by attrition in our Registry segment; higher depreciation and amortization costs, mainly due to the additional depreciation from capital assets in our Services segment; the increase in professional and consulting services due to costs associated with the exploration of growth initiatives and higher cost of goods sold, again due to the addition of our Services segment, which offers a Corporate Supplies product line.

Capital expenditures for the third quarter were $0.5 million compared to $1.1 million in 2015. For the nine months ended September 30, 2016, capital expenditures were $5.2 million compared to $2.5 million for the same period in 2015. For the third quarter, the Services segment reported a negative amount for capital expenditures, which was simply due to an adjustment to an intangible asset. Capital expenditures overall were focused on the renewal and enhancement of technologies supporting our corporate registry and the acquisition of the interest of a subcontractor included within Services segment.

As of September 30, 2016, the company had total debt of $23.4 million. Please refer to the MD&A for further details on our credit facilities. As of September 30, 2016, the company held $38.3 million in cash compared to $36.6 million at December 31, 2015, an increase of $1.5 million due to the continued strong cash flow from our operations. Free cash flow for the third quarter of 2016 was $5.6 million, flat compared to the same quarter in 2015.

We also announced yesterday that our Board of Directors approved our fourth quarterly cash dividend for 2016 in the amount of $0.20 per share. The dividend will be payable on or before January 15, 2017, to shareholders of record as of December 31, 2016.

I'll now turn the call back over to Jeff for some concluding remarks.

Jeff Stusek^ Thanks, Shawn. So, in closing, I'm pleased that at the end of Q3, we're tracking towards our full year EBITDA margin guidance set out earlier this year. Our balance sheet remains strong, and we continue to deliver strong free cash flow. We do expect that the Saskatchewan economy will continue on a relatively flat trajectory. So managing our cost to sustain our core business continues to be our main focus. In parallel to this, we will continue to examine and pursue growth opportunities in Canada and internationally, including potential strategic acquisitions to provide registry and other services in other jurisdictions.

That concludes my remarks for this morning. I'll now turn the call back to Jonathan.

Jonathan Hackshaw^ Thanks, Jeff. Chanel, we would now like to begin the question-and-answer session.

+++ q-and-a
Operator^ (Operator Instructions) Our first question comes from the line of Steve Arthur of RBC Capital Markets.

Steve Arthur^ First, I just wanted to clarify the point that I think you started with, Jeff, on the contingent payment for ESC. Are there any further potential payments on that acquisition? And I guess it's fair to assume by your comments that that was tied to some sort of performance threshold that they met or exceeded.

Shawn Peters^ Steve, it's Shawn. Excellent question. I'll take that one. A couple questions there. First of all, there are no further contingent consideration payments. The period of earn-out was the 12 months and that's now concluded. And you're right, the additional payment was based on performance factors, and they did exceed those performance factors.

Steve Arthur^ It just seems like more broadly this acquisition's gone quite well and contributing well. Any further comments on your appetite for more transactions like that and what the pipeline of those kind of opportunities might look like out there?

Jeff Stusek^ Yes, Steve, Jeff here. Yes, I think as we said when we acquired ESC that we expected it to do well; so we're not surprised by this. Our acquisition focus, as it relates to businesses like this, if they look and smell like ESC and they fit strategically, then we're interested but not just to make a deal for a deal's sake. And so, we're happy with the ESC transaction for sure.

Steve Arthur^ But there are other types of businesses that fit your profile that are under contemplation?

Jeff Stusek^ Like I said, as we work through the industry and the sectors that exist within, if something does crop up and makes sense, we will actively pursue it. But no commentary on anything that is active now.

Steve Arthur^ Of course. Okay, shifting gears a little bit just to project costs, R&D line has ticked higher a couple quarters, I think, now. Is this a reasonable level where we are now looking forward to anticipate that spending level? Or is that trending higher to support some new program development?

Jeff Stusek^ No, Steve, I think it would be a more normal indication. I think last year we talked about it this time that we were still a bit uncertain as to how the market was going to land, and so we were pretty cautious on our spend. But this year, we've taken it back to a normal level, and it's completing the initiatives we need to complete on an annual basis. So I would say this is more normal for us.

Steve Arthur^ I guess this is related; in fact, you might have just answered it. But in bigger picture looking at the Saskatchewan macro, general view seems to be flat maybe even slightly down this year and probably up a little bit over 2017, 2018, is that your basic planning assumption? And I guess, if in that context, if you look at over a two- or three-year plan or longer term plan, would you see general spending levels trending higher to pursue new growth opportunities or trending lower to try to defend or even improve margins?

Jeff Stusek^ I think it actually will be a combination of both of those, and so it may balance out. We continue to focus on efficiencies. And so your opening statement there that we expect to see Saskatchewan flat maybe even declining slightly in the short term and then picking up is our current view as well. So we'll continue to manage our expenses in the registry and the services side that way, but we're active in pursuing growth and we'll continue to do that. So I think we'll see the continued spend on the growth side as well.

Operator^ Our next question comes from the line of Stephanie Price of CIBC.

Stephanie Price^ Could you give us an update on any new registry opportunities that you're seeing in other jurisdictions right now?

Jeff Stusek^ Well, Stephanie, obviously we're interested in growing that side of the business and other jurisdictions, and we're actively pursuing business both in Canada and internationally. I know you'll appreciate that there's no way I could tell you which and how for competitive reasons. We are active and interested in both Canada and international opportunities.

Stephanie Price^ Okay. And then the changes to the brand and the costs associated with that roll-up, are those going to impact costs in 2017 materially? And maybe you can just put some parameters around that.

Jeff Stusek^ Yes, certainly we've incurred some costs in 2016 and will continue to roll that out in 2017; but in no way would that be material, no. So they won't be significant to our results.

Operator^ (Operator Instructions) Our next question comes from the line of Michael Urlocker of GMP Securities.

Michael Urlocker^ Jeff, if I step back and look at the business, the core registries are stable and have been stable all year, which is really good to see. And if I look at operating expenses, your largest ticket is wages and salaries, and that's up quite a bit. And you had a negotiation recently for some very modest wage hikes there. Can you just put that in a context how much of that is wage increases on the core business and what you think the outlook is for that spending? Thank you.

Shawn Peters^ Mike, it's Shawn. Maybe I'll take that question. So our wages and salaries are up significantly. That's almost entirely due to – in fact, it is entirely due to the addition of the new staff that we've taken over in our Services segment.

Michael Urlocker^ OK.

Shawn Peters^ In our Core Registry side, we've actually seen and continued to take advantage of attrition. So, our overall salaries there are down. Our collective bargaining, we did ratify that, of course, in July, and so we saw some retroactive adjustments during the third quarter. But actually they were not material, really, in the neighborhood of $100,000 to $150,000 all told; so not something that significantly affected our salary line. And we would expect to manage our salary line as we go forward. We don't see any significant increases in that beyond the collective bargaining agreement.

Operator^ Our next question comes from the line of Justin Keywood of GMP Securities.

Justin Keywood^ On the acquisition and integration costs of $1.8 million in deriving the adjusted EBITDA, would that include the $1 million contingent consideration charge?

Shawn Peters^ Yes, it does, Justin.

Justin Keywood^ Okay. And then what would the other $800,000 make up?

Shawn Peters^ That's -- some of that is related to the other acquisition and integrations that we've had in terms of some costs we spent integrating ESC as well as the pursuit to some of our growth activities.

Justin Keywood^ And then, looking back over the five quarters, I think the integration costs have been around $4.4 million. So would it be safe to assume that's mainly from the earn-out?

Jeff Stusek^ Yes. Some of it is part of the earn-out, but again that's -- over five quarters, that would be the combination of our pursuit of growth activities over that time. Plus, we also had costs related to our investment in one move which is now Dye & Durham as well as the acquisition of ESC. So there's a number of things that would be in there over five quarters.

Justin Keywood^ Okay. And the $1 million contingent consideration charge in the quarter, that was non-cash. Is that correct and then it would be paid out later?

Jeff Stusek^ That's correct, Justin, yes.

Justin Keywood^ Okay. And then how much of the earn-out is still to be paid out?

Jeff Stusek^ That’s it. So there’s the total contingent consideration will be paid out so that will be 5 million we originally estimated plus this $1 million adjustment so a total of $6 million.

Justin Keywood^ So there hasn’t been any amount paid for that $6 million so far?

Jeff Stusek^ That’s correct, yes. That was all due at the end of the earn-out, so.

Justin Keywood^ Okay. And then just to clarify, you mentioned the EBITDA as well as the adjusted EBITDA were affected by the contingent consideration. I just want to clarify so that the EBITDA had that charge in it as well?

Jeff Stusek^ It’s included in our regular EBITDA number. So we take effect of the $1 million in the EBITDA line, which brought that EBITDA margin down, and then we adjust out for it in the adjusted EBITDA line.

Operator^ I am no showing no further questions at this time. I would now like to turn the call over to Mr. Jonathan Hackshaw for closing remarks.

Jonathan Hackshaw^ Thanks, Chanel. With no further questions, I would like to, once again, thank everybody for joining us on today’s call, and we look forward to speaking with you again at our next reporting period.

Operator^ Ladies and gentlemen, thank you for participating in today’s conference. This concludes today’s program. You may all disconnect. Everyone, have a great day.