Information Services (Q4 2018 Earnings)

March 21, 2019

Corporate Speakers:
- Jonathan Hackshaw; Information Services Corporation; Director of IR & Corporate Communications
- Jeff Stusek; Information Services Corporation; President, CEO
- Shawn Peters; Information Services Corporation; Executive VP, CFO

Participants:
- Varun Choyah; CIBC Capital Markets, Research Division; Associate
- Steven Bain; GMP Securities L.P.; Research Division; Associate

PRESENTATION

Operator: Good morning, ladies and gentlemen, and welcome to the ISC Fourth Quarter 2018 Earnings Conference Call and Webcast.

(Operator Instructions)

I would now like to introduce your host for the conference today, Mr. Jonathan Hackshaw, Director Investor Relations and Capital Market. Sir, you may begin.

Jonathan Hackshaw: Thank you, Bridget, and good morning, ladies and gentlemen. Welcome to ISC's call for the year ended December 31, 2018. With me today are Jeff Stusek, President and CEO; and Shawn Peters, Executive Vice President and Chief Financial Officer.

Jeff will provide some opening comments followed by a review of operational and financial results for the year ended December 31, 2018 by Shawn. Jeff will then make some closing remarks before we open up the call for our question-and-answer session.

Before we begin, we would like to remind everyone that we will only be summarizing results today. ISC's audited consolidated financial statements and management's discussion and analysis for the period ended December 31, 2018 have been filed on SEDAR and are also available on the Investors 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 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 20, 2019 and ISC's audited consolidated financial statements and notes and management's discussion and analysis for the year ended December 31, 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 in the Investors section of our website.

With that, I'd now like to hand the call over to Jeff.

Jeff Stusek: Thank you, Jonathan. And good morning to everyone joining us for today's call. Overall, 2018 was a strong year for ISC. Revenue was up 27.3%, year-over-year, and the company recorded $119.1 million of revenue for the year compared to $93.6 million in 2017. EBITDA was also up 19.5% year-over-year, coming in at $35.9 million for 2018 compared to $30 million in the prior period.

The primary driver of our growth in 2018 came from our Services segment, largely through the acquisition of AVS Systems Inc. at the end of 2017. With the integration of AVS now complete, we expect to continue to compete effectively in the Know-Your-Customer and collateral management services base while increasing our market share over the course of 2019. While our Registry Operations segment has felt the effects of the economy, notably, increases in interest rates and introduction of new mortgage rules, it yet again delivered solid results while generating strong free cash flow.

At the start of 2018, we expanded our lines of business from 2 to 3 with the introduction of the Technology Solutions segment, which now compliments our Registry Operations and services segment. The diversification of our business over the last 3 years has allowed us to offset the economic impact to our Registry Operations segment and still deliver top and bottom line growth.

Turning to our Technology Solutions segment. 2018 was a successful year with a number of new business wins announced in the first quarter of 2018. As this segment's business model evolves, we expect to realize additional revenue from this segment in 2019 with a focus on profitability.

With that, I'd like to now ask Shawn to summarize our financial and operating performance for the year ended December 31, 2018.

Shawn Peters: Thank you, Jeff, and good morning, everyone. I'll provide you with some of the highlights of our full year on a consolidated basis and then provide some further commentary about each of our reporting segments and their performance for the reporting period.

On a consolidated basis, revenue for the fourth quarter grew by 31.5% compared to the prior year to $31 million. For the full year, revenue was up by 27.3% to $119.1 million compared to $93.6 million last year. Our Services segment, following the acquisition of AVS Systems, Inc. at the end of 2017 was the main driver of our revenue growth. EBITDA, which is earnings before interest, taxes, depreciation and amortization expense, 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 2017.

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 2017. Adjusted EBITDA for the fourth quarter was $7.5 million compared to $7.8 million in the same quarter last year, with an EBITDA margin of 24.3% compared to 33.2% last year. Our EBITDA margin was down as expected as a result of the lower margin profile of our collateral management product line following the acquisition of AVS.

For the full year, EBITDA was $35.9 million compared to $30 million in 2017, an increase of 19.5%, while our EBITDA margin was 30.1% compared to 32.1% in 2017, again, as expected following the acquisition of AVS. Our net income for the quarter was $3.2 million or $0.18 per basic and diluted share, a decrease of $15.6 million compared to the fourth quarter of 2017 when net income was $18.8 million or $1.07 per basic and diluted share.

Net income for 2018 was $18.7 million or $1.07 per basics and $1.06 per diluted share compared to net income of $27.8 million or $1.59 per basic and $1.58 per diluted share in 2017. For both the fourth quarter and full year, there was a decrease year-over-year in net income because of our gain on the sale of our ownership interest in Dye & Durham Corporation in the fourth quarter of 2017. Free cash flow for the quarter was $5.4 million compared to $2.8 million in Q4 of 2017, and for the year ended December 31, 2018, free cash flow was $25.2 million compared to $22.9 million in 2017, up 9.7%.

On November 6, 2018, we entered into an amended and restated credit agreement and now have up to $80 million in credit available under our new facilities. During the fourth quarter, we also finalized a new 5-year service agreement with our information technology service provider. Finalizing this agreement provides stability to our operations, while updated terms provide us with more flexibility in information technology cost management.

In our Registry Operations segment, revenue was $70.3 million for the year, a decrease of 6.2% compared to 2017. Revenue for the land registry decreased 8.7% to $50 million for the year due to a slower real estate market in Saskatchewan. The volume of regular land transfers, mortgage registrations and title searches declined by 4.9%, 10.7% and 7.5%, respectively, compared to 2017.

As we mentioned throughout 2018, new mortgage qualification guidelines introduced in January 2018, along with increases in interest rates since July of 2017, have impacted volume and revenue in 2018. We anticipate these factors will continue to influence the property market in the near term, particularly if further increases to interest rates occur in 2019.

High-value property registration revenue was also lower in 2018 when compared to a record revenue of $5.6 million in 2017. Each high-value registration generated revenue of $10,000 or more, and revenue from these types of our registrations was $3.9 million for 2018, down by $1.7 million versus 2017. Revenue for the Personal Property Registry was steady year-over-year at $10.2 million compared to 2017. Registration revenue for this registry decreased by 3.7% in 2018 compared to 2017. This was offset by increased search and maintenance revenue in 2018, up 12.3% and 23.5%, respectively, as a result of pricing changes made to search transactions in July of 2018.

Revenue for the Corporate Registry for the year was also steady at $10 million compared to 2017. Registration, search and maintenance revenue in the Corporate Registry declined by 2.5%, 0.2% and 0.6%, respectively, compared to 2017. This revenue decline was a product of lower transaction volumes. Registration, search and maintenance volume declined by 1.8%, 0.4% and 3.5%, respectively, as compared to 2017.

More specifically, revenue from the filing of annual returns and renewals declined by 3.8% in '28 (sic) [2018] compared to 2017. Revenue from the incorporation and registration of new business entities dropped by 2.3% compared to 2017. Looking at the full year's results in our Registry Operations segment, the impact of economic conditions, including increases in interest rates and changes to the mortgage qualification rules, are evident. However, this line of business remains a strong free cash flow contributor and even under the challenging economic conditions, has performed extremely well.

Turning to our Services segment. Revenue for the year ended was $42.4 million, up $27.4 million compared to $14.9 million in 2017. The increase in revenue year-over-year was a result of new revenue of $26.4 million from our collateral management product line, following the acquisition of AVS, along with organic growth within existing lines. In our Legal Support services, revenue increased through organic growth by 2.2% year-over-year to $8.8 million.

Revenue from this area of our Services segment consists of nationwide searches and registration services as well as corporate supplies provided to legal professionals. Our Financial Support Services grew from $6.3 million in 2017 to $33.6 million in 2018 because of the addition of AVS, the onboarding and ramping up of new customers and organic growth.

Finally, the first full year of our newest segment, Technology Solutions saw revenue of $21.2 million for the year ended December 31, 2018 compared to $20.4 million for the same period in 2017. As Jeff touched on, during the year we announced the signing of solution delivery and implementation agreements with a number of jurisdictions.

Revenue from external third parties increased year-to-date due to the achievement of initial contract milestones associated with agreements entered into during the year. This revenue is expected to continue to grow as the company achieves performance-related milestones identified in the contracts.

Internal related party revenue provided 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 DXC Technology Company contract in 2017. For the year ended December 31, 2018, our consolidated expenses were $96.7 million, an increase of 34.9% compared to $71.7 million for the same period in 2017.

A summary of our changes in our expenses is as follows: Our wages and salaries were $37.8 million, up $5 million for the year ended December 31, 2018 compared to the same period in 2017. The increase was due to annual wages and salary increases and standardization of salary and incentive programs across the business; additional wages and salaries in our Services segment, following the acquisition of AVS in December 2017; and additional wages and salaries in our Technology Solutions segment, following successful contract awards.

Our cost of goods sold was $25.1 million for the year ended 2018, an increase of $20.9 million compared to 2017, due to the nature of our expanded collateral management product line in our Services segment, which has a higher cost of goods sold. Depreciation and amortization costs were $9.9 million for the year ended December 31, 2018 compared to $7.5 million in the same period in 2017. The increase is due to increased amortization in our Services segment related to the AVS acquisition in 2017, somewhat offset by lower depreciation in our Registry Operations segment due to certain assets being fully depreciated.

Information technology costs were $8.5 million, down $2.4 million compared to 2017. The decrease in 2018 reflects savings associated with the termination of our technology services contract with DXC and bringing those resources in house. Professional and consulting services decreased for the year ended December 31, 2018 to $4.8 million compared to $6.3 million in 2017. The decrease was due to less costs incurred for acquisition and integration activities in 2018.

I would note that during the fourth quarter, we changed the presentation of project initiative expenses to reclassify them according to their nature. For more details on this, please refer to the table on Page 36 of our MD&A. We believe the revised presentation aligns with our operation of the business and provides more relevant information to readers.

Capital expenditures for the year ended December 31, 2018 were $2.8 million compared to $2 million for the same period in 2017. The increase was due to continued effort on system development work across our segments and a financial system upgrade in our corporate area. With respect to our debt, as at December 31, 2018, the company had $20 million of total debt outstanding compared to $21.6 million at December 31, 2017.

As mentioned previously, during the year, we also amended our credit facility and entered into a new amended and restated credit agreement, with the aggregate amount available under the facilities now being $80 million. Further details on our debt and our credit facilities can be found in our MD&A and financial statements.

From a liquidity perspective, as at December 31, 2018, we held $28.7 million in cash compared to $31.3 million as at December 31, 2017. As at December 31, 2018, working capital was $15 million compared to $18.3 million at December 31, 2017.

The decrease in working capital is the result of the contingent liability related to our ERS subsidiary moving from a noncurrent to a current ability and due to increased contract liabilities within our Technology Services segment.

Consolidated free cash flow for the year ended December 31, 2018 was $25.2 million compared to $22.9 million for the same period in 2017. The increase in 2018 was due to changes in working capital driven by increased receivables as a result of the higher sales, higher taxes due to increased results and the full consumption of our loss carryforward pool and new contract assets related to our Technology Solutions segment.

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, 2019 to shareholders of record as of March 31, 2019.

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

Jeff Stusek: Thanks, Shawn. Before we move to the Q&A session, I'd like to share a few thoughts with you about our outlook for 2019. We anticipate consolidated revenue growth to be driven by our Services segment through the continuing expansion of our collateral management product line, including further automation of the fulfillment of these services, thereby, reducing our cost of delivery.

Our Registry Operations segment is expected to remain a strong free cash flow contributor and a direct beneficiary of any future upswing in economic condition in Saskatchewan. We will continue to monitor the economic conditions while always looking for greater operational efficiencies.

Should there be further increases to interest rates in 2019, this could place further downward pressure on transaction volumes. In Technology Solutions, as projects for contracts the company signed in 2018 continue to move into the implementation phase in 2019, ISC expects to begin to recognize increased revenue from those contracts.

The key driver of expenses will continue to be wages and salaries, cost of goods sold and information technology costs as well as costs associated with the pursuit of new business opportunities. We also expect to spend between $2 million and $4 million on business as usual capital expenditures.

Taking the preceding outlook from 2019 into account, I'd like to reiterate our guidance issued in early February, where we expect revenue of between $129 million and $135 million; EBITDA, between $31 million and $35 million; and an EBITDA margin of between 24% and 27% in 2019.

To conclude, our focus remains on ensuring the stability of our business while pursuing strategies for growth, including accretive acquisitions. With that, I'll hand it back to Jonathan.

Jonathan Hackshaw: Thanks, Jeff. Bridget, we'd like to begin the question-and-answer session.

QUESTIONS AND ANSWERS

Operator: (Operator Instructions)

Our first question comes from the line of Varun Choyah with CIBC.

Varun Choyah: Well, just a couple of questions here. Can you talk about, like, the sort of the pipeline of opportunity in your Services division? Do you see more of it on the KYC side or on the collateral management side of the business?

Jeff Stusek: Good question, Varun. It's Jeff. I wouldn't quantify it as more or less – I think those opportunities, they're both in our wheelhouse. I wouldn't say it's an even split either, but it's not one over the other. I think the acquisition that we announced of Securefact in the last quarter, the addition of that in our Services business will certainly enhance our Know-Your-Customer business for sure, and that was the primary objective, strategic objective of that acquisition.

Varun Choyah: Okay. And in terms of, like, winning new businesses in – under Services umbrella, like, how long does it take when you start talking to the customers before they actually sign on to your solutions?

Jeff Stusek: Yes, I think it's very customer-dependent, Varun. It can be very quick, a matter of days, and it can take a while, depending on the relationship that they have with our competitors. And so it really depends. And so it depends on the magnitude and the volume of work they have and the relationship or where they're at from a sort of a contractual basis. So it's hard to predict, but we are very active in growing that business organically, sort of, a customer at a time.

Varun Choyah: Okay. And I guess, turning onto the Technology Solutions business. In your prepared remarks, you mentioned that you expect that additional revenue realization as you work – reach milestones in these contracts. What's, like – sort of, like, the duration of these implementation contracts in your Technologies Solutions business?

Shawn Peters: Yes, Varun, it's Shawn. Most of the implementation contracts range between 12 and 18 months.

Varun Choyah: Okay. And what are sort of – what's the pipeline in that business? Like how is that looking?

Jeff Stusek: Just back to Jeff here. We have a really strong product in the RegSys product, and we have a strong name and – attached with ISC and our registry expertise. The wins that we announced in 2018 are a reflection of the sort of customer interest that's out there. We're really focused in 2019 to deliver on the products that we are – the contracts that we announced in 2018.

But that isn't stopping us from trying to continue to fill the funnel and talk to customers, and our response from our potential customers continues to be positive as well. So I obviously can't speak specifically about the size and the types of opportunities, but we're confident in the business, and we like the business and the business model.

Varun Choyah: Okay. And I guess, switching gears, like, do you view, like, the U.S. pipeline? And I know you said that you have like a beachhead into the U.S. opportunity. How is that shaping up since last couple of quarters?

Jeff Stusek: Well, obviously, we haven't announced anything in more recent quarters, not because of anything particular. It's – there are a specific – though that the opportunities in the United States are very specific around specific state needs and our UCC products, and so we'll continue to work with the states and continue to work with them.

And as opportunities emerge, they're typically public processes that we'll participate in, and we're confident with our Ohio and Missouri implementation. That's – they're good sort of customer reference points for us with other states. So...

Varun Choyah: Okay. And just one follow-on for me. Your new service agreement with your technology provider, should we expect – like, how does that affect your – like your margin though? I know, your Capex spend on your new technology – like, could you mention it's more of an agile, cost-effective agreement for the next 5 years? Can you talk a bit about that?

Shawn Peters: Yes. It probably won't have a significant impact on our Capex. Our Capex is already fairly low as we've started to transition services to more cloud-based service. We still have more to do in that regard, but we think our $2 million to $4 million in Capex is going to be required across the business anyway. So I don't think you'll see a significant change in that.

Operator: And our next question is from Steven Bain with GMP Securities.

Steven Bain: Just a question on the revenue guidance. So the guidance is unchanged from the guidance released Feb 4. Given that you'll be adding some revenues from the Securefact acquisition, is that implying some softness in other segments of the business?

Shawn Peters: Steven, it's Shawn. Not necessarily. As we talked about, we do think that there are still challenges with our – the Registry Operations business in Saskatchewan, and we expect that will continue. But the Securefact acquisition, as Jeff outlined, is helping to position us even stronger in the KYC space, but it's a fairly new product.

It's a new product for us, and we'll be spending time with customers getting them to know that product. And so at this point, we've not changed our guidance. We think the range is sort of large enough to allow for the addition of Securefact this year. And if that changes throughout the year, we'd certainly revise guidance.

Steven Bain: Right. Okay. And just on the guidance for the EBITDA margins. Are you able to provide any for adjusted EBITDA margin for 2019?

Shawn Peters: Typically – so last year we did disclose that. Typically, our adjusted EBITDA margins are within a couple of percentage points of our EBITDA margin, just depending on what activities happen throughout the year. But generally, they would be just a couple of points higher than the EBITDA margin guidance that we gave.

Operator: And I'm not showing any further questions. So I'll now turn the call back over to Jonathan Hackshaw for closing remarks.

Jonathan Hackshaw: Thank you, Bridget. With no further questions, I'd like to thank everyone for joining us again on today's call. And we look forward to speaking you – with you again in our next reporting period. Have a good day.

Operator: Ladies and gentlemen, this does conclude the program. You may now disconnect. Everyone, have a great day.