Information Services Corporation 2017 Q2 Results
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Corporate Speakers

- Jonathan Hackshaw; Information Services Corporation; Director of IR & Communications
- Jeff Stusek; Information Services Corporation; President and CEO
- Shawn Peters; Information Services Corporation; VP of Finance and Technology and CFO

Participants

- Stephanie Price; CIBC World Markets Inc.; Analyst
- Steve Arthur; RBC Capital Markets, LLC; Analyst
- Justin Keywood; GMP Securities L.P.; Analyst

PRESENTATION

Operator^ Good day, ladies and gentlemen, and welcome to the Information Services Corporation 2017 Second Quarter Results Conference Call. (Operator Instructions)

I would now like to introduce your host for today's conference, Jonathan Hackshaw, Director of Investor Relations and Corporate Communications. Sir, you may begin.

Jonathan Hackshaw^ Thank you, Heather, and good morning, ladies and gentlemen. Welcome to ISC's conference call for the second quarter ended June 30, 2017. With me today are Jeff Stusek, President and CEO; and Shawn Peters, Vice President of Finance and Technology 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 financial statements and management's discussion and analysis for the second quarter ended June 30, 2017, have been filed on SEDAR and are 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 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 14, 2017, and ISC's unaudited consolidated financial statements and notes, and management's discussion and analysis for the second quarter ended June 30, 2017. 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. The first six months of 2017 has been positive for ISC as we continue to perform well and in line with our expectations. Our core registry business remained stable and our consolidated performance has been good overall, with a solid contribution from our Services segment. We still expect economic conditions to remain flat in 2017, but I continue to be optimistic and excited about our business going forward. With the addition of ERS at the start of the year, we've expanded our opportunities for growth, which we continue to pursue.

On that note, I'm pleased to report that during the quarter, through our subsidiary ESC, we completed the acquisition and amalgamation of Alliance Online Ltd., a personal property corporate and land registry search and submission provider. Although this was not a material transaction at a purchase price of $1 million plus working capital adjustments, it provides us with additional capacity in personal property registry services and systems and tucks in well and easily with our existing business in our Services segment.

With that, I'd like to ask Shawn to summarize our financial and operating performance for the second quarter ended June 30, 2017.

Shawn Peters^ Thank you, Jeff, and good morning, everyone. ISC operates in two reportable segments defined by their primary type of service offerings, namely Registries and Services. We report the balance of our corporate activities and shared services functions, including the services and functions provided by ERS in corporate.

Revenue for the second quarter of 2017 totaled $24.6 million on a consolidated basis. Year-over-year, our second quarter revenue was relatively flat by comparison. EBITDA for the second quarter was $8.8 million compared to $10.3 million last year, a decrease of $1.5 million, which resulted in an EBITDA margin of 35.8% compared to 41.7% for the same period in 2016.

Adjusted EBITDA for the quarter was $9.6 million, a 38.8% margin compared to $11.1 million or 45.1% margin for the same period in 2016. The decrease in adjusted EBITDA is mainly attributed to the modestly lower revenue generated in our Land Registry in the second quarter of 2017 compared to 2016.

New expenses related to the addition of ERS as well as costs related to our decision to terminate the technology services contract with DXC effective November 30, 2017. For clarification, DXC is a successor company to HP, with whom we previously had the contract. I will get into further detail on this when we talk about expenses for the quarter.

Our net income for the second quarter was $4.7 million or $0.27 per basic and per diluted share. For the second quarter in 2016, our net income was $6.6 million or $0.38 per basic and $0.37 per diluted share.

Turning to our Registries segment. Revenue was $20.3 million for the three months ended June 30, 2017, down 0.9% compared to the second quarter in 2016. Our second quarter results were lower year-over-year due to decreased revenue from the Land Registry, which was partially offset by an increase in revenue from the Corporate Registry.

That said, we saw an unusually high transaction volumes for the Land Registry in the second quarter of 2016 due to an influx of one-off resource sector interest transactions, which elevated last year's comparison revenues slightly. Despite the slight revenue decline of 2.8% for the Land Registry compared to the second quarter in 2016, there have been some positive signs for this registry. As you know, the majority of the revenue in the Land Registry comes from value-based fees. While most of 2016 saw declines of average land values for regular land transfers, there have been signs of improvement in 2017, with a 3.4% increase in average land values in the second quarter of 2017 compared to the same period in 2016.

Also notable is the increase of 3.3% in geomatics revenue for the second quarter compared to the same quarter last year. This is primarily due to civic address registry data sales in Saskatchewan. While this is not material to overall results, it is an indication of our success in developing new data-related products and services.

Revenue for the Personal Property Registry for the second quarter of 2017 was flat at $2.8 million compared to the same period in 2016. New motor vehicle sales have increased by 14.1% compared to the same period in 2016. Similarly, the primary transaction for this registry, personal property security registration setups, saw volumes grow by 3% in the second quarter of 2017 compared to the second quarter in 2016. However, revenue decreased by 0.3% compared to the same period last year because of registry fee changes made in July 2016, which lowered fees for setups as part of an effort to rebalance fees across our Saskatchewan registries. The rebalancing of fees is part of our ongoing efforts to simplify our flat fees and provide value to our customers.

Revenue for the Corporate Registry for the quarter was $2.6 million, up 10.2% compared to the same period in 2016. When we launched the new system for the Saskatchewan Corporate Registry in July 2016, we implemented a number of permanent changes to the fee structure. These changes, which also changed how we record volumes, included targeted fee increases and ultimately resulted in higher revenue for the registry.

Turning to our Services segment. Revenue for the quarter was $3.6 million, down 1.8% compared to the same period in 2016. While services saw a steady growth in its Know-Your-Customer services, which was up 3% compared to the second quarter of 2016, the overall revenue decrease was mainly due to lower transaction volumes in search and registration services as well as the timing of customer orders in corporate supplies for the quarter.

Search and registration services revenue was $1.5 million for the second quarter, down 4.7% compared to the same period in 2016. Corporate supplies revenue for the second quarter of 2017 was $0.8 million, down 7.7% compared to the same period in 2016. The corporate supplies business is traditionally static with little seasonality. However, it can be impacted by the timing of customer bulk orders, which accounted for the decrease in revenue for the second quarter.

Finally, we turn to our Corporate segment, where we saw an increase in income due to new and ongoing contracts with the government of Saskatchewan for additional services as well as the revenue from ERS.

With respect to expenses, our consolidated expenses were $18.4 million, an increase of 11.8% compared to $16.5 million for Q2 of 2016. The increase was due to a number of factors. Wages and salaries were up $1.5 million compared to the same period in 2016. This was mainly a result of additional wages and salaries from ERS. We also experienced increased salaries in our Services segment due to additional staffing, annual merit increases for out-of-scope employees, and increases to our in-scope employee salaries as per the collective bargaining agreement.

Information technology services costs were $3.1 million, up $0.7 million for the quarter compared to the second quarter of 2016, and for the six months ended June 30, 2017, were $5.5 million compared to $4.7 million for the same period of 2016. As noted earlier, the increase reflects costs related to our decision to terminate the technology services contract with DXC effective November 30, 2017.

Following our purchase of ERS, we are consolidating support and development functions internally to realize future cost savings. Occupancy costs were $1.4 million compared to $1.2 million in the second quarter of 2016. The increase was due to additional occupancy costs from our new subsidiary, ERS, as well as general occupancy cost increases.

Depreciation and amortization costs were $2 million, up $0.2 million compared to the second quarter in 2016. The increase over Q2 2016 was as a result of additional amortization and depreciation of assets from our subsidiary, ERS, and the amortization of a new asset in our Services segment that commenced in the third quarter of 2016.

Capital expenditures for the three months ended June 30, 2017, were $0.1 million compared to $3.4 million for the second quarter in 2016. In 2016, our capital expenditures were focused on the completion of our corporate registry modernization. The lower capital expenditures to date in 2017 are due to management's focus on integration activities, which has affected the expected timing of 2017 initiatives, some of which we still expect to commence later in the year. As such, we have revised our guidance for capital expenditures for 2017 downward from a range of 5.6 -- of $5 million to $6 million to $3.5 million to $5 million.

With respect to debt, as of June 30, 2017, the company had total long-term debt of $32.3 million. Further details on this debt and our credit facilities can be found in our MD&A. From a cash perspective, we had $31.6 million in cash on hand at the end of the reporting period, compared to $33.5 million as of December 31, 2016, a decrease of $1.9 million.

Our working capital was $15 million compared to $25.4 million at December 31, 2016. The change in working capital resulted primarily from a decrease in cash which was used to partially fund the purchase of ERS in the first quarter and fully fund the purchase of Alliance Online in the second quarter, as well as an increase in short-term debt used to fund the remainder of the purchase of ERS.

Free cash flow for the quarter was $7.7 million compared to $6.2 million for the same period last year. The increase in 2017 is primarily due to the acquisition of intangible assets within our Services segment in the second quarter of 2016.

Finally, we also announced yesterday that our Board of Directors approved our quarterly cash dividend in the amount of $0.20 per share. The dividend will be payable on or before October 15, 2017 to shareholders of record as of September 30, 2017.

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

Jeff Stusek^ Thanks, Shawn. To recap, we are pleased with our performance for the quarter and first six months of this year, and continue to anticipate the results for the Registries segment for 2017 will be similar to 2016.

For our Services segment, we expect the Ontario and Quebec economies to deliver modest growth based on optimism in recent real gross domestic product external forecasts. Overall, we expect moderate growth year-over-year in the Services segment due to organic growth, specifically, for Know-Your-Customer services.

We will continue to focus on the integration of ERS into both our business and sales activities while pursuing the business opportunities in the registry technology space globally. With the first half of 2017 already behind us, we reiterate our consolidated annual EBITDA margin guidance for 2017 to be between 31% and 33%.

To conclude, our focus remains on ensuring the stability of our core business while pursuing our strategies for growth to deliver long-term value for our shareholders.

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

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

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Your first question comes from the line of Stephanie Price with CIBC.

Stephanie Price^ In terms of the increase in expenses that we saw in the quarter, can you talk a bit about how much of this is recurring and how much are kind of onetime items related to new projects and bidding activities, et cetera?

Shawn Peters^ Well, a good majority of it is recurring, Stephanie. A lot of it is related to the addition of ERS. So what we're seeing in wages and salaries and what we're seeing in occupancy and those types of cost are all recurring. What would be more onetime and nonrecurring include the termination cost that we see around the DXC contract. And I think the activities and the expenses we have incurred to look at different growth activities and pursue those would be ongoing as well. We have a pretty consistent focus on that.

Stephanie Price^ Okay. Perfect. And then in terms of those growth opportunities, can you maybe talk a bit about what you're seeing in the market? I think you mentioned the corporate revenue line that was in government of Saskatchewan additional services there, and maybe talk more broadly as well.

Jeff Stusek^ Stephanie, Jeff here. I think as we've talked about on several of these calls, our focus really on the business -- we have sort of two focus areas. One is the stability of our core business and making sure it continues to run well and be there for the long term. But on the growth side, we still fundamentally believe that our growth strategies that we have in place are correct and right and we're pursuing those, and those look like finding other jurisdictions to run registries. But with the addition of ERS this year, it opened up some doors from a technology side where we can talk to jurisdictions about applying our RegSys technology to their jurisdictions.

So it's kind of widened, maybe, our growth aperture a little. We're seeing a lot of activity. I obviously, and you know this can't speak specifically on specific opportunities, but we're seeing a lot of activity and we're excited about the growth potential in the company.

Stephanie Price^ Great. And maybe just one more for me on Alliance Online. Maybe you can talk a bit more about what it adds. I sounds like it's a tuck-in that goes with ERS?

Shawn Peters^ Yes, with ESC in our Services segment. It is very much a tuck-in. So ESC already was providing a search and registration, PPSA type of activities. This is just another platform to do that with a book of business of its own and so it gives us a little bigger footprint in that area.

Operator^ And your next question comes from Steve Arthur with RBC Capital Markets.

Steve Arthur^ Just a couple of quick follow-up questions. On the IT expenses, it sounds like those are higher in the quarter, partially on some onetime items, just over $3 million -- totaling just over $3 million. Once some of that is brought in-house, what kind of a run rate might you expect at that stage or how much lower from the Q2 level?

Shawn Peters^ Steve, it's Shawn. So we've been continually decreasing our IT costs over time as we continue to make that more efficient. We are seeing this onetime bump, as you noted, in terms of just the termination of the contract. I think what we'll continue to see as we bring the support and development in-house is a continual downward trend. I'm not really at liberty to talk about what we'll see until we get to that point, but I think you'll continue to see our downward trend that you saw before continue into 2018 and beyond.

Steve Arthur^ Okay. And just on ERS, maybe just to -- if possible, to elaborate a little bit more on the nature of the integration activities that are going on there. Are they the kind of things that would pull costs in or just trying to generate more revenue opportunities? And I guess, related to that, how's the pipeline of new business looking with ERS?

Jeff Stusek^ Steve, I think it's probably a little of both. More than -- this is -- ERS was an established running business with its own pipeline and we wanted to -- and we want to continue to sort of take advantage of that. So it wasn't an acquisition, as we talked about before, built upon synergies and a cost-saving model as much as it's a growth positioning company for us and a strategic acquisition in that way. So I'd say where there are opportunities that makes sense, we're going to go after those synergies, but really the focus is on the growth side.

Steve Arthur^ And that pipeline of new business opportunities, is it expanding --

Jeff Stusek^ Sorry, I neglected to answer that question, I wasn’t (inaudible - microphone inaccessible).

Steve Arthur^ I asked [four] in one.

Jeff Stusek^ But it's all good. The pipeline is -- when we purchased the company, we were aware of the pipeline. It's solid and there's a lot of opportunity in the marketplace. The registry market continues to evolve and develop, and technology is just a key aspect of any registry and any -- certainly, any modernization of the registry. So we liked -- we were really attracted with the RegSys platform as a customer, and we're still are very attracted as an owner now. And there's a good pipeline there. It's a competitive business. That side of the business is certainly competitive, but we're well positioned to be successful in a number of opportunities for sure.

Steve Arthur^ Just switching gears a little bit. The share of earnings from the associates was, I think, almost $600,000 in the quarter, a little bit more than expected and it's bounced around some. Is this a reasonable run rate to look at in future quarters, Shawn?

Shawn Peters^ Yes. It would be, Steve. I expect actually it will be up a little bit. What you saw, the bouncing around was -- so that's our investment, as you know, in Dye & Durham. Dye & Durham acquired OnCorp in March and so there was a bit of bouncing around because of acquisition and integration expenses, but we're sort of in a normal period now, so you should see this continue.

Steve Arthur^ Okay. And just final one on CapEx plan, understand the changes there. Is it right to think of that as a deferral of opportunities and things that you'll probably pick up in '18 and beyond? Or was there change in some of the opportunities that you're pursuing?

Shawn Peters^ It's a little bit of both. I'd say mostly a deferral, Steve. But as Jeff talked about and we talked about on the call, there is some integration going on with ERS in bringing that support and development in-house. As we -- as you know, our Saskatchewan Corporate Registry is built on the RegSys platform. And now that we have that technology and that expertise in-house, we're also looking at how that will apply across some of our other registries. So we're deferring a little bit while we conduct that analysis and integration. So I expect most of it will get picked up, but a couple pieces might drop off that are no longer applicable.

Operator^ (Operator Instructions) Your next question comes from Justin Keywood with GMP Securities.

Justin Keywood^ Just in the outlook section, there is some commentary of continued expectation for a flat year this year compared to last. I was just wondering if that's excluding the ERS acquisition contribution?

Shawn Peters^ Yes. Yes and no, I guess. We still expect to see flat for 2017. So with the Saskatchewan and Ontario, Québec, as we talked about, when we purchased ERS, and Jeff talked about this before, it's more of a strategic acquisition positioning us for growth. So we didn't see it being meaningful towards results in 2017 either, so it's also included in that flatness. But there are a number of opportunities that Jeff talked about. And as those come in, it will have an impact. I just wouldn't expect that in 2017.

Justin Keywood^ Okay. Fair enough. And just on the resource-based transactions. I'm wondering if you're expecting this to be a headwind for the remaining two quarters of the year? And how do you see that going forward?

Jeff Stusek^ Yes. I think -- I don't know if I'd call it a headwind. I think we're in a time where it's more consistent with our usual. What we saw last year was sort of an influx, a large influx of transactions that happened as the price of oil was sort of in trouble. We seem to be in more of a stable period now and I think we'll see the continued stability for the rest of the year.

Justin Keywood^ Okay. That's helpful. And then just, finally, I saw some commentary on the impact of higher interest rates on the Land Registry, but maybe you can give some additional color on how you anticipate that affecting your business going forward?

Jeff Stusek^ Yes. It's one of the key factors, obviously, that we include in our forecasting for our registries. From a conceptual standpoint, it's fairly straightforward in the sense that the higher interest rates tend to put people off of buying a new home for a period of time, but it's usually fairly short lived. This is the first increase we've seen in a long, long time, as you know. And so we're not expecting, at this point, a significant impact to the registry volumes. But time will tell if that interest rate continues to go up.

Operator^ And I'm showing no further questions at this time. I'd like to turn the call back over to Mr. Jonathan Hackshaw for closing remarks.

Jonathan Hackshaw^ Thank you, Heather. And with no further questions, I'd like to, once again, thank everyone for joining us 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 participating in today's conference. This does conclude the program and you all may disconnect. Everyone, have a wonderful day.