Information Services(Q2 2019 Earnings)

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Corporate Speakers:

- Jonathan Hackshaw; Information Services Corporation; Director of IR & Capital Markets
- Jeff Stusek; Information Services Corporation; President & CEO
- Shawn Peters; Information Services Corporation; Executive VP & CFO

Participants:

- Scott Fletcher; CIBC; Analyst

PRESENTATION

Operator^ Good day, ladies and gentlemen. Welcome to the ISC Q2 2019 Earnings Conference Call and Webcast. (Operator Instructions) As a reminder, this conference call is being recorded. I would now like to introduce your host for today's conference, Mr. Jonathan Hackshaw, Director of Investor Relations and Capital Markets. Sir, you may begin.

Jonathan Hackshaw^ Thank you, Jimmy. And good morning, ladies and gentlemen. Welcome to ISC's conference call for the period ended June 30, 2019.

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 by Shawn. Jeff will then make some closing remarks before we open up the call for the question-and-answer session.

Before we begin, we would like to remind everyone that we'll only be summarizing results today. ISC's unaudited, condensed, consolidated interim financial statements and management's discussion and analysis for the period ended June 30, 2019, have been filed on SEDAR and are also available in the Investors section on 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 for the year ended December 31, 2018, and ISC's unaudited, condensed, consolidated interim financial statements and notes and management's discussion and analysis for the 3 and 6 months ended June 30, 2019.

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 Investors section of our website. With that, I'd now like to turn the call over to Jeff Stusek.

Jeff Stusek^ Thank you, Jonathan. Good morning to everyone joining us for today's call. The second quarter, much like the first, was a solid quarter with consolidated revenue and net income both up year-over-year.

Our EBITDA for the quarter was flat compared to last year but only because of a $1 million adjustment we made in Q2 2018. Otherwise, it would've been $1.1 million higher for Q2 2019 compared to Q2 2018. Shawn will provide more details about this.

Our Registry Operations segment continues to feel the effects of economic conditions, but it is still a strong free cash flow contributor, and I'm really pleased with the year-over-year organic growth of our Services segment. The acquisitions we've made to enhance or complement our Services segment are yielding results.

And most importantly, the feedback from our existing customers about these additional offerings is positive. We will continue to look for opportunities to broaden our offerings in the Services segment to help our customers with their regulatory solution needs.

With that, I'll turn the call over to Shawn to summarize our financial and operating performance for the 3 months ended June 30, 2019.

Shawn Peters^ Thank you, Jeff, and good morning, everyone. I'll provide you with some of the highlights of the second quarter 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 3 months ended June 30, 2019, was $34.2 million, an increase of 10.3% compared to the second quarter of 2018 due to strong organic growth in our Services segment, offsetting slightly lower revenue in our Registry Operations.

Net income for the period was $5.8 million or $0.33 per basic and per diluted share compared to $5.2 million or $0.29 per basic and diluted share in the second quarter of 2018.

EBITDA for the quarter was $10.8 million, flat when compared to $10.7 million reported in the same quarter last year. By way of comparison, in the second quarter of 2018, we made a $1 million adjustment to the fair value estimate of the contingent consideration associated with our AVS acquisition.

Excluding the $1 million fair value adjustment in 2018, EBITDA was $1.1 million higher for the 3 months ended June 30, 2019, versus 2018.

The EBITDA margin for the second quarter of 2019 was 31.4% compared to 34.4% in the same quarter in 2018, down as expected, as a result of the continued growth in our lower-margin collateral management product line.

Excluding stock-based compensation expense or income, stock option expense, transactional gains or losses on assets and acquisition and integration costs, adjusted EBITDA was $10.9 million for the quarter, up compared to $10 million in the same quarter last year with an adjusted EBITDA margin of 31.8% for the quarter compared to 32.3% in the second quarter of 2018.

For the 3 months ended June 30, 2019, our consolidated expenses were $26.3 million, an increase of $2.1 million compared to the same period last year due to increased cost of goods sold for the new services revenue and increased staffing in Services and Technology Solutions.

These increases were partially offset by reduced technology cost, decreased staffing in Registry Operations and decreased depreciation in professional and consulting expenses in Services.

Free cash flow for the 3 months ended June 30 was $8.6 million, an increase of $1.1 million compared to $7.5 million in the second quarter of 2018 due to higher results of operations from the higher revenue and services.

Turning to our specific segments. Revenue for Registry Operations was $18.5 million for the 3 months ended June 30, 2019, a slight decline of $0.2 million compared to the second quarter in 2018 due to decreased revenue from the Saskatchewan Land Registry. Most of the revenue generated from the Land Registry is from the Land Titles Registry, and is derived from value-based fees.

Land Titles Registry revenue for the quarter ended June 30, 2019, was $13.2 million, a decline of $0.3 million compared to the same period in 2018 from a combination of lower transaction volumes, partially offset by increased high-value transactions.

Revenue from high-value transactions was $1 million for the second quarter of 2019, up from $0.9 million in the same period in 2018. As a reminder, each high-value registration generates revenue of $10,000 of more.

Overall transaction volumes for the Land Registry decreased by 4.5% for the second quarter of 2019 compared to the same period last year. The volume of mortgage registrations and title searches declined by 4.3%, while regular land transfers volumes increased by 1%. Volumes appeared to be continued -- appear to continue to be impacted by the general economic conditions, which have contributed to the softness in the Saskatchewan real estate market.

The Saskatchewan Personal Property Registry and Saskatchewan Corporate Registry both performed well in the second quarter and were largely stable as compared to last year.

While smaller in size than the Land Registry, these 2 registries continue to make solid contributions to our top and bottom line given that they're both highly automated. Nearly 100% and over 80% of all transactions for the Personal Property Registry and Corporate Registry, respectively, are completed online.

Expenses for Registry Operations were $8.5 million for the quarter, a decrease of $1 million from the same period in 2018 due to lower related party expenses for technology services and lower staffing expenses.

As a result, Registry Operations EBITDA for the second quarter of 2019 was $10 million, up compared to $9.5 million in the same period last year as the overall decrease in costs offset the lower revenue.

Turning to our Services segment. Revenue for Services was $13.8 million for the 3 months ended June 30, 2019, an increase of $2.3 million or 20% compared to the second quarter of 2018. This year-over-year increase was the result of a combination of organic growth within existing customers and the ramping up of new customers, particularly in the KYC, due diligence and collateral security registration space.

Financial Support Services revenue was $11.5 million, up $2.2 million compared to $9.2 million for the same period of 2018. This increase represents the strong growth in our collateral management product line combined with additional expansion into KYC, including growth within existing customers.

We also saw a consistent year-over-year contribution from our Legal Support Services with revenue in the second quarter of 2019 remaining flat at $2.2 million compared to the second quarter in 2018. For the quarter, Services expenses were $11.8 million, an increase of $3.5 million compared to $8.3 million for the same period in 2018.

The increase was due to increased cost of goods sold for the new revenue as well as costs associated with our acquisition of Securefact and planned integration and technology improvements as we look to optimize our existing platforms and offerings.

EBITDA for Services was $2 million for the 3 months ended June 30, 2019, a decrease from the $3.2 million reported for the same period last year. As a reminder, EBITDA in the second quarter of 2018 was augmented by a $1 million adjustment to the fair value estimate of the contingent consideration associated with our AVS acquisition.

Excluding the $1 million fair value adjustment in 2018, EBITDA services was $0.2 million lower for the 3 months ended June 30, 2019, versus 2018 as a result of the Securefact acquisition and technology optimization expenses mentioned previously.

Finally, in our Technology Solutions segment, revenue was $4.9 million for the 3 months ended June 30, 2019, compared to $4.6 million in the same period in 2018. Revenue from external parties and fees due to technology solution definition and implementation services and software licenses.

As expected, the revenue from external parties continues to grow as the company executes on implementations that are scheduled throughout 2019.

Technology Solutions expenses were $5.1 million for the quarter, a slight decrease of $0.2 million compared to $5.3 million for the same period in 2018. Although slightly negative for the quarter, EBITDA for our Technology Solutions segments for the 3 months ended June 30, 2019, improved compared to the second quarter of 2018.

Capital expenditures for the 3 months ended June 30, 2019, were $0.8 million compared to $0.6 million for the same period in 2018. Our capital expenditures are focused on enhancements to the system supporting corporate and other system and development work across our business segments.

With respect to our debt as at June 30, 2019, the company had $19 million of total debt outstanding compared to $20 million at December 31, 2018. 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 June 30, 2019, we held $19.2 million in cash compared to $28.7 million as at December 31, 2018. Working capital at the end of the quarter was $10.9 million compared to $13.2 million at December 31. The decrease in both cash and working capital is primarily a result of our acquisition of Securefact in February 2019.

Consolidated free cash flow for the 3 months ended June 30, 2019, was $8.6 million compared to $7.5 million for the same period in 2018. The increase in the quarter was due to higher results of operations from higher revenue and services.

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, 2019, to shareholders of record as of September 30, 2019. I'll now turn the call back over to Jeff for some concluding remarks.

Jeff Stusek^ Thanks, Shawn. With the first half of the year behind us, we remain focused on ensuring that we achieved the goals that we have set at the start of the year.

Registry Operations continues to feel the effects of general economic conditions, but it continues to deliver strong results, along with a healthy free cash flow. The growth in our Services line with revenue of over 20% year-over-year in Q1 and Q2 2019, respectively, is helping to offset economic effects in Saskatchewan. The segment now accounts for nearly 40% of consolidated revenue.

We expect the primary driver of our growth in 2019 to come from Services, largely through the continued growth of our customer base and our collateral management services product line. We also expect to continue to compete effectively in the KYC space while increasing our overall market share over the course of 2019.

Technology Solutions continues to focus on executing on current implementations of the new contracts when we expect to realize additional revenue from the segment in 2019 and profitability in the short term.

While we'll always look to grow our Services and Technology Solutions businesses organically, we will also continue to look for acquisition opportunities that will add value to our current offering and help out our customers. As always, we will only invest capital in the right opportunity at the right price. With that, I will turn the call back to Jonathan.

Jonathan Hackshaw^ Thanks, Jeff. Jimmy, we'd now like to begin the question-and-answer session.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from Scott Fletcher with CIBC.

Scott Fletcher^ EBITDA margins for Registry Operations came in at 54% for the quarter. I was wondering if you could provide some more detail on some of the drivers behind the strong performance there and whether we should be expecting margins going forward.

Jeff Stusek^ It's Shawn. Thanks for the question. Yes, Registry Operations, as we talked about, is continuing to feel the top line effects of the Saskatchewan economy, so we're seeing the lower volumes and that's translating a bit into lower revenue.

But the primary drivers in that segment continue to be wages and salaries and technology costs, both of which we saw decreases in the quarter and year-to-date. So the margin improvement that you see there, I think you going to expect to continue to see that.

We don't see any changes to our staffing in terms of having to move that up over the course of the year as we expect 2019 to be pretty flat. And our technology costs, we continue to work to drive those down.

Scott Fletcher^ Great. That's helpful. I have another question. Just quickly, CREA has forecasted just over a 4% increase in sales activity for Saskatchewan during the year. Do you expect that to translate into any increases in the Registry business over the second half of the year?

Shawn Peters^ It's Shawn again, Scott. It's a good question. So CREA is obviously one of the sources that we use to forecast our results as well. But only one of the forecast that we use -- there are several other ones.

At this point, we're not seeing a pickup in 2019. While that may happen, one of the things that happens in our registries is we're usually a bit of a lag, usually at least a 6-month lag, to any sort of pickup in Saskatchewan. So even if that does pan out, I don't think we'd see anything from that in 2019.

Operator^ (Operator Instructions) And speakers, I'm showing no further questions at this time, so I'll be handing the call back to Jonathan Hackshaw for any closing remarks.

Jonathan Hackshaw^ Thanks very much, Jimmy. And with no further questions, just remains for me to thank everybody for joining us again on today's call, and we look forward to speaking with you again at our next reporting period. Have a good day.

Operator^ Ladies and gentlemen, thank you for your participation on today's conference. This does conclude your program, and you may all disconnect. Everyone, have a great day.