Information Services (Q3 2019 Earnings)
November 07, 2019

Corporate Speakers:

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

Participants:

- Scott Fletcher; CBIC Capital Markets; Analyst

PRESENTATION

Operator^ Ladies and gentlemen, thank you for standing by, and welcome to the ISC Third Quarter 2019 Earnings Conference Call and Webcast.

(Operator Instructions)

Please be advised that today's conference is being recorded.

(Operator Instructions)

I would now like to hand this conference over to your speaker today, Mr. Jonathan Hackshaw. Thank you. Please go ahead, sir.

Jonathan Hackshaw^ Thank you, Skyler, and good morning, ladies and gentlemen. Welcome to ISC's conference call for the quarter ended September 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 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 condensed consolidated interim financial statements and management's discussion and analysis for the period ended September 30, 2019, have been filed on SEDAR and are also available in 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 for the year ended December 31, 2018, and ISC's unaudited condensed consolidated financial statements and notes and management's discussion and analysis for the three and nine months ended September 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 would like to turn the call over to Jeff.

Jeff Stusek^ Thank you, Jonathan, and good morning to everyone joining us for today's call. Our performance this quarter was solid even though we continue to be impacted by a challenging economic environment in Saskatchewan.

Both Registry Operations and Services performed well, and we're also pleased to announce the award of a new contract for our technology services business by the Irish Aviation Authority subsequent to the end of the quarter. The total value of the implementation contract is approximately CAD 7 million with a subsequent agreement expected for the system support and maintenance. The new system is expected to go live in 2021.

As I said at the time of the announcement, we continue to pursue opportunities that will expand the application of our products and solutions to fit a range of new registry and regulatory markets. This agreement with the Irish Aviation Authority not only demonstrates the strong capabilities of our RegSys technology as a modern and advanced solution for aviation regulatory systems, but also the confidence in our team to deliver a world-class product.

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

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

Revenue was $32.2 million for the quarter, an increase of $2 million or 6.6% compared to the third quarter of 2018 due to continued growth in our Services segment. Net income for the quarter was $3.3 million or $0.19 per basic and per diluted share, a decrease of $4.5 million compared to the same period of 2018.

During the quarter, the company made the decision to close three of its regional service centers in Saskatchewan, in addition to other services, due to customers' reduced need for counter services given the online services offered by the company.

As a result, included in the quarterly results are $1.4 million of costs related to severance, safety commissioning, contract termination costs and the impairment of related assets. Therefore, the year-over-year decrease in net income for the quarter is largely due to the $1.4 million in onetime costs related to the closures as well as the $2.8 million gain we had in 2018 from an adjustment to the contingent consideration associated with our AVS acquisition.

Our EBITDA, or earnings before interest, taxes, depreciation and amortization expense, for the third quarter was $8.6 million compared to $12.1 million for the same quarter last year. Excluding the $2.8 million adjustment in 2018 and the onetime cost this quarter related to office closures, EBITDA was flat for the quarter as compared to the same quarter in 2018.

The EBITDA margin for the quarter was 26.7% compared to 40.2% in the same quarter in 2018, down as a result of the contingent consideration adjustment last year and, as expected, due to the continued growth of our lower-margin Services 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 $8.7 million for the quarter compared to $9.7 million in the same quarter last year, down largely due to the onetime costs associated with our office closures.

Free cash flow generated in the quarter was $6.6 million, a decrease of $1 million compared to the third quarter of 2018, again, mainly due to the onetime costs associated with the office closures.

Turning to our specific segments. Revenue for Registry Operations was $17.6 million for the quarter, a slight decline of $0.3 million compared to the third quarter in 2018 due to decreased revenue from the Saskatchewan 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 was $12.4 million, a decline of $0.4 million compared to the same period in 2018 from a combination of lower transaction volumes, partially offset by pricing increases made in July 2019, which primarily affected title searches.

Revenue from high-value transactions was $0.8 million for the quarter, up from $0.7 million in the same period in 2018. As a reminder, each high-value registration generates revenue of $10,000 or more.

The Saskatchewan real estate market continues to display softness as evidenced by the lower transaction volumes we've experienced year-to-date in 2019. Overall transaction volumes for the Land Registry decreased 3.4% for the third quarter of 2019 compared to the same period last year.

The Saskatchewan Personal Property Registry and Saskatchewan Corporate Registry both performed well in the third quarter and were largely stable as compared to last year. While smaller in size than the Land Registry, these two registries continue to make solid contributions to our top and bottom line, given that they are both highly automated. Nearly 100% and over 80% of all transactions for the Personal Property Registry and the Corporate Registry, respectively, are completed online.

Expenses for Registry Operations were $9.2 million for the quarter, a slight increase of $0.2 million for the same -- from the same period in 2018. The increase as compared to last year was due to the onetime office closure costs mentioned earlier, partially offset by lower costs for technology services and lower corporate allocated costs, which have also contributed to lower year-to-date costs overall.

As a result, Registry Operations EBITDA for the quarter was $8.3 million, down from $8.9 million in the same period last year due to the slightly lower revenue and the increased expenses in relation to the office closure costs.

Turning to our Services segment. Revenue for Services was $12.9 million for the third quarter, an increase of $2.4 million compared to the third quarter of 2018, up as a result of a mixture of organic growth within existing customers and the addition of new customers, particularly in KYC, due diligence and collateral security registration.

Financial Support Services revenue was $10.8 million, up $2.3 million or 27.6% compared to $8.5 million for the same period of 2018. The improvement represents the strong advancement in our collateral management product line, combined with further extension 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 quarter up to $2.1 million, an increase of 5.2% compared to the third quarter in 2018.

For the quarter, Services expenses were $11.1 million, an increase of $2 million compared to $9.1 million for the same period in 2018. The increase was primarily due to an increase in wages and salaries due to increased staffing levels required to support the growing business as well as the addition of staff related to our acquisition of Securefact in the first quarter of 2019; an increase in our cost of goods sold for the quarter, consistent with the rise in related revenue in the quarter; and an increase in our IT costs due to our acquisition of Securefact and our planned integration and technology improvements as we look to optimize our platforms and offerings for our growing business.

EBITDA for Services was $1.8 million for the quarter, a decrease of -- a decrease from the $4.1 million reported for the same period last year. As a reminder, EBITDA in the third quarter and year-to-date last year was augmented by adjustments to the fair value estimate of the contingent consideration associated with our AVS acquisition. Excluding the $2.8 million fair value adjustment in the third quarter of 2018, EBITDA for Services was $0.5 million higher for the third quarter of 2019 versus 2018.

Finally, in our Technology Solutions segment, revenue was $5.1 million for the quarter compared to $5.5 million in the same period in 2018, with the decrease in revenue from external parties being due to the timing of milestone-based contracts.

Technology Solutions expenses were up $0.3 million for the quarter compared to the same period in 2018 due to higher wages and salaries as we increased employee levels to service the contract to customers in the growing business, which was partially offset by decreases in information technology costs under our renewed service contract. The net result is a slightly negative EBITDA for the quarter, impacted mostly because of the timing of certain milestone-based contracts.

Capital expenditures for the quarter were $0.8 million compared to $0.6 million for the same period in 2018. Our capital expenditures are currently focused on enhancements to the system supporting corporate and other system and system development work across our business segments.

With respect to our debt, as at September 30, 2019, the company had $18.5 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 September 30, 2019, we held $19.3 million in cash compared to $28.7 million at December 31, 2018. Working capital at the end of the quarter was $12.8 million compared to $13.2 million at December 31, 2018. The decrease in both cash and working capital is primarily the result of our acquisition of Securefact in February 2019.

Consolidated free cash flow generated in the quarter was $6.6 million compared to the $7.6 million for the same period in 2018. The decrease in the quarter was primarily due to the onetime costs associated with our office closures.

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 January 15, 2020, to shareholders of record as of December 31, 2019.

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

Jeff Stusek^ Thanks, Shawn. Registry Operations continues to feel the effects of general economic conditions, but it is still delivering healthy free cash flow. The growth in our Services line is helping to offset those effects, and this segment now accounts for nearly 40% of consolidated revenue. Technology Solutions continue to focus when executing on current implementations of the new contracts, and we expect to realize profitability in the short term.

The diversification of our business remains a key part of our strategy. And for the balance of 2019, ISC will continue to drive the organic growth of all our segments by looking to expand our service offerings, secure new business and explore appropriate acquisition targets which are complementary to or add value to our existing lines of business.

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

Jonathan Hackshaw^ Thanks, Jeff. Skyler, 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^ I just wanted to ask about registry margins and whether the full impact of those onetime expenses is going to be felt in Q3, if any of that is going to bleed over into Q4 at all?

Shawn Peters^ Scott, it's Shawn. Thanks for the question. No, most of that impact should be felt in Q3. We think we have a pretty good estimate of the value of all those costs, so it should all be accrued in Q3. There'll only be very, very minor, spillover into Q4, if any.

Scott Fletcher^ Okay, great. I had a second question, just about the technology business. And just wondering broadly if the signing of the Irish Aviation Authority deal provides sort of a framework for other deals within the technology business in terms of deal size or target customer.

Jeff Stusek^ Good question. It's Jeff. The obvious answer is, yes, we're excited that the Irish Aviation Authority and us could partner on this exciting new project. It's really a project that's taking the basis of registry expertise and technology and applying it in a new space.

That obviously, in many ways, creates a new marketplace potentially down the road. We're focused currently on successful delivery on the Irish Aviation Authority, but I think it demonstrates that we do have world-class technology and we have world-class people that will deliver.

And so it does open, if you will, the sort of aperture of where we could apply this registry technology in different sort of, I'll say, nontraditional markets to us. But it sort of demonstrates our expertise in the registry space and the regulatory space.

Operator^ (Operator Instructions)

I'm showing no further questions at this time. I'd like to turn the call back over to Jonathan for any closing remarks.

Jonathan Hackshaw^ Thanks, Skyler. With no further questions, once again, we'd like to thank everyone for joining us on today's call. We look forward to speaking to you again when we next report. Have a good day.

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