Information Services (Q1 2020 Earnings)
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Corporate Speakers:

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

Participants:

- Stephanie Price; CIBC World Markets Inc.; Analyst
- Paul Treiber; RBC Capital Markets; Analyst

PRESENTATION

Operator^ Ladies and gentlemen, thank you for standing by. Welcome to the ISC Q1 2020 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 the conference over to your speaker today, Jonathan Hackshaw, Director, Investor Relations & Capital Markets. Thank you.

Please go ahead, sir.

Jonathan Hackshaw^ Thank you, Angela. Good morning, ladies and gentlemen. Welcome to ISC's conference call for the quarter ended March 31, 2020.

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 quarter by Sean. Jeff will then make some closing remarks before we open up the call to the 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 notes and management's discussion and analysis for the period ended March 31, 2020, 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.

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 meanings 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 unaudited condensed consolidated interim financial statements and notes and management's discussion and analysis for the three months ended March 31, 2020. 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.

Jeff Stusek^ Thank you, Jonathan. Good morning to everyone joining us for today's call.

Like everybody else, COVID-19 has ended up being the dominant factor for the first quarter of 2020, despite what, for us, was a very solid quarter, even when you consider the impact of COVID.

As you know, we have offices and people operating in several different jurisdictions and acted -- have acted 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 assess the impact on our people, our operations and our business overall.

At this time, our primary focus, until all restrictions related to COVID-19 are removed or at least relaxed, is ensuring the continuity of our services with the health and safety of our employees, customers and stakeholders a top priority. All our businesses are operating, with most of our employees working from home. And our results for the quarter were excellent, considering the circumstances. My thanks go to all our employees for coming together, ensuring we can continue to deliver for our customers.

I'll now ask Sean to summarize our financial and operating performance for the quarter.

Shawn Peters^ Thank you, Jeff, and good morning, everyone. I'll provide you with some of the highlights of the 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 was $29.6 million, an increase of $1 million or 3.5% compared to the first quarter of 2019 due to higher revenue in our Services segment. Our consolidated expenses were $24.5 million, an increase of $0.7 million compared to the same quarter last year, mainly due to increased cost of goods sold, consistent with the increased revenue and services, some increased wages and salaries in Services and Technology Solutions to support our growing business and customer needs, which were partially offset by lower information technology costs, decreased staffing in Registry Operations related to the regional service center closures in the third quarter of 2019 as well as decreased professional and consulting services for the quarter.

EBITDA, which is earnings before interest, taxes, depreciation and amortization expense, was $7.8 million compared to $7.4 million in the same quarter last year, an increase of 6.4%. EBITDA margin for the first quarter of 2020 was 26.5% compared to 25.7% in the same quarter in 2019. Adjusted EBITDA was $7.9 million for the quarter compared to $7.8 million in the same quarter last year, with an adjusted EBITDA margin of 26.7% for the quarter compared to 27.3% in the first quarter of 2019. Net income was $3.5 million or $0.20 per basic and diluted share, an increase of $0.5 million compared to the first quarter of 2019, when net income was $3 million or $0.17 per basic and diluted share.

Turning to our business segments. Revenue in Registry Operations was $15.5 million for the quarter, down $0.8 million compared to the same period in 2019. As you would expect, transaction volumes and revenues in our Land Registry and Personal Property Registry were lower than expected for the quarter due to restrictions implemented in response to the COVID-19 pandemic. To date, the restrictions have negatively affected the ability of our customers and ultimately, their customers to transact. Nevertheless, the registries remain operational, and our staff are able to provide service to customers via our online portal or by telephone.

Revenue for the Land Registry decreased to $10.4 million in the quarter, down from $11.3 million in Q1 of 2019. The decrease in 2020 compared to the prior year was due to transaction volumes that were down by 4.6% for the quarter, primarily during the last half of March due to the restrictions imposed for COVID-19. High-value property registration revenue, where each high-value registration generates revenue of $10,000 or more, was down in the quarter at $1 million when compared to a record first quarter in 2019 at $1.3 million.

Revenue for the Personal Property Registry was $2.2 million for the quarter down $71,000 or 3.1% from the same quarter in 2019. Overall volume was down 1.7% for the quarter compared to the same period in 2019 with some impact from the restrictions imposed for COVID-19 in the last 2 weeks of the quarter. More specifically, registration revenue in the Personal Property Registry in the quarter was down by 4.7% from 2019, while volumes were down 4.8%. Search revenue was flat on stable volumes compared to last year. Maintenance revenue was down 2.1% compared to the same period in 2019 on lower volumes, which were down 5.4%.

Revenue for the Corporate Registry for the quarter was $2.9 million, up $0.2 million or 7.1% compared to the same period in 2019 as pricing changes came into effect during the third quarter of 2019. Pricing changes resulted in maintenance revenue growing by 8.2% and registrations growing by 7.7% in the quarter compared to the same period in 2019. Search revenue was flat in the first quarter of 2020 compared to the same period in 2019.

EBITDA for Registry Operations for the quarter was $6.4 million compared to $6.8 million for the same period last year. The decrease was due to decreased revenue, as explained earlier, from the impact of COVID-19, which was partially offset by reduced staffing expenses from our regional service center closures in 2019 as we continue to manage costs.

In Services, revenue for the first quarter of 2020 was $11.8 million, an increase of $0.8 million or 7.4% compared to the same period in 2019 due to a combination of organic growth from existing customers and the ramping up of new customers, mainly in KYC, due diligence and collateral security registration.

Revenue in Legal Support Services for the quarter increased to $2.4 million, up 6.4% compared to the first quarter of 2019 due to organic growth and product expansion. Revenue in Financial Support Services for the quarter was $9.4 million, up $0.7 million or 8.3% compared to $8.7 million for the same period in 2019. Revenue growth was due to new customers in our collateral management services and expanding our KYC offerings to existing customers. The transaction volume in both Legal and Financial Support Services was negatively impacted in the last 2 weeks of March due to the impact of COVID-19, and we expect this will continue until restrictions related to COVID-19 are lifted across Canada and the economy restarts.

EBITDA for Services was $2.1 million for the quarter compared to our reported $1.5 million for the same period last year. However, as explained in our MD&A, on January 1, 2020, we adopted a new methodology for allocating corporate costs to the operating segments. Had this method been applied in 2019, EBITDA for Services would have been $1.9 million in 2019, making the increase in EBITDA $0.2 million year-over-year, consistent with the margin on increased revenue.

Finally, Technology Solutions saw revenue of $4.7 million for the quarter, a decrease of $0.2 million compared to $4.9 million for the same period in 2019. Revenue from external parties for the quarter was $2.2 million, an increase of $0.8 million compared to the same period in 2019 due to the completion of milestones in the quarter on our current contracts. Internal-related party revenue in any quarter is dependent on resources used or consumed internally, particularly in Registry Operations. Our intent is to continue to service the needs of our internal customers as efficiently and as effectively as possible, including the provision of service via related-party resources. And therefore, this figure may vary over time.

EBITDA for Technology Solutions was $0.6 million for the quarter compared to the $0.4 million that we reported in the first quarter of 2019. Again, as explained in our MD&A,

had the new method of corporate cost allocations to our segments been applied in 2019, EBITDA for Technology Solutions would have been $0.2 million in 2019, making the increase in EBITDA of $0.4 million year-over-year consistent with our efforts to look for efficiencies in our technology service provision.

On to other items. Our capital expenditures were $0.3 million for the quarter compared to $0.9 million for the same period in 2019. Capital expenditures in the first 3 months of 2020 were primarily related to systems supporting our corporate functions and system development work across our business segments versus some larger technology additions in 2019.

With respect to our debt, at March 31, 2020, the company had $17.5 million of total debt outstanding compared to $18 million at December 31, 2019. Further details on our debts and our credit facilities can be found in our MD&A and financial statements.

From a liquidity perspective, at March 31, 2020, we held $21.2 million in cash compared to $23.7 million at December 31, 2019. As of the end of March 31, working capital was $19.5 million compared to $17.7 million at the end of last year. The increase in working capital is primarily the result of decreased current liabilities related to the timing of payables and the payment of taxes as well as decreased income tax payable.

Consolidated free cash flow for the quarter was $6.4 million compared to $5.3 million for the same period in 2019. The increase was due to higher results of operations and less additions to intangible assets in the quarter. 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 July 15, 2020, to shareholders of record as of June 30, 2020.

With that, 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. This pandemic has had a negative effect on the global economy, which has made the future uncertain. One factor influencing the outlook for both our Registry Operations and Services segments is the impact on our transaction volumes due to the restrictions put in place to help contain the spread of COVID-19. Despite this, the services offered by both segments have remained available to all our customers via our online portal or telephone and without interruption since the spread of COVID-19 began. Nevertheless, we expect our volumes from existing customers to be lower than normal for the balance of 2020.

For our Technology Solutions segment, several implementations are ongoing. As jurisdictions focus on responding to COVID-19, we expect that the time lines and, therefore, the recognition of our revenues for some of our implementations will be delayed. Due to the uncertainty surrounding the duration and potential outcomes of the COVID-19 pandemic, we are unable, at this time, to predict the overall impact on our operations and our financial results for the remainder of the year, but the impact may be material. As a result, we are withdrawing our guidance.

Although we expect COVID-19 to adversely impact transaction volumes, revenue and EBITDA in the short term, the company is well positioned to manage through the situation, and our long-term strategy remains centered on delivering value for shareholders through the consistent performance of our existing business and the execution of our appropriate growth opportunities.

We believe we've built a strong, sustainable and growing business, underpinned by our 2 largest segments, Registry Operations and Services. These 2 segments deliver consistency and growth, respectively, while our Technology Solutions segment focuses to become a meaningful contributor to our consolidated results in the years to come. We will get through this and emerge stronger for it on the other side.

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

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

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions)

And your first question comes from Stephanie Price with CIBC.

Stephanie Price^ Despite the headwinds in the economy, ISC's margins have continued to hold in. And I was hoping you could talk a bit about your fixed versus variable cost base, some of the levers you're using to respond to the crisis.

Shawn Peters^ Stephanie, it's Shawn. Thanks for the question. It's a good question. Obviously, we do have a fair bit of fixed cost as we've outlined in calls and discussions in the past, those being our technology costs and our people costs being the 2 largest ones.

Having said that, we're certainly taking advantage of any opportunities in both those areas to control the costs. And some of the moves that we made last fall in the closures of our 3 regional service centers are certainly helping in that regard. The impact is a little bit more significant in our Services segment, where Ontario and Quebec shut down fairly early. And so we're taking the appropriate steps in those -- in that segment, in particular, with respect to the variable costs to control them as best we can.

Stephanie Price^ And then I was hoping you could give just a little bit more color on the Technology Solution division implementation. So can it be done somewhat remotely? Or does it have to be all on-site? And how should we kind of think about revenue coming from that division as regions are kind of shut down here for a bit?

Shawn Peters^ Yes, that's an interesting one. So the simple answer is, yes, by and large, it can be done remotely. And in fact, we were already doing that in some of our jurisdictions. That being said, we did often have some people on the ground at client sites and locations, and so we've had to change how we do the business there. But that's been pretty seamless for us.

The challenge in implementing that now is really more on the client side and their ability to work from home and to get things organized. But so far, that's been going fairly well. As Jeff outlined, though, we do expect that there could be some impact to that as jurisdictions maybe have to pause or just reprioritize some of their activities over the next few weeks or months, and that might delay some of those implementations, but we're certainly able to do all of them remotely.

Stephanie Price^ Okay. And then just one final one for me. In terms of the guidance commentary. It included in the sentence noting that you were continuing to look at M&A. And I was just curious about the current M&A environment. And are you seeing better valuations just given the environment we've got out there?

Jeff Stusek^ Stephanie, Jeff here. I think, as always, our approach to M&A is such that we're going to look for opportunities that make sense for us at the right price that fit into sort of our strategy. And that, quite frankly, is no difference through COVID. And there are opportunities that sort of emerge, maybe they're because of COVID, who could speculate. And we continue to look at those under that scenario.

I would say COVID probably has an effect. And if you were talking to most CEOs, COVID has had an effect on valuations, and we're probably seeing something similar. That being said, that's not something necessarily imminent coming for us, but we're not diverting from our strategy through COVID. And we're -- we still do have a strong balance sheet, and still able to be aggressive if we need to on the pursuit of opportunities.

Operator^ Your next question comes from Paul Treiber with RBC Capital Markets.

Paul Treiber^ Sorry, I missed the earlier portion of the call, so I may be repeating something that came up earlier. But just in light of the financial pressures overall in the market from COVID, have you had any recent discussions with governments that are considering outsourcing or selling their registry businesses in light of this environment?

Jeff Stusek^ Thanks for the question, Paul. I'd say the conversation is no different than it is typically. So directly to your question, as a result of COVID, we have not had conversations with governments. That being said, we continue to have conversations with governments about their outsourcing of the registries. So I'd say COVID hasn't changed that -- those conversations in any way.

Paul Treiber^ And with the move to work from home, and then considering all transactions now are either online or via your call centers, have you considered further moving away from your retail stores and just essentially becoming an online-only business?

Jeff Stusek^ Great question, Paul. I think we were accelerated to this move from home from an external cause, i.e. COVID, and we're able to seamlessly transition our customers that way. That sort of begs the question. I think we have to take a good hard look at that, but we also have to sort of assess what the customer impact has been. And so customers have found a way. But maybe that's not an effective way, and we have to assess that for sure.

What we are able to say is we crossed a hurdle in essentially being able to serve our customers almost exclusively remotely. And so that hurdle gives us an opportunity to take a look at all of our operations and sort of attack our service delivery in an effective way. But we also have to make sure our customers are continuing to get the service they need because that's sort of an underpinning of our infrastructure, if you will, of our business. So that's a long answer to your question that it does give us some something to consider as we look at our service delivery model going forward.

Operator^ (Operator Instructions)

And you have no further questions at this time. I'll hand the call back to Mr. Hackshaw for closing remarks.

Jonathan Hackshaw^ Thank you, Angela. With no further questions, we'd like to thank everyone for joining us on the call today. We look forward to reporting and speaking with you again when we report our second quarter later on in the year.

Have a good day.

Operator^ Ladies and gentlemen, this concludes today's conference call.

Thank you for participating. You may now disconnect.