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Information Services Corporation
Q2 2018 Earnings Conference Call
August 8, 2018

C: Jonathan Hackshaw; Information Services Corporation

C: Jeff Stusek; Information Services Corporation; Pres., CEO

C: Shawn Peters; Information Services Corporation; EVP, CFO

P: Stephanie Price; CIBC; Analyst

P: Justin Keywood; GTMP Securities; Analyst

+++ presentation

Operator^ Good day, ladies and gentlemen; and welcome to the earnings 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.

If anyone should require operator assistance, please press star then 0 on your touchtone telephone.

As a reminder, this conference may be recorded.

I would now like to turn the conference over to Jonathan Hackshaw. Sir, you may begin.

Jonathan Hackshaw^ Thank you, Lisa, and good morning. Welcome to ISC's conference call for the second quarter ended June 30, 2018.

With me today are Jeff Stusek, President and CEO, and Shawn Peters, Executive Vice President and Chief Financial Officer.

Jeff will provide opening comments followed by a review of the second quarter operational and financial results by Shawn Peters.

We will keep our prepared remarks brief and follow with a question-and-answer session.

Before we begin, we would like to remind everyone that we will only be summarizing results today.

ISC's unaudited consolidated interim financial statements and management's discussion and analysis for the second quarter ended June 30, 2018 have been filed on SEDAR and also available in the investor section of our website under financial reports.

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 information 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 condensed consolidated interim financial statements and notes, and management's discussion and analysis for the second quarter ended June 30, 2018.

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.

With that I will now turn the call over to Jeff.

Jeff Stusek^ Thank you, Jonathan. Welcome, everyone, and thank you for joining us today.

So far this year it has become clear that increases in interest rates and new mortgage qualification rules are driving the year-over-year softening of results in our registry operations business in Saskatchewan. However, it continues to be an important part of ISC.

Our services business continues to grow organically through the award of new contracts, as demonstrated by our results this quarter and for the first six months of the year.

As we have said, the acquisition of AVS has positioned us as a competitive player in the collateral management business.

As a result, new contracts combined with the addition of AVS mean that the services segment has become a meaningful contributor to our revenue stream and offset the economic policy factors currently impacting registry operations.

Our newest line of business, technology solutions, is gaining momentum in the form of four new contracts in Canada, the U.S. and Ireland.

In the U.S. we've established a beachhead and we will continue to pursue similar opportunities there and internationally where our RegSys platform has been well received.

These quarterly results that demonstrate the robust nature of our overall business which is benefiting from having diversified yet complementary revenue streams.

With that I would now like to ask Shawn to summarize our financial and operating performance for the quarter ended June 30, 2018.

Shawn Peters^ Thank you, Jeff; and good morning, everyone.

I'll provide you with some of the highlights of Q2 on a consolidated basis and then provide some further commentary about each of our reporting segments and their performance for the reporting period.

Revenue for the second quarter of 2018 totaled $31.1 million on a consolidated basis. Year-over-year, we saw an increase of $6.4 million or 26%.

The increase was driven largely by new revenue from the acquisitions of AVS Systems Inc and Alliance Online Limited, as well as strong growth in our services segment, which more than offset lower revenue in our registry operation segment.

Net income for the quarter ended June 30, 2018 was $5.2 million or $0.29 per basic and diluted share, a 9.1% increase from the second quarter of 2017 when net income was $4.7 million or $0.27 per basic and diluted share.

The increase was due to increased earnings in our services segment and a $1 million adjustment to the fair value estimate of the contingent consideration associated with our AVS acquisition.

Consolidated EBITDA, or earnings before interest, taxes, depreciation and amortization expense, for the second quarter of 2018 was $10.1 million compared to $8.8 million in the same quarter last year, an increase of $1.3 million or 14.6%.

Like net income, the increase in EBITDA is due to additional revenue in our services segment and a $1 million adjustment to the fair value estimate of the contingent consideration associated with our AVS acquisition.

For clarity, IFRS requires that we review and, if necessary, revalue the contingent consideration on a quarterly basis.

The EBITDA margin for the second quarter of 2018 was 32.6% compared to 35.8% in the same quarter in 2017.

Our adjusted EBITDA, which excludes stock base compensation expense or income, stock option expense, transactional gains and losses on assets, and acquisition and integration costs, was $9.5 million for the second quarter compared to $9.6 million in the same quarter last year with an adjusted EBITDA margin of 30.5% for the quarter compared to 38.8% in the second quarter of 2017.

For our registry operation segment, revenue was $18.7 million, a decline of $1.6 million or 8.1% compared to the second quarter of 2017.

In the Saskatchewan land registry revenue was $13.5 million for the quarter, a decline of 9.8% compared to the same period in 2017. This was mainly due to lower transaction volumes.

Overall transaction volumes fell by 7.6% for the second quarter of 2018 compared to the same period last year with a decrease in the majority of transaction types.

The volume of regular land transfers, mortgage registrations and title searches declined by 15%, 15.3% and 5.9%, respectively, when compared to the same period in 2017.

As Jeff said, we believe the new mortgage qualification guidelines introduced in January 2018, along with the rise in interest rates are impacting volumes.

We expect they will continue to influence the property market in the near term and, therefore, negatively impact transaction volumes for the remainder of 2018.

Revenue for the Saskatchewan personal property registry for the second quarter of 2018 was $2.7 million, a modest decline of 2.5% compared to the same period in 2017.

This was again due to lower volumes with personal property security registration setups down 4.6% compared to the same period last year, suggesting a modest softening in this portion of the Saskatchewan economy.

Revenue for the Saskatchewan corporate registry for the second quarter was $2.5 million, down $0.1 million compared to the same period in 2017.

As we saw in the first quarter of 2018, this quarterly variance is largely explained by lower volumes across most transaction types.

In summary, on a total basis, revenue for registry operations was largely impacted by slower general activity, particularly in the Saskatchewan land registry.

As a result, EBITDA for our registry operation segment for the second quarter of 2018 was $9.1 million compared to $10.2 million for the same period last year; and for the six months ended June 30 was $15.8 million compared to $17.4 million last year.

For our services segment revenue for the second quarter was $11.5 million, up $7.9 million compared to the same period last year.

The increase in year-over-year revenue was the result of an increasing uptake of services for both legal and financial services customers for KYC, due diligence and cloud security registrations.

Beyond organic growth within existing lines, a primary driver of growth compared to the previous year, was $7.2 million in new revenue from our AVS acquisition.

This revenue was primarily from collateral security registration services provided to financial institutions and original equipment manufacturer [captives] financing activity across Canada.

As a result, EBITDA for our services segment was $3.1 million for the three months ended June 30, 2018, an increase of $2.8 million compared to $0.3 million for the same period last year, and was $4.2 million compared to $1.2 million for the six months ended June 30, 2018 and 2017, respectively.

Finally, with respect to our technology solutions, which we began reporting as of January 1 of this year, revenue was $4.6 million for the three months ended June 30 compared to $5.6 million for the same period on 2017.

As a reminder, we generate revenue for this segment from external parties through the sale of software licenses and accompanying ongoing annual subscription fees related to the RegSys technology platform, and the provision of technology solution definition and implementation services, as well as monthly hosting support and maintenance services.

Revenue from external third parties increased in the second quarter and year-to-date due to new and additional solution delivery and implementation services.

Revenue for recently announced contracts will be recorded once the related services on those contracts have been performed.

Our technology solution segment also records revenue from internal related parties such as our registry operation segment.

Intersegment services to registry operations are provided based on time incurred in support of the registries and the cost to do so.

Intersegment revenue provided in the second quarter and year-to-date decreased due to a reduction in our cost to provide the services as a result of the savings associated with the termination of our DXE technology company contract in 2017.

As a result of the reduced revenue and the timing of employee short term incentive payments and increased expenses related to the acquisition and commencement of new business, EBITDA for our technology solutions segment decreased in the quarter.

However, compared to the same period in 2017, EBITDA for the six months ended June 30, 2018 as consistent.

Moving to expenses for the quarter, our consolidated expenses were $24.3 million, an increase of $5.9 million compared to $18.4 million for Q2 of 2017. The increase was due to a number of factors.

First, our wages and salaries were up $1.3 million to $9.2 million compared to the same period in 2017 in our services segment, additional wages and salaries, largely due to the acquisition of AVS in December 2017.

In our technology solution segment, the addition of wages and salaries following the incorporation of employees who were formerly with DXE in the third quarter of 2017, and across the business annual wages and salary increases for all employees, and the recording of our short term incentive program awards for [out-of-scope] employees on a quarterly basis.

Second, our depreciation and amortization costs and our cost of goods sold increased as a result of our acquisition of AVS.

In our information technology service cost, which were down $1 million for the quarter compared to the second quarter of 2017, we achieved the anticipated efficiencies and savings associated with the termination of our technology services contract with DXE, as mentioned earlier.

Adjusted EBITDA was relatively flat at $9.5 million, a 30.5% margin for the three months ended June 30, 2018 compared to $9.6 million, a 38.8% margin for the same period in 2017.

For the six months ended June 30, 2018 adjusted EBITDA was up as a result of additional revenue in our services segment to $16.4 million, a 28.4% margin compared to $15.8 million or a 34.2% margin for the same period last year.

As discussed last quarter, the acquisition of AVS with a high revenue, low margin profile changes the EBITDA margin profile of the Company as compared to previous years.

Capital expenditures for the quarter were $0.6 million compared to $0.1 million for the same period in 2017. The increase in 2018 is due to system development work across our segments and in particular to enhance our RegSys platform within our technology solution segment.

With respect to debt, as at June 30, 2018 our total long term debt was $20.8 million compared to $21.6 million as at December 31, 2017.

Further details on this debt and our credit facilities can be found in our MD&A and financial statements.

From a cash perspective, we had $31.6 million in cash on hand at the end of the reporting period compared to $31.3 million as at December 31, 2017.

As at June 30, 2018 our working capital was $9.3 million compared to $18.3 million at December 31, 2017.

The change in working capital is largely the result of the AVS contingent consideration being recognized as a short term liability in the second quarter of 2018 compared to being recognized as a long term liability as at December 31, 2017.

Free cash flow for the quarter was $7 million compared to $7.7 million for the same period last year. The decrease in 2018 compared to the same period in 2017 was due to increased current tax expense and additional spending on intangible assets.

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 October 15, 2018 to shareholders of record as of September 30, 2018.

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

Jeff Stusek^ Thanks, Shawn.

After a busy year in 2017 completing a number of key strategic acquisitions as part of our overall growth strategy, we are leveraging organic growth opportunities in our service and technology solutions line of businesses while ensuring that we provide great service to existing clients and customers across the Company.

On the expenses front, we are starting to realize some reductions in expenditures, not including the addition of expenditures from recent acquisitions, particularly with our IT costs where we saw a year-over-year reduction for the second quarter of $1 million.

EBITDA remains healthy, and we will continue to manage our costs judiciously while growing our business.

Our guidance for 2018 remains unchanged, although with the continuing softening of the registry operations business we expect to be on the lower end of revenue guidance.

That said, there's still much to be done in 2018 as we pass the halfway mark. I'm confident about the road ahead as we look to deliver long term value for our shareholders.

With that, I will now turn the call back over to Jonathan.

Jonathan Hackshaw^ Thanks, Jeff.

Lisa, we would now like to begin the question-and-answer session please.

+++ q-and-a

Operator^ Thank you, sir. Ladies and gentlemen, if you have a question at this time, please press star then the 1 key on your touchtone telephone. If your question has been answered or you wish to remove yourself from the queue, please press the pound key.

To prevent any background noise, we ask that you please place your line on mute once your question has been stated.

One moment for questions, please.

There's a question coming in from Stephanie Price from CIBC. Your line is open.

Stephanie Price^ Good morning.

Jeff Stusek^ Good morning, Stephanie.

Stephanie Price^ It looks like margins year-to-date are about 29%. You mentioned some reductions in expenditures. Can you, kind of, walk through how we should be thinking about the back half of the year in terms of margins?

Shawn Peters^ Stephanie, it's Shawn. Thanks for the question.

I think margins for the first half of the year were a little bit stronger than we had anticipated; but we do still see that the back half of the year we'd be consistent with our guidance that was provided. So we're in and around that 29% as you stated, thinking that will land in the 26% to 28% by year-end.

Stephanie Price^ OK. OK. Great. And then in terms of the outlook for the land registry business in the second half of the year, could you just expand on your prepared remarks a bit there?

Shawn Peters^ We continue to see softening in the Saskatchewan economy as we talked about, and we talked about that late last year and early this year that we expected the market to be flat if not down a little bit. And that seems to be what's playing out.

At present, we see this continuing. There doesn't seem to be an immediate turnaround in that, and so we would expect the back half of the year to be fairly similar to what we've experienced in the first half of the year with transactions being down; and that's why we've guided revenue where we have.

Stephanie Price^ Great. And then just in terms of the announcement about the state of Missouri, could you maybe talk a little bit more about the U.S. opportunity and how you're thinking about that region right now?

Jeff Stusek^ Stephanie, Jeff here.

You know, as we announced, the Missouri transaction or opportunity, we see RegSys gaining some momentum and recognition to fit the needs of some of the states, and so we've announced two - the state of Ohio and Missouri.

We run very similar systems across as it relates to the UCC business. And so we just see the U.S. as a good opportunity for us, and we're going to continue trying to make RegSys more aware in the United States and that region because of the similarity of the opportunity in each state.

Stephanie Price^ Great. Thank you very much.

Shawn Peters^ Thank you, Stephanie.

Operator^ Next question comes from Justin Keywood from GMP Securities. Your line is open.

Jeff Stusek^ Good morning, Justin.

Justin Keywood^ Good morning. Thanks for taking my call. Thanks.

Just on the registry business, I understand the land scene declines, but there was also some softness in the personal property included in the registry. And I think for corporate registry that was the second consecutive quarter of declines.

Just wondering if there's anything particular to account for that?

Shawn Peters^ Yes, Justin; it's Shawn. Thanks for the question.

Nothing specific that we can point to. You know, Saskatchewan's economy has been a little bit slower for us for some time, as you noted.

This is the first time we're seeing a little bit of a - or the second quarter - this is being the first year we're seeing a little bit of decline in the corporate registries. But that's not unexpected given what the last couple of years have had.

We've still got a strong number of active corporations in the province, but not unexpected to see a few of those slip off, and I think that's what we're seeing.

The personal property registry is largely just drive by general economic activity; and with that being down for some period of time, I think we're just seeing a little bit of the impact of that; but nothing significant at this point.

Justin Keywood^ OK. Thank you.

And then just coming back to the comments on the land registry business in the back half of 2018 being similar to the front half, if I'm doing my math here correctly that would be about a 5% decline if we average it. Would that be in line with your expectations?

Shawn Peters^ I don't have that number off the top of my head, Justin, but I think that sounds about right based on what we were expecting for 2018.

Justin Keywood^ OK. And then on the technology solutions EBITDA, it was a slight loss in the quarter. I'm just wondering how you see that EBITDA progressing as the new contracts start to contribute?

Shawn Peters^ A good question. So as we talked about, revenue for these new opportunities has not yet been shown in our books obviously as we're just starting those contracts and have yet to fulfill some of the commitments on them.

So the EBITDA is a bit challenging here in the second quarter, but we think that's going to begin to turn around as we start to recognize revenue on these new contracts; and our intention is to continue to grow that with a number of contracts and with the EBITDA margin.

Justin Keywood^ And is there, like, a near term goal? Is the idea to bring these EBITDA margins up maybe to the services segment level?

Shawn Peters^ We don't really give guidance on that, Justin; but the businesses are very different so I wouldn't directly compare the technology solutions with the services segment.

What we'll do is we're continuing to win the contracts with margins that are acceptable and we'll just report those as they play out.

Justin Keywood^ OK. And if I could just fit in one more - on the organic growth for the services and technology solutions division, if you have that, given the new classification?

Shawn Peters^ Sorry, Justin. What was the question there?

Justin Keywood^ The organic growth for the services and technology solutions division?

Shawn Peters^ In terms of what makes up that organic growth?

Justin Keywood^ What was the organic growth in the quarter for each of those segments?

Shawn Peters^ Oh, OK. Yes. Sorry. So the organic growth in the services segment, we're referring primarily to what we would loosely call the historical ESC business, so the previous ESC business before the AVS acquisition.

What we've seen is an increase in the transactions and customers in the historical ESC business. That's the due diligence, KYC business.

So that's just whether it's strengthening slightly on the Ontario and Quebec economy with respect to those transactions; but just generally, we've seen organic growth from new contracts and new customer business in the ESC. So that's the services segment.

In the technology solutions segment it's the new contracts that we've been awarded that we're starting to see some momentum on. That's what we were talking about with organic growth there.

Justin Keywood^ OK. And would you be able to disclose what the actual rate was?

Shawn Peters^ No, I couldn't, Justin.

Justin Keywood^ OK. All right. Great. Thank you for taking my questions.

Shawn Peters^ Thanks, Justin.

Operator^ Ladies and gentlemen, if you have a question at this time, please press star then the 1 key on your touchtone telephone.

There are no further questions. I would like to turn the call back over to Mr. Jonathan Hackshaw for further remarks.

Jonathan Hackshaw^ Thank you very much, Lisa.

So with no further questions we'd like to, once again, thank all of you for joining us on today's call. And we look forward to speaking with you again when we report next for our Q3 2018 results.

Have a good day.

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.