Information Services (IQ4 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:

- Paul Treiber; RBC Capital Markets; Director of Canadian Technology & Analyst
- Stephanie Price; CIBC Capital Markets; Director of Institutional Equity Research and Software & Business Services Research Analyst

PRESENTATION

Operator: Ladies and gentlemen, thank you for standing by. Welcome to the ISC Q4 2019 Earnings Conference Call and Webcast. (Operator Instructions)

I would now like to hand the conference to your speaker today, Jonathan Hackshaw, Director, Investor Relations and Capital Markets. Please go ahead, sir.

Jonathan Hackshaw: Thank you, Joelle. Good morning, ladies and gentlemen. Welcome to ISC's Conference Call for the year ended December 31, 2019. On the call 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 by Shawn. Jeff will then make some closing remarks before we open the call up for the 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, 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.

We 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, 2019, and ISC's annual consolidated financial statements and notes and management's discussion and analysis for the fourth quarter and year ended December 31, 2019. Those risks and uncertainties may cause actual results to differ materially from those stated. Today's comments are made as 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.

Jeff Stusek: Thank you, Jonathan. Good morning to everyone joining us on today's call. I'm very pleased to report that we ended the year with some excellent results, in line with our strategy of producing profitable and sustainable growth. I'm especially proud that we delivered nearly $133 million in revenue and almost $39 million in EBITDA, both new records for us.

As always, the strength of our Registry Operations segment helped lay the foundation for these results. While economic conditions continue to impact our registry operations, our team delivered consistent results through prudent management of the business, which, in turn, delivered a consistent quality customer experience. We appreciate the trust our customers in Saskatchewan and the provincial government place in us every day to deliver services to or on their behalf.

While 2019 was a quieter year for new acquisitions, it allowed us to focus on integrating our operations and growing organically through our Services and Technology Solutions segments, achieving a 12% increase in consolidated revenue.

Since we became public in July 2013, we focused on becoming a more diverse business with multiple avenues from which to grow. It's clear to me through the execution of our strategy, we've been delivering leading Registry and Regulatory Service and Solutions, in addition to having a second to none foundation upon which to build.

Our November 2019 announcement regarding the award of a contract by the Irish Aviation Authority to deliver a new safety regulation system is just a small indication of our efforts to expand our offerings.

So as we close the book on 2019, it's safe to say that it really was a great year for us.

Before I look ahead to 2020, I'll ask Shawn to summarize our financial and operating performance for the year, but first, I'd like to make a few comments about COVID-19.

Like everyone, we are monitoring the potential impact of the current outbreak of the coronavirus on our people, operations and business. The situation is evolving rapidly, and we will continue to assess any effect on the company's operations and the economies in which we operate. As you know, our offices are in several different jurisdictions, and we're taking action based on the directions of the applicable local public health authorities. We're also aware of the changes in the condition of the global economy as a result of COVID-19, and we will continue to actively monitor the situation and impacts -- and assess the impacts on our people, our operations and our business overall.

I'll now hand the call over to Shawn.

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 was $133 million for the year, an increase of $13.8 million or 11.6% compared to $119.1 million for the previous year. The increase was due as expected to the higher revenue generated by Services and Technology Solutions.

Net income for the year was $19.4 million or $1.11 per basic and diluted share compared to $18.6 million or $1.06 per basic and diluted share last year. The increase was a result of strong results in all segments and lower overall corporate costs for 2019.

EBITDA for the year was $39 million compared to $38.1 million last year. I'd like to remind everyone that 2018 EBITDA contained a onetime gain of $3.6 million for the adjustment to the fair value estimate of the contingent consideration associated with our AVS acquisition. Therefore, looking at adjusted EBITDA, which excludes stock-based compensation expense or income, stock option expense, transactional gains or losses on assets, and acquisition and integration costs, results were $40 million for the year compared to $35.6 million last year, an increase of 13%.

Our EBITDA margin for the year was 29.3% compared to 32% for 2018. The reduction in year-over-year EBITDA margin was due to the previously discussed impact of the contingent consideration adjustment in 2018, which produced the unusual 2018 margin. Absent the contingent consideration adjustment, the EBITDA margin for 2018 would have been 29%. Our adjusted EBITDA margin of 30.1% for the year was up just slightly compared to 29.9% last year.

Free cash flow for the year increased to $30 million compared to $27.4 million for the same period of 2018 due to higher results from operations.

Looking at some of our significant announcements during the year. On February 19, the company announced that its wholly owned subsidiary, ESC Corporate Services Limited acquired substantially all of the assets used in the business of Securefact Transaction Services, Inc. for $6.8 million by way of an asset purchase agreement.

In September of 2019, the company made the decision to close 3 regional service centers in Saskatchewan due to a steadily declining need for counter service and customers' adoption of online services offered by the company.

On October 9, 2019, we announced that our wholly owned Irish subsidiary, Enterprise Registry Solutions Limited signed an agreement with the Irish Aviation Authority to implement and support its new Safety Regulation System. The total value of the implementation contract is approximately $7 million, with a subsequent agreement expected for system support and maintenance. The new system is expected to go live in 2021.

Turning to our business segments. In Registry Operations, revenue was $70.4 million for the year, flat compared to 2018. Revenue for the Land Registry decreased by 2.3% to $48.9 million for the year. The decrease in 2019 compared to 2018 was due to lower volumes in the Land Titles Registry, which were down 5.4%. However, revenue declined at a lesser pace compared to volume due to slightly higher average land values for regular land transfers, coupled with pricing changes made in July of 2019, affecting title searches. High-value property registration revenue was higher in 2019 at $4.3 million compared to $3.9 million in 2018. Each high-value registration generates revenue of $10,000 or more.

As noted earlier, revenue-generating transactions in the Land Titles Registry fell 5.4% in 2019 due to a slower real estate market in Saskatchewan. Volume of regular land transfers, mortgage registrations and title searches declined by 5.3%, 3% and 4.5%, respectively, compared to 2018.

Revenue for the Personal Property Registry was steady year-over-year at $10.2 million compared to 2018. Registration revenue decreased by 2% compared to 2018, while maintenance revenue was lower by 16.6% in 2019 due to additional revenue in 2018 from a onetime contract for system enhancement. This decline in maintenance revenue was offset by higher search revenue in 2019, up 14.4% compared to 2018 as a result of pricing changes made to search transactions in the third quarter of 2018.

Revenue for the Corporate Registry for the year was $10.2 million, up 1.9% or $0.2 million compared to 2018. This is largely a result of pricing changes made in the third quarter of 2019. Search and maintenance revenue in 2019 improved by 1.5% and 3.3%, respectively, compared to 2018. More specifically, revenue from the filing of annual returns and renewals increased by 6.8% in 2019. Registration revenue declined by 1.1% compared to 2018. EBITDA for Registry Operations was $34.1 million for the year compared to $32.4 million last year, and the increase was primarily due to decreased expenses in registry operations.

Looking at the full year's results in Registry Operations, the impact of economic conditions continue to be evident. However, this line of business remains a strong free cash flow contributor for us, and under the circumstances, has performed extremely well.

In Services, revenue for the year was $51.2 million, up $8.8 million compared to $42.4 million in 2018. Revenue in Services continues to grow, primarily as a result of efforts to generate more business from existing customers through new products and services, such as those from our Securefact acquisition and winning additional mandates with new customers.

Revenue for Legal Support Services was $9 million for the year, a modest increase compared to last year. Revenue from this area consists of nationwide search and registration services as well as corporate supplies provided to legal professionals.

Revenue in Financial Support Services grew from $33.6 million in 2018 to $42 million in 2019. The year-over-year growth is attributed to the winning of new customers in our Collateral Management Services, combined with an expansion of our KYC offering to existing customers. EBITDA for services was $7.1 million for the year compared to $10.1 million last year. As mentioned earlier, EBITDA for 2018 was augmented by an adjustment to the fair value estimate of the contingent consideration associated with our AVS acquisition. Excluding the $3.6 million fair value adjustment, EBITDA was $0.6 million higher for 2019 compared to 2018 due to continued growth, offset by some planned increased spending in services this year.

Finally, in Technology Solutions, we saw revenue of $24.2 million for the year compared to $21.2 million for the same period in 2018. Revenue from third-parties increased to $11.4 million compared to $6.4 million in the same period in 2018, as delivery against milestones on signed contracts advanced during the year. Internal related-party revenue for the year decreased as we worked to continue to reduce our cost to provide the maintenance services to our internal customers. EBITDA for Technology Solutions was $2.3 million for the year, compared to $0.5 million last year, again due to the timing of completion of the contract milestones.

With respect to expenses, our consolidated expenses for the year were $105.3 million, an increase of $9 million compared to the same period in 2018. The increase for the year was due to increased cost of goods sold related to the corresponding increased revenue in Services and increased staffing in Services and Technology Solutions to service our new development and existing implementation and maintenance commitments.

Capital expenditures for the year were $3.9 million compared to $2.8 million for the same period in 2018. Capital expenditures in 2019 were primarily related to the purchase of systems supporting corporate and other, and system development work across our business segments.

With respect to our debt, as at December 31, 2019, the company had $18 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 our financial statements.

From a liquidity perspective, as at December 31, 2019, we held $23.7 million in cash compared to $28.7 million as at December 31, 2018. At the end of December 31, working capital was $17.7 million compared to $13.2 million at the end of last year. The increase in working capital is primarily a result of decreased current liabilities related to the payment last year of the contingent consideration associated with our ERS purchase, the reduction of short-term contract liabilities as we progress through contract milestones, as well as lower income tax payable due to installments made in the quarter.

Consolidated free cash flow for the year was $30 million compared to $27.4 million for the same period in 2018. The increase was due to higher results of operations.

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, 2020, to shareholders of record as of March 31, 2020.

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

Jeff Stusek: Thanks, Shawn. Before we move into the Q&A session, I'd like to share a few thoughts with you about our outlook for 2020.

Similar to 2019, we expect to deliver continued organic growth driven by our Services segment through the expansion of offerings to existing customers as well as the acquisition of new customers throughout the year. In tandem with this, we will also explore appropriate acquisition targets, which are complementary to or add value to existing lines of business.

The diversification of our business remains a key part of our strategy, which we will continue to pursue. Although we expect Saskatchewan's economy to remain flat in 2020 as it pertains to our registries, Registry Operations will continue to be a strong contributor to results in 2020, due largely to the high level of operational efficiency and the resulting strong cash flow this business generates on a consistent basis.

In Technology Solutions, as projects continue to move into the implementation and completion phases in 2020, we expect to recognize increased revenue and profitability on those contracts. Many of those will move into maintenance, and we will continue to pursue new contracts in both the registry and regulatory sectors.

In January, we issued our guidance where we expect revenue of between $135 million and $139 million, EBITDA to be between $37 million and $41 million, and EBITDA margin between 26% and 30%. As of today, that remains unchanged. However, as we noted, we will continue to assess any effect of COVID-19 on the company's operations and economies in which we operate.

To conclude, our focus remains on ensuring the stability of our business, while pursuing our strategies for growth, including accretive acquisitions.

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

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

QUESTIONS AND ANSWERS

Operator: (Operator Instructions) Our first question comes from Paul Treiber with RBC Capital Markets.

Paul Treiber: Just in regards to your retail stores in Saskatchewan, on Monday, you announced that you'd be closing them due to COVID-19. Could you outline the potential financial impact of those closures, if any?

Jeff Stusek: Sure. This is Jeff. Thanks for the question, Paul. Most of our business is done online through our Registry Operations in Saskatchewan. That's a pretty strong online service for us. The closure of the offices to the public, sort of, to walk-in customers was made of sort of interest of the safety of both our staff and of the customers themselves. We actually don't expect those closures to have a financial impact. Those transactions will still happen. They will just happen in alternative ways, through our online channels, through our call center, et cetera.

Paul Treiber: Okay. That's helpful. The -- are there other measures that you're taking to help mitigate the potential disruption to your operations from COVID-19, like things like work from home, or other self-isolation?

Jeff Stusek: Yes, great question. Yes, so the COVID-19 response has been front and center for all of us from the beginning. As I've stated, we have offices, certainly globally, and as the virus sort of evolved around the globe, our response also did. What we have done specifically is, where we can, we are working from home. A lot of our work is done electronically, if you will. And so that ability to work from home and support our customers without a glitch has been a focus of ours. It's public safety, safety of our employees first, safety of our customers first.

Economic decision sort of secondary in that. But we -- I'm confident that we have a really strong work from home. Many of our employees are currently working from home. We've implemented some quarantine processes for anyone that has traveled. So I'm confident with our response to date. As I said, it's probably too early to tell sort of the economic impacts of what's going to happen in the business because it is just frankly too early. But from our business as usual standpoint, I think we're as prepared as we could be.

Paul Treiber: And then in regards to Technology Solutions, it looks like that you hit a number of revenue recognition milestones this past quarter. Was it a number of them just bunching up together? Or is it 1 big one? And then do you anticipate any change in the cadence of milestones going forward either because of normal course of business operations or maybe related to COVID-19?

Shawn Peters: Paul, it's Shawn. Yes, so with respect to the milestones in 2019, we talked a little bit in Q2 and Q3. Some of those milestones were actually expected in Q2 and Q3, and were delayed for various reasons, including just some delays that happened on the customer side. So they did bunch up a little bit in Q4, but we would have expected to recognize most, if not all of those, over the course of 2019. So sort of at the end of the day, it played out correctly.

We are continuing to work on implementation projects into 2020. And so we do still have regular milestones planned for that. Irish Aviation Authority is an example. And then moving some of those into maintenance and support. The cadence on it, as Jeff said, related to specifically COVID-19, it's a little hard to tell at this point. A lot of that work is done electronically or remotely anyways. The impact, we'll have to assess is what's happening with our customers who are also now having to work from home and how that might impact the schedule of some of these implementations or the development. And that's something that we're just working with our customers to see how that will play out.

Paul Treiber: Thanks for that commentary. It's helpful just in light of the uncertainty of the situation. Just last one, just to summarize, like in terms of Technology Solutions. Should we think at a high level, like 2020 revenue for Technology Solutions, at least based on your guidance, should increase year-over-year even taking into account the milestones that fell in Q4?

Shawn Peters: Yes. I think what we're seeing as we go into 2020 as we are seeing the continuation, one of the things that we will be watching and one of the impacts that we'll have to see is how quickly governments, which are largely our customers in that space, progress with some of the initiatives they might have had. So our focus for Technology Solutions is to continue to increase that -- the revenue in that, profitability in that line of business. But 2020 -- we're being a bit cautious on 2020 right now just because of the impact of some of those other factors. Generally speaking, we'd expect that to increase. 2020, we might see a bit more flat in that line with the growth really coming still as we would hope in our services area.

Operator: (Operator Instructions) Our next question comes from Stephanie Price with CIBC.

Stephanie Price: I just wanted to follow up on Paul's question on the Tech Solutions and the MD&A mentioned that much of the implementation revenue was recognized in Q4. And I just want to understand a little bit more how those contracts are structured in terms of the implementation versus the ongoing maintenance?

Shawn Peters: Sure, Stephanie. It's Shawn. Thanks for the question. Generally, the contracts are structured with specific milestones through them. There's fairly traditional waterfall approach to these and that we determined some requirements upfront and deliver those documents, which is a milestone.

And then there'll be milestones through the development work. And then upon implementation, which can be a couple of things. In our cases, we've -- in 2019, in the ones that we've recognized, we've delivered the system ready for implementation and therefore, recognized the revenue associated with that. The customer is yet to go live because they've got internal other items that they need to complete.

And at the point when that happens, we'd have one further milestone, which is the provision of the warranty period. So that's typically how most of the contracts play out, although we are seeing a little bit more -- some shift, I guess, to agile development or IAA contract. We'll have some milestones, but it'd be a little bit more agile in that. But typically, that's how our contracts are structured. And then sorry, after the warranty, then they move into a support and maintenance arrangement.

Stephanie Price: And is that maintenance kind of 8% to 10% of the overall kind of license value? Or how do you kind of think about? I'm just trying to understand the size of that maintenance piece.

Shawn Peters: Yes, good question. It's situation dependent, depending on how much the customer is looking for potential future enhancements because a lot of them will have some level of that built into the support agreement. But we'd be in line sort of with the normal software maintenance, which is usually anywhere between sort of that 10% to 18% or 20% of the value.

Stephanie Price: Okay. Perfect. And then in terms of just the overall economic environment, I was hoping you could walk through what happened in the Registry business in the last recession? And how you kind of worked with the Saskatchewan government there as well?

Shawn Peters: Sure. So I'll start on that. Yes. Yes, I'll start and then if Jeff wants to jump in. So through the -- one of the things we've been lucky to see is the strong performance of Registry Operations through even 2015, as you recall, we -- Saskatchewan is on a pretty significant growth spurt from about 2007 or '08 up to '15 when we started to see that pull off.

And we've been in the challenging situation in Saskatchewan since 2015.Through that whole time, we've maintained our service level standards. We've seen transactions drop. We've had a lot of conversations obviously with our regulator in Saskatchewan about how that's going. But really no impact specifically in -- on requirement in working with the government of Saskatchewan. We have an open dialogue with them all of the time, and we just sort of deal with these as they come. I'm not sure, Jeff, if you have anything else to add to that or...

Jeff Stusek: Yes, I don't know the specificity of the question, Stephanie. So you can clarify that. But certainly, in 2008, sort of through the financial crisis, if you will, where there was some dip in the business, that didn't move any or any changed anything with our sort of relationship, both contractual or otherwise, with the government of Saskatchewan. We still think it's a good solid business. It's a good cash-generating business, and it's efficient.

And so it is able to sort of weather some of these sort of ebbs and flows that might happen in the economy. So specifically, the question on what happened last time. Really nothing, we kept running the business. And sort of we continue to talk with our partners at the government of Saskatchewan. And I don't know what is going to unfold certainly over the next weeks and months, but we'll assess that and work with it as it does.

Stephanie Price: Perfect. Yes, I saw that in 2008, 2009, there might have been some sort of agreement with the government where you had raised prices a bit, or maybe I'm misremembering that.

Jeff Stusek: You know what, honestly, you're probably misremembering it a little bit. There was a situation at that time, remembering we were Crown Corporation owned by the government and there was some policy choices that the government was making at the time, which actually lowered fees, not raised during that time. So if you looked historically at our financials in that time period, there was a bit of an impact on the financial crisis, but there was also the impact of some fees that got lowered through a policy choice. But remember, that was a different time. That was when ISC was a Crown Corporation owned by the government and they're certainly under -- we're under a different sort of contractual relationship with the government now.

Stephanie Price: Fair enough. And then I just had one more around the closing of the in-person regional centers. I know that you closed one permanently in October. And I was just wondering how many more of those do you think could be closed? As you said, I mean, most of your business is now online and through call centers.

Jeff Stusek: Great question, Stephanie. We actually closed 3, to be clear. And so we -- 3 centers that had the lowest walk-in traffic. It really was a statement, a response, if you will, to the evolution of the business that the amount of walk-in traffic, walk-in customer traffic, it's diminishing. And it's diminishing in today's world. It is certainly diminishing in the businesses that we operate as more and more services are available online and more and more customers adopt them.

To answer the question, how many more could we? I think that depends on the evolution of the business and the responsiveness of what happens with our customers. We'll continue to assess that around efficiency. But we'll also assess it around customer need and ensuring that we're meeting the customers' needs as well as that balance of efficiency. So at this point, we don't have plans to close further.

But that's something we're -- we'll always continue to take a look at the best service delivery models that meet the customer needs and are efficient and effective. And so I don't have an answer to your question how many more we could, because right now, we're not closing anymore, but we did close 3 last year.

Operator: I'm not showing any further questions at this time. I would now like to turn the call back over to Jonathan Hackshaw for any further remarks.

Jonathan Hackshaw: Thank you, Joelle. With no further questions, I'd like to thank all of you for joining us on today's call, and we look forward to speaking to you again when we report next. Have a good day.

Operator: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.