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ISV.TO - Q4 2017 Information Services Corp Earnings Call

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## CORPORATE PARTICIPANTS

**Jeff Stusek** *Information Services Corporation - President & CEO*

**Shawn Peters** *Information Services Corporation - EVP & CFO*

## CONFERENCE CALL PARTICIPANTS

**Stephanie Price** *CIBC World Markets - Analyst*

**Justin Keywood** *GMP Securities - Analyst*

## PRESENTATION

**Operator**

Good day, ladies and gentlemen and welcome to the Information Services Corporation 2017 Fourth Quarter and Yearend Results conference call. At this time, all participants are in a listen-only mode. Later, we will conduct a question-and-answer session and instructions will be given at that time. (Operator Instructions). As a reminder, today's program may be recorded. I would now like to introduce your host for today's program, Mr. Jeff Stusek, President and CEO. Please go ahead.

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**Jeff Stusek** - *Information Services Corporation - President & CEO*

Thank you, Jonathan, and good morning, ladies and gentlemen. Welcome to ISC's conference call for the fourth quarter and year ended December March 31, 2017. With me today is Shawn Peters, Executive Vice President and CFO.

I will provide some opening comments followed by a review of operational financial results for the fourth quarter and year ended December 31, 2017 by Shawn. I will then provide some closing remarks before we open the call out for the question-and-answer session.

Before we begin, we'd like to remind everyone that we will only be summarizing results today. ISC's unaudited consolidated financial statements and management's discussion and analysis for the period ended December 31, 2017 have been filed on SEDAR and are also available in the Investor section of our Web site under Financial Reports. We encourage you to review those reports in their entirety.

I'd like to also 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 are described in detail in the Company's SEDAR filings, in particular, in ISC's Annual Information Form dated March 13, 2018 and ISC's unaudited consolidated financial statements and notes and management's discussion and analysis for the fourth quarter and yearend -- year ended December 31, 2017.

Those risks and uncertainties may cause the 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 Web site.

On our last call, I concluded my remarks noting that we are on the right path. Based on the results for the fourth quarter and fiscal 2017, I'm even more confident about this than ever. In 2017, we delivered growth both organic and through three acquisitions.

We made investments to advance the business and future growth by extending our leadership team and renewing our focus on technology solutions to position us to meet a wide array of customer needs. These decisions have already yielded positive results.

In the last two weeks, subsequent to the end of this fiscal year, we announced two new agreements -- one between ISC in the province of Nova Scotia, and the second with the Company's registration office in Ireland.

In both instances, we will be replacing their current technology with our RegSys platform, helping both partners to enhance the technology supporting the registries when to deliver their services more efficiently and effectively.

In Nova Scotia, we will also be providing technical support over the 10-year life of the agreement. In addition, we will -- we also implemented the RegSys platform in the State of Ohio, enabling the Secretary of State's office to deliver a new uniform commercial code portal.

This is not material to us in the financial sense but it was and is in the business development sense as it serves as a meaningful entry point into the U.S. market we will -- where we will look for additional opportunities in the future.

While there is no question about our commitment to our core registry business as well as to our relationship with the government of Saskatchewan, we are seeing our business grow beyond our home province.

2017 was a big year for us in that respect. We made three acquisitions -- ERS based in Ireland, as well as Alliance Online and AVS Systems, both of which we amalgamated into ESC.

We announced the divestment of our ownership in Dye & Durham for $25 million in cash or an $18 million gain on total capital deployed of $7 million. While we had been very pleased with our investment in Dye & Durham, the time was right to divest so we can focus on other growth objectives such as expanding the capability of our services segment through the acquisition of AVS.

We expect the addition of AVS to have a positive impact on our top-line and we announced -- as we announced in December, we expect this acquisition to be accretive beginning in 2019. We expect that our services segment is well-positioned to see further customer growth in 2018 and beyond following this latest edition.

I also announced some organizational changes to our ISC leadership team to help me advance the business and future growth of the Company. In addition, we noted that we would increase our focus on providing technology solutions to complement our existing registry operations and services businesses.

The result has been the establishment of three distinct business lines, each with their own leader, and through which we will deliver services and solutions to clients and customers, supported by other key functions such as finance, legal, business strategy and people and culture.

Shawn will provide more details in what this means for our segment reporting commencing with the 2018 first quarter results. With that, I'd like to ask Shawn to summarize our financial and operating performance for the fourth quarter and year ended December 31, 2017.

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

Thank you, Jeff, and good morning, everyone. As Jeff outlined, we are pleased that our business continues to grow. On a consolidated basis, revenue for the fourth quarter grew by 11.3% to $23.6 million.

For the full year, revenue was up by 5.9% to $93.6 million compared to $88.4 million last year. Both our registries and services segments contributed to the revenue growth.

EBITDA, or earnings before interest, taxes, depreciation and amortization, grew by 14.8% to $7.8 million for the quarter, which resulted in an EBITDA margin of 33.2% compared to 32.2% in the fourth quarter of 2016.

EBITDA for the full year was $30 million compared to $29.5 million in the same period last year with an EBITDA margin of 32.1% compared to 33.4% for 2016. Adjusted EBITDA for Q4 was $9 million compared to $7.3 million in the same quarter last year with an adjusted EBITDA margin of 38% compared to 34.6% last year.

For the full year, adjusted EBITDA was $33.4 million compared to $33.5 million in 2016 with ISC generating an adjusted EBITDA margin of 35.7% compared to 37.9% in the previous year.

We adjust for stock-based compensation expense or income, stock option expense, transactional gains and losses on assets and acquisition and integration costs.

Our net income for the quarter was $18.8 million or $1.07 seven per basic and diluted share. In the fourth quarter of 2016, net income was $2.9 million or $0.17 per basic and diluted share. For the full year, net income was $27.8 million or $1.59 per basic and $1.58 per diluted share compared to $15.5 million or $0.89 per basic and $0.88 per diluted share in 2016.

The increase in net income and earnings per share for the quarter and for the year was largely due to the impact of the $15.4 million accounting gain before tax on the sale of our 30.1% ownership interest in Dye & Durham for $25 million in cash in October of 2017, which Jeff mentioned earlier.

Without the impact of the gain, net income for the fourth quarter would have been $5.4 million or $0.31 per basic and diluted share, and $14.4 million or $0.82 per basic and diluted share for the full year.

Also contributing to the increase in net income and earnings per share for the quarter was the impact of a 1% increase in substantively enacted future corporate tax rates by the Saskatchewan government in December of 2017.

This resulted in a reduction in deferred income tax expense in the current period of $1.4 million, an increase of $0.08 per basic and diluted share. This tax increase reversed the previously announced reduction which affected and was reported in our third quarter results.

As we turn to the segments, ISC operates in two reportable segments defined by their primary type of service offerings namely registries and services. We report the balance of our corporate activities and shared services functions, including the results of our subsidiary ERS in corporate.

In our registry segment, revenue was $18.5 million for the quarter, an increase of 5.5% compared to the fourth quarter of 2016 on higher revenue from both the land titles registry and corporate registry.

Revenue for the land registry increased by 5.5% to $13.8 million for the quarter. This was mainly due to stronger high-value property registration revenue. Revenue from high-value property registrations was a record $1.9 million for the quarter with two unusually high transactions accounting for $0.6 million in revenue.

Overall transaction volumes in the land registry grew by 3.8% for the fourth quarter of 2017 compared to the same period last year, partly due to a rise in resource sector interest transactions.

The volume of regular land transactions and title searches grew by 1.7% and 3.3%, respectively, compared to the same period in 2016. However, the volume of mortgage registrations continued to show a decline, down 15.8% for the quarter compared to last year.

Revenue for the personal property registry has been steady at $2.3 million, consistent with the same period in 2016. Transaction volumes for the fourth quarter increased by 1.3%. Specifically, registration volumes grew by 1.2% and search transactions by 2.8%, offsetting an 8.2% decline in maintenance volumes.

Revenue for the corporate registry for the quarter grew by 9.5% to $2.5 million on increases across most transaction types, up overall by 7.8% compared to the fourth quarter of last year. Specifically, registration volumes grew by 15.3%, search transactions by 6% and maintenance volumes by 9.5%.

Looking at the full year's results in our registry segment, revenue for all registries increased by 1.3% year-over-year to $74.9 million. The land registry revenue was $54.8 million, a slight decrease of 0.2% compared to 2016.

Over the course of 2017, we saw volume and revenue declines in most key transaction types in the land registry. However, overall revenue was flat as a result of a number of high-value property transactions processed in the second half of 2017.

We received $5.6 million in revenue from these transactions in 2017, well above the $3.6 million in 2016. To provide some perspective between 2010 and 2016, we averaged $3.3 million in high-value property transactions on an annual basis.

Revenue for the personal property registry for the year was stable at $10 million. Personal property security registration setups, we saw volumes modestly improved by 0.6% while revenue for the same transaction type decreased by 0.7% in 2017 partly due to registry fee changes made in July of 2016, which lowered fees for setups as part of our rebalancing of fees across the Saskatchewan registries.

Revenue for the corporate registry in 2017 was $10.1 million, up 11.7%. This is as a result of a full year's impact of structural pricing changes implemented in July of 2016 and year-over-year growth in key transaction categories.

Turning to our services segment, revenue for the fourth quarter grew by 17.7% to $4 million due to three primary factors -- the continued expansion of new financial services clients adopting KYC services which on its own was up by 10.7; a full quarter of incremental revenue from our (Alliance) acquisition; and post-acquisition revenue from AVS for December 21 to December 31, which is captured in the search and registration category in our services segment.

Looking at the year as a whole, 2017 was a solid year for our services segment with growth across most of our lines of business. This was due to a combination of the two strategic acquisitions we made along with increases in legal activity across the country and strong compliance driven activities in the financial services industry that triggered active due diligence on companies nationwide.

For the full year, revenue rose by 9.2% to $14.9 million on growth in ESC's KYC services along with the new revenue as a result of acquiring AVS in December. Revenue from search and registration services was $6.4 million, up 7.7%, due in part to new revenue from the Alliance and AVS acquisitions.

Revenue from KYC services increased 19.6% to $5.4 million on both organic growth of the existing customer base as well as new customer onboarding. Revenue from corporate supplies for the year was down slightly to $3 million or 2.8%. The decrease was due to a declining revenue customer base in Quebec and Ontario.

Finally, we saw revenue in our other segment recorded into our corporate activities, mainly due to our subsidiaries ERS that contributed $1 million in revenue in the fourth quarter and $3.8 million for the year.

On that note, I'd like to quickly outline the changes to our operating segments for 2018. With the acquisitions in 2017 and additions to our management team, we will now organize into three segments -- registry operations, technology solutions and services.

Registry operations, which is currently our registry segment, will focus on the delivery of registry and services on behalf of governments. Technology solutions will provide support for the development, delivery and support of registry and related technology solutions. Services will continue to deliver products and services that utilize public records and data to provide value to customers in the legal and financial sectors.

Furthermore, we will adjust the revenue categories in our services segment in 2018. With the addition of AVS, we will simplify the way in which we report revenue to better reflect the business by the industries and the customers we serve.

The three categories of search and registration, know your customer and corporate supplies will be consolidated into two categories namely legal support services and financial support services.

Legal support services revenue will consist of revenue from the corporate supplies business as well as search and registration services provided to our legal customers. Financial support services will consist of search and registration, KYC and other services that ESC provides to non-legal customers such as financial institutions and auto finance companies.

As a result, we will begin reporting these segments and revenue categories with the disclosure of our first quarter of 2018 financial results which will replace our current reporting format.

Back to our 2017 results, consolidated expenses for the fourth quarter of 2017 were $17.5 million, down 3.9% compared to $18.2 million for the fourth quarter of 2016. For the year, consolidated expenses were $71.7 million, an increase of 5.5% compared to 2016.

The increases in expenses were mainly a result of increased salaries and wages and I.T. services. Wages and salaries were $32.8 million, up $4.8 million for the year. The increase was mainly the result of the additional wages and salaries from our acquisitions but also included increased salaries from the insourcing of the former DXC Technology contract, expansion to our leadership team and normal annual salary increases.

Information technology services increased to $10.2 million compared to $9.6 million in 2016. The variance was due to a combination of the additional information technology services costs from our ERS subsidiary, partially offset by the savings realized from the cancelled DXC contract.

Capital expenditures for the quarter were $1.7 million related to system development work in ERS and ESC compared to $1.1 million for the same period in 2016. For the year, capital expenditures were $2 million compared to $6.3 million in 2016.

Capital expenditures in 2016 were mainly focused on our corporate registry modernization which was completed in 2016. The lower capital expenditures in 2017 are due to management's focus on integration activities of our three acquisitions last year. In addition, we are gradually shifting to more hosted and cloud service providers thereby reducing our [span] in certain historical capital areas such as hardware technology.

With respect to our debt, as of December 31, 2017, the Company had $21.6 million of total debt outstanding compared to $23.4 million at December 31, 2016. Further details on our debt and our credit facilities can be found in our MD&A and financial statements.

From a liquidity perspective, as of December 31, 2017, we held $31.3 million in cash compared to $33.5 million as of December 31, 2016. As of December 31, 2017, working capital was $18.3 million compared to $25.4 million at December 31, 2016.

The change in working capital is mainly the result of increased income taxes payable at December 31, 2017 due to the taxes associated with the sale of our stake in the Dye & Durham and increases in accounts payable and accrued liabilities and deferred revenue.

Consolidated free cash flow for the quarter was $2.8 million compared to $4.1 million for the same period of 2016 and $22.9 million for the year compared to $20 million last year. The increase for the year was primarily due to less cash additions to our intangible assets in 2017 versus 2016.

Finally, we also announced yesterday that our Board of Directors approved our quarterly cash dividend of $0.20 per share. The dividend will be payable on or before April 15, 2018 to shareholders of record as of March 31, 2018,

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

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**Jeff Stusek** - *Information Services Corporation - President & CEO*

Thanks, Shawn. ISC continued to evolve as well as grow in capacity and competency in 2017. With a combination of a strong balance sheet, growing pipeline of opportunities and first-class talents, we are extremely well-positioned to continue to execute on our growth strategy in 2018 and beyond.

We're also as -- also as well-positioned to capitalize on our organic growth as we have ever been and we'll continue to develop our business to maintain our competitive advantage.

The announcements subsequent to the end of the quarter regarding ERS' recent business development successes are just an example of our objective to deliver organic growth and not just grow through acquisitions.

This brings me to our outlook for 2018. We see two factors influencing the outlook for our registry segment, specifically the Saskatchewan land registry. Those being changes to the mortgage rules and an increase in the overnight lending rates.

The Office of the Superintendent of Financial Institutions implemented revisions to its mortgage rules effective January 1, 2018, which now include a requirement to stress test borrowers with uninsured loans to ensure that they could withstand increases in interest rates.

In addition, the Bank of Canada raises overnight lending rate on January 17, 2018, following two similar increases in 2017. These interest rate changes often influence consumer behavior, and as such, they may affect ISC's business.

We expect, however, it will be sometime before the impact of these changes is known. In general, we expect the performance of our registry segment to be in line with that of 2017.

In our services segment, we expect to see further customer growth in the financial support services category with customers leveraging KYC onboarding services as their programs come on stream during the year.

Our recent acquisition of AVS will add to that revenue growth as we're now able to provide complete best-in-class service offerings to the market. ESC will continue to invest in its core technology platforms to enable integrated solutions in conjunction with this AVS technology in the year ahead.

The acquisition of AVS with a high revenue, low margin profile changes ISC's consolidated revenue and EBITDA margin profile compared to previous years. With that in mind and based on our outlook, ISC currently expects total revenue of between $124 million and $130 million with an EBITDA margin of between 24% and 26%.

Capital expenditures are expected to range between $4 million and $6 million and will be funded through operating cash flow. Keep in mind our guidance does not include revenue or costs from any potential new contracts in any of our reportable segments.

To conclude, our focus remains on ensuring the state stability of our core business while pursuing our strategies for growth to deliver long-term value for our shareholders. And with that, I will now ask Jonathan to begin the question-and-answer session.

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**Operator**

Certainly. (Operator Instructions). Our first question comes from the line of Stephanie Price from CIBC. Your question, please.

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**Stephanie Price** - *CIBC World Markets - Analyst*

Can you talk a bit more about the revenue growth at AVS and what you have baked into your 2018 outlook in terms of AVS?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

Sure, Stephanie, it's Shawn, thanks for the question. So, AVS is a fairly fast-growing company. Obviously, we can't disclose what contrast we might be looking at, but we're looking at growth in the auto motive and financial institution market as it relates to their credit processes. So, that's where

AVS really shines in terms of offering technology to help streamline the credit process for those types of institutions. So, that's what we've baked into our forecast.

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**Stephanie Price** - *CIBC World Markets - Analyst*

Okay. And so, should we assume a similar sort of -- I think historically, it's been earning 16% revenue growth. Is that how we should think about it?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

16% on AVS specifically?

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**Stephanie Price** - *CIBC World Markets - Analyst*

Yes.

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

Yes, that would be about right.

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**Stephanie Price** - *CIBC World Markets - Analyst*

Okay. And then just on the margin side on AVS again, can you talk a bit about that margin profile and if you think you can get it to kind of the ISC-type margins eventually?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

Yes. No, it will never get to the ISC-type margins. It's a completely different business. As we said, it's sort of a high revenue, low margin business just due to the disbursements that they passed through to clients that are recorded in our cost of goods sold. So, it will always be a lower margin business.

And for those margins, and you can sort of figure this out from the guidance that we've issued, are in and around that 10% to 12% on AVS.

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**Stephanie Price** - *CIBC World Markets - Analyst*

Okay, Okay. And then on ERS, you had a number of solid wins you've announced recently. Can you talk a bit about that pipeline and the activity you're seeing there?

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**Jeff Stusek** - *Information Services Corporation - President & CEO*

Sure, Stephanie, Jeff here. So, when we acquired ERS in January, we knew we were acquiring best-in-class software and technology and people that sort of can put those pieces together.

And so, there are many jurisdictions around the globe that are in need of solutions that are really aligned to the RegSys platform. Obviously, I can't get into the specifics of the pipeline, but our recent announcements of the Corporate Registration Office in Ireland and Nova Scotia are examples of the type of growth you should expect to see out of ERS for the coming years.

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**Stephanie Price** - *CIBC World Markets - Analyst*

Great, thank you.

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**Operator**

Thank you. (Operator Instructions). Our next question comes from the line of Justin Keywood from GMP Securities. Your question, please.

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**Justin Keywood** - *GMP Securities - Analyst*

Good morning and thanks for taking my call. Just had some follow-up questions on the ERS. The government of Ireland expansion of services, are you able to give an indication of the magnitude of what this increase might be versus the prior business?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

Yes, Justin, it's Shawn. So that contract, the Company's registration office is a smaller contract. It's not material, so it's about $3.3 million Canadian contract for us.

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**Justin Keywood** - *GMP Securities - Analyst*

And so, is that on annual basis or is that over a term?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

That's over the implementation term, so that would be over an 18 to 24-month implementation term.

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**Justin Keywood** - *GMP Securities - Analyst*

And is there a recurring component of that?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

There normally will be and we expect there would be. We will continue to provide or we intend to continue to provide support to the company's registration office as part of the contract but there's no specific details around that at this point.

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**Justin Keywood** - *GMP Securities - Analyst*

Okay, thank you. And then on the Ohio contract and entrance into the U.S. market, what would be the opportunity to expand there? Would it be similar to what you're doing with the government of Ireland and Nova Scotia or is there something else?

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**Jeff Stusek** - *Information Services Corporation - President & CEO*

Justin, it's Jeff. I think what we have done in Ohio with the Secretary of State there, they -- that sort of model certainly is replicable, if you will, in other states just because we're offering in this uniform commercial code application.





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It's not exactly like the CRO announcement. It has certainly some similarities but it is something that we look as a bit of a beachhead or entry point into the U.S. market and we'll use as a reference with other states for sure.

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**Justin Keywood** - *GMP Securities - Analyst*

Okay. And maybe just to take a step back, just given the traction on ERS, I'm wondering, should we equate this to some of the new business development leaders that were brought in or was it just the -- just some maturity that needed to happen from acquiring a business early last year or maybe you can give some additional color there?

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**Jeff Stusek** - *Information Services Corporation - President & CEO*

Sure. When we acquired ERS, they had an established pipeline certainly of potential clients. I would say it is the combination of the two, both structure and management as well as their current staff like there hasn't been a lot of turnover of ERS staff and we've sort of built the momentum and continue that momentum through and combining it with the rest of ISC proper has proven to be beneficial in that sales process. So, I'd say, to answer your question, it's a little bit of both specifically.

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**Justin Keywood** - *GMP Securities - Analyst*

Okay. And then just one final question, just looking to clarifying, in the Outlook section on the guidance, it says it does not include any revenue or costs from any potential new contracts. Is this from December on or like business include that new ERS contracts that were already announced or how should we interpret that?

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

Yes, Justin, thanks. That's meaning from any potential unannounced contracts, so anything that we've announced is included in our guidance.

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**Justin Keywood** - *GMP Securities - Analyst*

Got it. Thank you for taking my questions.

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**Shawn Peters** - *Information Services Corporation - EVP & CFO*

You're welcome.

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**Operator**

Thanks. Thank you. (Operator Instructions). And this does conclude the question-and-answer session of today's program. I'd like to hand the program back to Jeff Stusek.

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**Jeff Stusek** - *Information Services Corporation - President & CEO*

Thank you, Jonathan. So, with no further questions, I'd like to once again thank all of you for joining us on today's call and have a great day.

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**Operator**

Thank you, ladies and gentlemen, for your participation in today's conference. This does conclude the program. You may now disconnect. Good day.

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