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PRESENTATION

Operator

Good day, and thank you for standing by. Welcome to the ISC Q2 2023 Earnings Conference Call. (Operator Instructions) Please be advised that today's conference is being recorded. I would now like to hand the conference over to your speaker today, Jonathan Hackshaw, Senior Director, Investor Relations and Capital Markets. Please go ahead.

Jonathan Hackshaw ***Information Services Corporation - Senior Director of IR & Capital Markets***

Thank you, Shannon, and good morning to everyone joining us today. Welcome to ISC's conference call for the second quarter ended June 30, 2023. On the call today with me are Shawn Peters, President and CEO; and Bob Antochow, Chief Financial Officer. This morning, Shawn will take you through some of the highlights of the quarter. Bob will then provide some financial and operating highlights for the quarter before passing the call back over to Shawn for some closing remarks.

Before we begin, we would like to remind everyone that we will only be summarizing results today. The company's financial statements and MD&A have been filed on SEDAR+ and are available on our website. 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. 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 laws. 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. I would now like to turn the call over to Shawn.

Shawn B. Peters ***Information Services Corporation - President & CEO***

Thank you, Jonathan, and good morning to everyone joining us for today's call. Results highlight the overall stability that we've built into our business with solid diversification and key acquisitions. While successive increases to interest rates by the Bank of Canada, including the most recent and somewhat unexpected one have affected activity in the Saskatchewan Land Registry, the other parts of our business are making up for that.

Activity in our Services business and the addition of our Property Tax Assessment business helped offset any impact to our revenue in the quarter from the lower Land Registry transactions. While adjusted EBITDA has naturally been affected from the change in revenue mix and related margins, the overall results are solid. More specifically on Registry Operations, we expected some contraction in our Saskatchewan registry markets with a higher interest rate environment and that's what we've seen.

As I noted in May, when we reported our first quarter results, we expect that will continue for the balance of the year, but that does not diminish the contribution of our registry results. And the steady revenue from the addition of the Ontario Property Tax Assessment Services business is helping to offset any impact to Registry Operations overall. As you see in our results, Registry Operations remains a strong adjusted EBITDA and free cash flow contributor to the overall business.

At the same time, Services continues to be the main driver of organic revenue growth for ISC. The Regulatory Solutions division had a strong quarter, driven by many of our financial institution customers implementing increased due diligence as a result of the higher interest rate environment. We also continue to acquire and onboard new customers even in a challenging macro environment.

And finally, as expected, Technology Solutions has been advancing the delivery of various contracts announced earlier in the year, and we're starting to see this reflected in our revenue for the segment as we hit various milestones for those and other ongoing contracts. The progress on these new contracts and focus on completing the ongoing contracts has bolstered third-party revenue for the current year.

As most of you know, subsequent to the end of the quarter, we announced the extension of our master service agreement with the province of Saskatchewan. This was a milestone and one which positions us incredibly well for the future while securing the stability of the Saskatchewan Registries by having a known and trusted provider in place until 2053. The extent of our investment in the Saskatchewan Registries addressing the evolving security infrastructure and other escalating people and technology costs that are required to deliver the reliable and assured title transaction services on a timely basis that we do.

As an organization, we continue to execute on our strategic priorities. Our focus on continued organic growth, our execution on strategic and accretive acquisitions and now having completed a 30-year registry contract to underpin all of that, we are extremely well positioned to continue to deliver the strong, stable and growing results within our hallmark. I'll now turn the call over to Bob to discuss some financial highlights before providing some closing thoughts.

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

Thank you, Shawn, and good morning, everyone. As Shawn said, our 2023 results are in line with our expectations and (inaudible) positive. This performance was driven by a number of factors, but more specifically, revenue was $53.3 million for the quarter, an increase of 5% compared to the second quarter of 2022. This was primarily driven by increased revenue and services spurred by continued transaction and customer growth in Regulatory Solutions and additional third-party revenue in Technology Solutions as progress was made on both ongoing and new contracts.

Registry Operations also contributed to the increased revenue as a result of the full 3 months of results from the Ontario Property Tax Assessment Services division compared to 1 month in the prior year following its acquisition on June 1, 2022. This was offset by a decrease in Saskatchewan Land Registry revenue due to reduced activity in the Saskatchewan real estate sector during the quarter.

Net income was $8.2 million or $0.47 per basic and $0.46 per diluted share compared to $11.7 million or $0.66 per basic share and $0.65 per diluted share in the second quarter of 2022. The decrease in net income compared to the prior year is the result of the decrease in Saskatchewan Land Registry revenue, an increase in share-based compensation, increased investments in people, offset by income from the Ontario Property Tax Assessment Services division for 3 months in the current year compared to 1 month in the prior year.

Net operating activities was $14.3 million for the quarter, an increase of $2 million, driven by changes in noncash working capital, primarily an increase in accounts payable, increase in cash flows, partially offset by lower net income. Adjusted net income was $9.3 million or $0.52 per basic share and $0.51 per diluted share compared to $10.8 million or $0.62 per basic share and $0.60 per diluted share in the second quarter of 2022. This decrease primarily relates to a decrease in Saskatchewan Land Registry revenue, higher intangible assets arising from the acquisition of the Ontario Property Tax Assessment Services division in 2022 as well as higher net finance expense.

Adjusted EBITDA was $17.8 million for the quarter compared to $19.2 million in 2022, primarily due to a reduction in Saskatchewan Land Registry revenue in the current year to Saskatchewan real estate sector, increased personnel costs supporting both Technology Solutions and the corporate segments, partially offset by a full 3-month adjusted EBITDA contribution from Ontario Property Tax Assessments compared to 1 month in the prior year and additional revenue from customer and transaction growth in Regulatory Solutions. Adjusted EBITDA margin was 33.4% compared to 37.8% in the second quarter of 2022.

Adjusted free cash flow for the quarter was $11.9 million, down 10% compared to $13.2 million in the second quarter of 2022, primarily related to reduced revenue in the Saskatchewan Land Registry due to lower activity in the Saskatchewan real estate sector accompanied by increased interest expense resulting from higher interest rates and borrowings outstanding when compared to the prior year.

Turning to our balance sheet. With respect to our debt (inaudible) 2023, the company had $51.1 million of total debt outstanding compared to $66 million as at December 31, 2022. During the second quarter, due to excess cash and the desire to minimize interest expense, we made a $5 million voluntary prepayment against our revolving facility, bringing total year-to-date prepayments against the revolving facility to $15 million. After all this, as at June 30, 2023, we held $26.6 million in cash compared to $34.5 million as at December 31, 2022.

Subsequent to June 30, 2023, and in connection with the extension agreement announced on July 5, ISC entered into an amended and restated credit facility with its syndicated lenders. The aggregate amount available under the amended and restated credit facility has been increased from $150 million to $250 million and consists of ISC's existing $150 million revolving credit facility plus a new $100 million revolving credit facility.

In addition, ISC maintains access to a $100 million accordion option, providing the flexibility to upsize the aggregate revolving credit facility up to $350 million. (inaudible) funded debt-to-EBITDA financial covenant has been increased to provide additional balance sheet flexibility to ISC. The expiry date of the amended and restated credit facility of September 2026 remains unchanged. We funded the upfront payment of $150 million and other related extension agreement transaction costs by drawing on our amended and restated credit facility and with cash on hand.

Further, on July 27, the lending syndicate (inaudible) facility expanded to include BMO as a participant. The inclusion of BMO is a logical and prudent step to ensure that we remain well positioned to fund our ongoing growth strategy. Further details on our debt and credit facilities can be found in our MD&A and financial statements.

In February, we provided our outlook and guidance for 2023 and following the announcement of the extension to the MSA with the province to 2053 on July 5, 2023, we conducted a review of the annual guidance metrics we publish to ensure we provide the most appropriate metrics by which to guide for our forward-looking performance. Going forward, we will only be using revenue and adjusted EBITDA and have ceased using net income and free cash flow. As such and as a result of the extension of the MSA, we now expect revenue to be between $207 million and $212 million and adjusted EBITDA to be between $71 million and $76 million.

Before I turn the call back over to Shawn, I'd like to finish by highlighting that we also announced yesterday that our Board of Directors approved a quarterly cash dividend of $0.23 per share. That dividend will be payable on or before October 15, 2023, to shareholders of record as of September 30, 2023. I'll now turn the call back over to Shawn for some concluding remarks.

Shawn B. Peters ***Information Services Corporation - President & CEO***

Thanks, Bob. As I stated at the outset, our second quarter and year-to-date results are a testament to the strength and diversity of our business. As Bob mentioned, we've affirmed our guidance for the year. While we expect the reduced activity in the Saskatchewan Land Registry to continue for the balance of the year, we expect to see customer and transaction growth remain strong in Services, particularly Regulatory Solutions, while volumes in Recovery Solutions will likely remain at current levels until the impact of (inaudible) to permeate into this part of our business.

In Technology Solutions, implementation work is well underway on several (inaudible) will also be supporting the registry enhancement work that has commenced for (inaudible). The new business pipeline also remains healthy as we actively pursue a number of opportunities. With that, I'll now turn the call back over to Jonathan.

Jonathan Hackshaw ***Information Services Corporation - Senior Director of IR & Capital Markets***

Thank you, Shawn. We'd now like to begin the question-and-answer session.

QUESTIONS AND ANSWERS

Operator

(Operator Instructions)

Our first question comes from Maxim Matushansky from RBC Capital Markets.

Maxim Matushansky ***RBC Capital Markets, Research Division - Analyst***

I just wanted to touch on the Services. You mentioned that the regulatory services strength was driven by financial institution customers implementing stronger due diligence as a result of the higher interest rate environment. Can you just help provide some color into how this actually plays out? Is this customer now utilizing you for more validation and identification services than you previously did or how does this actually look like?

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

Maxim, it's Bob here. Yes, you're exactly right. It's the KYC, the reaching out with KYC services. So exactly as you described, they're coming forward with increased services requests in that area.

Maxim Matushansky ***RBC Capital Markets, Research Division - Analyst***

And is that increase consistent with behavior you saw in previous rate hike cycles? Do you have any sense of how you expect -- do you expect that to slow in the future? Or how should we think about the cadence of that kind of increase in due diligence?

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

Really, this is sort of in the first time period that since 2022, where interest rates have increased significantly over the period. So we haven't seen that before. But as we're in this environment now of higher interest rates, we expect for the near term that would continue. But as the interest rate environment changes, right, that could change as well.

Maxim Matushansky ***RBC Capital Markets, Research Division - Analyst***

Got it. And just final 1 for me on Technology Solutions. Can you maybe help provide some more color there in terms of how the new environment for -- or the environment for new opportunities looks like post pandemic? And I guess just how you would categorize the business pipeline today as compared to previous years?

Shawn B. Peters ***Information Services Corporation - President & CEO***

Yes. Maxim, it's Shawn. Thanks for the question. It really is -- we talked a few quarters ago about our view that we were seeing increased activity post pandemic. So as we've talked about in the past, during the pandemic, although we saw really strong results in our Registry Operations and our Services, the Technology business was a bit slow as we just completed existing contracts or preexisting contracts. The jurisdictions were concerned about health and safety and rebuilding the economy, restarting the economy and those, I just think, are procuring technology software.

But we saw (inaudible) And so that really is the post pandemic. What we're seeing is jurisdictions coming forward with new opportunities as well as opportunities that they put on hold during the pandemic. And that's what's creating the really strong pipeline that we're seeing. We do expect that will continue for some time or at least for the foreseeable future is we're seeing continued opportunities come to market or quarter after quarter, month after month.

Operator

Our next question comes from Scott Fletcher with CIBC.

Scott Fletcher ***CIBC Capital Markets, Research Division - Research Analyst***

I wanted to ask a question on the decision to remove the free cash flow and net income numbers from the outlook. Is that -- could you just walk through that in a little more detail? Is there less predictability in those numbers with the new MSA? And secondly, do you still expect a similar free cash flow conversion as you did prior to the extension?

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

Scott, I'll start it off here. Yes, just with the extension, there is some costs that are nonrecurring that for the first few years, obviously, there's transaction costs associated with the extension. And then there will be some initial costs as we maintain and modernize the registries. And so really, what we wanted to give investors a perspective of is the ongoing operational profitability of the business.

In terms of your second question in terms of free cash flow conversion, again, in the initial periods, we are going to have higher interest. But from an operating perspective, again, we've moved to that adjusted free cash flow measure to show the potential of the business, again, from excluding nonoperational type items.

Scott Fletcher ***CIBC Capital Markets, Research Division - Research Analyst***

Okay. And the second question was just on, if you could provide any commentary on Services margins in the back half of the year. Through H1, we've seen some fluctuations relative to the prior year. I'm wondering if you have any color at least directionally relative to the prior year.

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

Scott, yes. That Services business traditionally is in that 20% to 22% margin business if you look at last year as an example and where we're tracking this year, so we expect that margin to continue around that same range at this point.

Shawn B. Peters ***Information Services Corporation - President & CEO***

It's a little hard sometimes for us to predict, Scott, just because of the mix of services that we provide. And as Bob said, on average, it's around that 20%, 22% range. We have quarters where we see a lot of collateral management, which is slightly lower margin, loss of business, loss of revenue at a little lower margin, and then others where we get more different services in the -- like the KYC or in the Regulatory, which is higher margin, but using that sort of 20% just a good benchmark.

Operator

Our next question comes from Jesse Pytlak from Cormark Securities.

Jesse Pytlak ***Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research***

Just with respect to the $1.7 million in onetime in the quarter, can you just kind of run through what contributed to this?

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

Yes, the share-based compensation is the main -- is the biggest component of that. And again, we -- just with the change in share price this quarter compared to (inaudible) quarter last year, there was a larger change. And of course, that translated into that $1.6 million and $1.7 million impact.

Jesse Pytlak ***Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research***

So then there are no, I guess, charges in there related to the MSA extension negotiations?

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

There is, but the more material item is the share-based compensation.

Jesse Pytlak ***Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research***

Okay. Moving kind of just over to the Services business. Can you just kind of run us through what it will take to kind of see a pickup in the Recovery business? Like I understand that greater economic stress could drive more signings. But do you need anything to change in the used car market for growth to pick up for you? Is it really just kind of seeing interest rate impact through the economy?

Shawn B. Peters ***Information Services Corporation - President & CEO***

Yes, it's a combination really of both of those (inaudible) and higher interest rate environments, which creates challenges for folks on the loans and the financing is a big part of that. Used car market is also a big part of it. If the used car market remains strong or is strong, that gives another avenue for folks that might (inaudible) to actually sell the car and pay off the outstanding loan. So it's a combination of the 2.

I would say the used car market was quite impactful to us during COVID in the quite strong, and that's what kept the Recovery business fairly steady but not sort of taking off. That combined with, of course, the subsidy payments that were present through COVID. But it's probably now the more impactful thing is really the interest rate hikes so we are expecting to see that continue. We're seeing increased number of assignments. I think that will be the bigger impact right now.

Jesse Pytlak ***Cormark Securities Inc., Research Division - Analyst of Institutional Equity Research***

Okay. And then just 1 last 1. In terms of Technology Solutions, it sounds like you're still seeing pretty robust procurement activity. I guess based on what you're seeing, do you have confidence you might be able to announce more wins this year? And if so, would those be upside to guidance or have you already kind of baked in some other additional wins into the guide?

Shawn B. Peters ***Information Services Corporation - President & CEO***

Yes. So as we continue to pursue those, obviously, we'll announce anything that we think is exciting and material. At this point, I wouldn't comment (inaudible) the guidance and if something on that changes, we'll announce that at the time.

Operator

Our next question comes from David Pierse from Raymond James.

David Pierse ***Raymond James Ltd., Research Division - Associate***

Just on the annual registry CPI adjustments, my understanding is that it usually gets implemented around this time of year. Can you confirm that? And then, if possible, could you confirm the magnitude of that increase?

Robert Jeffrey Antochow ***Information Services Corporation - CFO***

David, yes, Bob here. Yes, you're correct. They do get implemented this time this year. And so it's in the month -- typically in the month of July. And the -- in terms of the Saskatchewan CPI which the rate increases are based on, it's in excess of the (inaudible) Where that SaaS CPI landed so that will -- you'll see that reflected (inaudible) on that fees.

Jonathan Hackshaw ***Information Services Corporation - Senior Director of IR & Capital Markets***

And just to add to that, David, we actually implemented that on July 29, and all those are on the website if you want to dive a bit deeper into that.

David Pierse ***Raymond James Ltd., Research Division - Associate***

Perfect. And just moving over to Services. On the Ontario business or Registry changes, are you seeing any early impact there on your Corporate Solutions business?

Shawn B. Peters ***Information Services Corporation - President & CEO***

David, it's Shawn. Absolutely, we are. But we had predicted that. We forecasted that and included that in our guidance. And as we've said previously, we've been preparing that. Since the day we bought we always knew that, that was a potential risk for the business around that. But there is an impact. It's just the onboarding of new customers and the additional services are helping to offset that.

Operator

Our next question comes from Natalya Davies from Edison.

Natalya Davies ***Edison Investment Research Limited - Analyst***

Just a few questions from me. Firstly on M&A, can we expect any more deals this year? And what's the multiples do you look for regarding acquisitions? And following on from that, what level of debt are you comfortable taking on, given the $150 million more payment for the contract extension this year?

Shawn B. Peters ***Information Services Corporation - President & CEO***

Yes. Thanks, Natalya, for the question. We always -- we are continually looking at M&A. We're looking at both organic and inorganic growth. And so we constantly are looking for opportunities where (inaudible) we think that there -- within our wheelhouse, usually, they are companies that have lots of runway for growth. And so that's still active. I can't comment on whether we'd announce any more this year, but I can say that we're always active in that space and we'll continue to do so.

Multiples for those types of companies, multiples have changed a bit as we saw over COVID. We saw probably multiples for good companies with strong cash flows and good customer service -- or sorry, good customer bases go up a bit. We're starting to see that normalize a bit more now. But I would say we tend to be in that 7 to 9x EBITDA multiple usually land a really good, solid business for us.

And then on the debt question, we've talked for some time that we'd be fine at 4x EBITDA really just based on deleveraging capabilities of the business. And we even said for the right deal, we'd go slightly above that and delever quickly. So we're very comfortable with where it is now. We know the cash flow nature of the business and the deleveraging capabilities. And again, if the right deal comes along, we'd look at that and expect we'd be able to have a successful financing behind that.

Operator

(Operator Instructions)

This concludes our question-and-answer session. At this time, I would like to turn the call back over to Jonathan for closing remarks.

Jonathan Hackshaw ***Information Services Corporation - Senior Director of IR & Capital Markets***

Thank you very much, Shannon. With no further questions, we'd like, once again, to thank you all for joining us on today's call, and we look forward to speaking with you again later on in the year. Have a great day.

Operator

This concludes today's conference call. Thank you all for participating. You may now disconnect.