Information Services Corp (UPDATE)

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Corporate Speakers:

- Jonathan Hackshaw; Information Services Corp; Senior Director, Investor Relations and Capital Markets
- Shawn Peters; Information Services Corp; President and CEO
- Robert Antochow; Information Services Corp; Chief Financial Officer

Participants:

- Maxim Matushansky; RBC Capital Markets; Analyst
- Scott Fletcher; CIBC; Equity Research Associate
- David Pierse; Raymond James; Equity Research Associate

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the ISC Q3 2023 Earnings Conference Call and Webcast. (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.

Jonathan Hackshaw^ Thank you, Josh, and good morning to everyone joining us today. Welcome to ISC's conference call for the third quarter ended September 30, 2023.

On the call with me today 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 as well as speak to some operational highlights as well.

Before we begin, we would like to remind everyone that we'll 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 your entirety.

I would 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 rules.

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. With that, I would now like to turn the call over to Shawn.

Shawn Peters^ Thank you, Jonathan, and good morning to everyone joining us for today's call. The results for the third quarter and year-to-date for 2023 continue to demonstrate our consistently strong performance. News in the quarter was dominated by our milestone announcement on July 5, 2023, regarding the extension of the term of ISC's exclusive master service agreement, or MSA, with the Province of Saskatchewan to manage and operate the Saskatchewan Registries until 2053.

The extension of the MSA with the Province of Saskatchewan has been an important priority for the company and is beneficial for all stakeholders. From ISC's perspective, it immediately added new revenue through certain fee adjustments, thereby enhancing the company's scale and financial profile.

With respect to the performance of our three segments during the third quarter and year-to-date, Registry Operations realized the benefits of the new fee adjustments, which were implemented on July 29, 2023, with a positive impact on both revenue and adjusted EBITDA in the Saskatchewan Registries division. This was further enhanced by the implementation of annual CPI fee adjustments in the Saskatchewan Registries during the quarter and a full nine months of Ontario property tax assessment services in the current year compared to only four months in the prior year.

Offsetting these increases were costs associated with our extension commitment to transforming the Saskatchewan Registries. Costs early in the project are largely expensed versus later costs that we expect to capitalize. Transaction volumes in the Saskatchewan Registries were lower during the quarter and year-to-date, following successive interest rate increases by the Bank of Canada. Although Saskatchewan continues to be impacted less than other jurisdictions in Canada and remains generally in line with our expectations for our annual guidance provided in February as well as when we updated our annual guidance in August?

Consistent with our growth strategy, our Services segment continues to drive organic growth, with revenue and adjusted EBITDA both growing during the quarter and year-to-date. The main driver has been the Regulatory Solutions division as business from financial institutions, including auto lenders, continues to grow as they implement enhanced and more frequent due diligence procedures in a higher interest rate environment. We also saw a positive increase in asset recovery revenue in Recovery Solutions compared to the same quarter in 2022, which is to be expected, as Recovery Solutions generally benefits from tougher economic conditions.

During the quarter, Service has also renegotiated an extension for the Ontario corporate registry contract with the Province of Ontario to the end of January 2025. This agreement ensures that Services can continue to access the Ontario Corporate Registry on behalf of clients while preserving preferential access rates. Technology Solutions continues to benefit from procurement activities through both new mandates with existing clients and new client wins.

Subsequent to the end of the quarter, we announced that the State of Michigan had awarded a contract to ISC to upgrade the technology supporting the state's uniform commercial code system. This is in addition to the new work we have with clients in deploying the RegSys platform to the Department of Registrar of Companies, an intellectual property in CyprUS in partnership with net new consultants and a project with the states of Guernsey to build and launch the online register of charities and nonprofit organizations to the public, also utilizing the RegSys platform.

Many of these implementations see expenses occurring in advance of revenue recognition. And so we saw much of that as we build the teams to deliver, with revenue being recognized in subsequent quarters. Our Technology Solutions team is also responsible for the delivery of registry enhancements for the Saskatchewan Registries in Registry Operations in conjunction with our commitment under our new MSA. This work is expected to result in long-term benefits for the users of the Registries as well as support the company's pursuit new registry opportunities globally.

In summary, the third quarter and year-to-date for 2023 have been periods of sustained positive performance that reflects the company's extremely strong fundamentals as well as its ability to perform well in challenging economic conditions and execute on strategically important initiatives. I'll now turn the call over to Bob to discuss the financial highlights before providing some closing thoughts.

Robert Antochow^ Thank you, sHAWN, and good morning, everyone. As Shawn said, our 2023 results are in line with our expectations, and our performance has been consistently positive. This performance was driven by a number of factors, but more specifically, revenue was $54.6 million for the quarter, an increase of 12% compared to the third quarter of 2022.

The increase was due to continued customer and transaction growth in services, combined with fee increases implemented in Rede Operations in July 2023. Net income was $4.2 million or $0.24 per basic share and $0.23 per diluted share compared to $7.8 million or $0.44 per basic share and $0.43 per diluted share in the third quarter of 2022.

The reduction in net income during the quarter resulted from increased net finance expense due to increased interest rates, higher borrowings used to fund upfront payment, interest accrued on the vendor concession liability to the province of Saskatchewan and amortization related to the intangible asset associated with the right to operate the Saskatchewan Registries.

This was partially offset by strong adjusted EBITDA contributions from Registry Operations and Services. Net cash flow provided by operating activities was $14.6 million for the quarter, a 3% reduction from $15.1 million in the prior year due to noncash working capital changes in accounts receivable due to higher revenue in the current year and timing of income tax payments, partially offset by the growth of adjusted EBITDA in Registry Operations and Services.

Adjusted net income was $8.4 million or $0.47 per basic share and $0.46 per diluted share compared to $8.7 million or $0.49 per basic share and $0.48 per diluted share in the third quarter of 2022. THE Slight decrease for the quarter was driven by increased interest expense on long-term debt largely offset by the strong performance of Registry Operations following fee adjustments introduced during the quarter and continued customer and transaction growth in Services.

Adjusted EBITDA was $19.2 million for the quarter compared to $17 million in 2022, primarily due to a higher contribution from Registry Operations driven by fee adjustments implemented during the quarter and continued customer and transaction growth in Services. This increase was partially offset by lower adjusted EBITDA in Technology Solutions and Corporate DUE to the timing of revenue recognition and the continued investments in people and technology. Adjusted EBITDA margin was 35.2% compared to 34.9% in the third quarter of 2022.

Adjusted free cash flow for the quarter was $14.4 million, up 27% compared to $11.4 million in the third quarter of 2022, primarily related to stronger results from operations in Registry Operations and Services during the quarter. This was partially offset by increased capital expenditures related to Technology Systems in Registry Operations and Services, and increased interest expense due to higher interest rates and higher principal outstanding as a result of the borrowings to fund the Upfront Payment.

Turning to our balance sheet. In connection with the extension agreement announced on July 5, the company entered into an amended and restated credit agreement with Syndicated Lenders.

The AGREED amount available under the amended and restated credit agreement has been increased from $150 million to $250 million and consists of ISC's existing $150 million revolving credit facility, plus a new $100 millio 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.

And the consolidated net funded debt-to-EBITDA financial covenant has been increased to provide additional balance sheet flexibility to ISC. The inquiry date of the amended and restated credit facility of September 2026 remains unchanged. We 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 associated with our credit facility expanded to include Bank of Montreal 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.

With respect to our debt, for the period ended September 30, 2023, the company had $187.2 million of total debt outstanding compared to $66 million as at December 31, 2022.

The increase is due to our initial $150 million upfront cash payment related to the extension agreement, less $29 million of prepayments during the year, including $14 million in the quarter ended September 30, 2023. As we move forward, the company is focused on continuing sustainable growth and rapidly deleveraging towards a long-term net leverage of two to 2.5x as evidenced by these prepayments.

After all this, as at September 30, 2023, we held $21.4 million in cash compared to $34.5 million as at December 31, 2022. Further details on our debt and our credit facilities can be found in our MD&A and financial statements.

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 January 15, 2024, to shareholders of record as of December 31, 2023. I will now turn the call back over to Shawn for some concluding remarks.

Shawn Peters^ Our year-to-date results continue our history of positive quarter-after-quarter performance and stability, and we expect that to continue. At the end of October, the Bank of Canada held interest rates at 5%, noting that it was prepared to raise interest rates, again, if inflation remains high. Economic conditions in Canada then will likely remain in line with our expectations for the remainder of 2023. As a result, we expect volumes in the Saskatchewan Land Registry within Registry Operations to remain at current, but seasonally adjusted levels.

The Saskatchewan Realtors Association recently noted that strong housing sales continued in October despite persistent inventory challenges, again, evidencing that Saskatchewan real estate market is faring better than other jurisdictions in Canada and supporting that our Registry Operations segment will continue to be a strong contributor to adjusted EBITDA and free cash flow generation.

In Services, we see continued organic growth and a continuing positive impact in the Regulatory and Recovery Solutions divisions due to increased due diligence searches and asset recovery activity, respectively. As Bob mentioned, we'll continue to execute on our plan to delever the balance sheet to realize a long-term net leverage target of 2x to 2.5x, a plan which commenced immediately following the announcement of the extension in July as evidenced by our third quarter 2023 payment against our outstanding debt.

Overall, we believe our performance will remain strong for the balance of the year, being steady in our core products and services, well positioned with certain countercyclical businesses and ready to benefit positively from our focus on growth and any improvements to market conditions in the future.

With all of that as context, we're pleased to reiterate our updated annual guidance provided in August 2023, with revenue for 2023 expected to be between $207 million and $212 million, and adjusted EBITDA to be between $71 million and $76 million.

Given the strength of the business to date, we expect revenue to be at the top end of our guidance range and adjusted EBITDA to be towards the lower end of the guidance range, which accounts for variations in our product mix and related margins and as we continue to invest in people and technology to position ourselves for the growth ahead.

In closing, we're proud of the work we've done in 2023 to realize our short-term objectives for the year, while pursuing our long-term goals for growth. Although the capital markets are currently challenging and not presently recognizing ISC's extremely strong fundamentals, the company is stronger than ever, especially with the extension completed, a robust plan to delever in the near term and the management team focused on long-term growth. With that, I'll now hand the call back over to Jonathan.

Jonathan Hackshaw^ Thanks, Shawn. Josh, we'd now like to begin any question-and-answer session, please?

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from Maxim Matushansky with RBC Capital Markets.

Maxim Matushansky^ I just wanted to start on margins. Can you help us think through what the appropriate margin level might be across different segments? Is there something -- is there more margin potential in the registry business from the MSA extension fee adjustments flowing through or the lower level of high-value transactions potentially offsetting that? And then the Services segment, is it just mix shift that was dragging margins below 20%? Or anything else to call out there?

Shawn Peters^ Yes, Maxim, thanks for the question, it's Shawn. I'll maybe start off with a couple of comments just around the strategy and then turn it over to Bob for some of the financial. So your question was sort of around what is giving some guidance on the margins. There's a couple of factors in that. The first one is that we continue to invest in people and technology across the business.

We've commented several times during the pandemic and then post pandemic that we were running pretty lean during the pandemic, and that was just being conservative. We didn't really know what the future was going to look like. Now that we have more visibility on that and we can see the growth potential that's in front of us, and in fact, is happening to us right now, we're making very strategic and logical investments in people and technology. And so that is having a bit of an impact on the margins.

But we concluded we can only run so lean for so long, and then we would run into problems in terms of delivering against the revenue that's coming in the door and the growth that's coming in the door and executing on future growth. So there's a bit of that that's happening in the current quarter and year-to-date. On some of the product mix stuff, that's a good catch, and I'll just turn that over to Bob and let him talk about that.

Robert Antochow^ Sure. Thanks, Shawn Yes. And Maxim, I know part of your question was just by segment the different margins. And as Shawn mentioned, as it relates to Registry Operations, that business segment is impacted significantly by Land Registry volumes revenue. And of course, that -- it's a high-margin business.

And when volumes are down, we see that impact on our EBITDA margins and adjusted EBITDA margins. And so that's what we're seeing this year in terms of overall volumes being slightly down from last year.

And then as Shawn mentioned, as we work on registry enhancement, we've got additional expenses that will flow through in that segment. In terms of Services, that is -- again, Shawn mentioned the mix there between the different product lines we have there. Traditionally, that's been around 20% historically, give or take, of percentage, and we see that to continue there. Obviously, we continue to work to enhance our software solutions to try to work to improve that. But that 20% is a rough range.

And then finally, Technology Solutions, as Shawn mentioned, we're investing in that area, and that margin varies as we recognize revenue. And currently, we're ramping up to service the contracts that we announced at the start of the year and the Michigan contract, which we announced this quarter. So those are the main factors. And then in terms of this quarter and year-to-date for 2023, we're also impacted by the acquisition, integration and other costs specifically related to Monarch. So that's more an EBITDA impact.

Those costs are for adjusted EBITDA, but it is -- if you're focused on the EBITDA, that would be one thing where the costs are almost double Q3 year-to-date versus Q3.

Shawn Peters^ Yes. And I might close that off, Maxim, just to say that some of the pressures Bob outlined on margins, some of it is just product mix, and so that's the different parts of the business and Services being stronger. And part of it is just temporary as we invest in this to look towards growth and revenue growth. So we would expect to see improvements in margins by some of the technology improvements that we're making, but that requires the investment now. So...

Maxim Matushansky^ Got it. Okay. That's very helpful. Maybe just to follow up on that on the Technology Solutions. Is there any point where -- I guess, any guidance where you can give around when you expect that to return to profitability?

Or maybe, even said another way, is there a certain maybe run rate margin level that we should be thinking about over the longer term?

Robert Antochow^ Yes. So it's revenue -- as work progresses on these projects, the expectation is that, that is -- in 2024, we'll see that improve. The ramp-up this year bringing on the higher investments in people to service those contracts, where expectations, we should see that positive results in 2024. And that business, depending on the contracts, certain contracts are more profitable than other contracts, but they end goal would be looking at that 20% margin or higher range. But again, it depends on the specific customer, the mix of customer contracts in a given year.

Shawn Peters^ Yes. And I'd add that we'd expect, as Bob said, in 2024 to see that return to profitability and continue to grow. As I said, we are seeing a significant increase in procurement activities. And so that's going to translate into more and more -- in our belief, more and more contract wins as we get into 2024. And so we're going to continue to grow that segment and continue to invest. But our goal would be back to profitability after these investments in 2024.

Maxim Matushansky^ Got it. And maybe if I can sneak one about 2024. I mean now that we're nearing the end of the year, can you maybe talk about the trends that you expect next year in 2024? Obviously, it's a bit tough to predict the land registry activity, and you said that you expect continued growth in the Services segment. But can you maybe speak to how you're thinking about the growth across the business lines into next year and maybe the factors that we should be thinking about that might accelerate or slow down your growth across those segments?

Shawn Peters^ Yes. For sure. I mean, we obviously haven't released any guidance for 2024 yet. But I think we've given our outlook for the balance of 2023, and we'd expect that generally to continue. We do think that Saskatchewan continues to do better than the rest of the country in terms of real estate activity and stability, and prices are holding up as well, largely due to some of the inventory challenges in certain spots.

So I think we would expect that to continue subject, of course, always to interest rate changes. As we said, the Bank of Canada has held rates for now, but has indicated that they could increase rates if they don't see the impact that they're hoping. So it would always be subject to Arcavia to something like that.

And then as I said, we continue to see organic growth in the Services part of the business. We're focused on that. We're focused on creating the infrastructure to be able to scale that business. And then finally, our Technology Solutions, again, largely a procurement-driven exercise right now as that comes post-pandemic. And as we continue to onboard clients and get into the sort of support and maintenance part of that business, I think, it will see a good 2024 as well.

And again, when we issued guidance, we'll sort of talk a bit more about that. But that's at least sort of consistent with what we're seeing here in the last part of the year.

Operator^ Our next question comes from Scott Fletcher with CIBC.

Scott Fletcher^ I wanted to ask a question about the impact of the new fees in the quarter. It looks that registry -- Land Registry was up nicely year-over-year, and I assume these fees are a good part of that. But in the MD&A, you called out the impact of the Adverum. I think at what looks like it was around $200,000. Can you just sort of help me, I guess, understand how the new fees impacted the quarter and what you think -- if that was in line with what you were expecting?

Robert Antochow^ Yes. I'll maybe start. So yes, the majority of the increase in Land Registry revenue quarter over the prior year quarter was due to the fee increase associated with the MSA extension. There was a small piece that related to the CPI -- annual CPI increase with -- and so that had a little bit of impact in the land -- overall land revenue. But in terms of total registry operations, that was a small contributor. The -- and then in the land, basically, that was offset with reduced volumes, right?

But the biggest part of that increase year-over-year -- or quarter over prior year would be the registry enhancement fee increases -- or sorry, the MSA extension fee increases.

Scott Fletcher^ Okay. And then on the debt repayment, you mentioned it looks like you've repaid $2 million in the quarter, and that lines up pretty closely with the free cash flow, the adjusted free cash flow number in the quarter. Is that the plan going forward to sort of match the repayments with what you think you're going to do in terms of the free cash flow number until you hit that leverage target?

Robert Antochow^ Yes. Yes. Yes. We're focused on rapidly deleveraging, as mentioned, and aiming for that 2% to 2.5% sort of long-term target. So as we progress quarter-over-quarter, that will be our focus.

Shawn Peters^ Yes. I think that's absolutely right, Scott. And subject, of course, to continuing to execute on our growth strategy. So as we said, we're focused on both growth and leverage. But in these quarters where we've got good strong free cash flow, as you noted, that's where our focus will be.

Scott Fletcher^ Okay. I'll ask one more. Just on the -- when you announced the MSA extension, you sort of -- you pointed to $17 million in additional revenue and $16 million in EBITDA, obviously, a high-margin revenue there. Is that -- do those estimates still largely hold given what's happened? Given -- not happened, but what you've seen so far with the new fees?

Robert Antochow^ Yes. They largely hold. The -- as we work on registry enhancement going forward, part of those costs are operating in capital. And as we execute on our plan, we've got IFRS rules we need to adhere to, which as we move through different stages and make selections as whether certain parts are part of the solutions are built, third-party solutions, it gets different accounting treatments. So that can impact the EBITDA on -- that we forecasted as well.

Shawn Peters^ Yes. On a pure basis, Scott, I think that remains consistent with our expectations as announced in July. As Bob just mentioned, we also announced the commitment to the registry enhancement or enhancement of the registries in

Saskatchewan. And so we haven't disclosed what that project will be, but we said that we would start to incur those costs starting in Q3 and we have. And so those will continue for a bit here as we continue to enhance the registries. But the 17 and the 16 on a pure basis is still accurate.

Operator^ (Operator Instructions) Our next question comes from David Pierse with Raymond James.

David Pierse^ Just a point of clarity on the debt target. Does that include the vendor concession liability in the debt number?

Robert Antochow^ Yes. Yes, it does.

David Pierse^ Okay. So sort of getting down to 2x within two years would include that $140 million.

Robert Antochow^ Correct. Yes.

David Pierse^ Okay. And then just on the Land Registry business and specifically the land transfer business, can you provide some detail as to what mix of land transfer transactions or call it related to real estate purchases versus non-real estate purchases, things like a state transfers. Just trying to get a sense of that.

Shawn Peters^ Yes. Maybe I'll start on that, David. So any time -- like at a high level, any time the name on the title changes, that's considered a land transfer of some form. Generally, what we're talking about, though, are actual purchase and sale transactions. There are other cases like you say, on an estate where there might be joint title and then it goes down to just one title holder.

We have reduced fees for those types of transactions because it's not an actual transfer of the land from one buyer to another. So we still have some fees in there. But largely what we're talking about when we're talking about title transfers and applying the ad valorem fee, it's on a purchase and sale transaction.

Operator^ (Operator Instructions) And 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 closing remarks.

Jonathan Hackshaw^ Thank you, Josh. With no further questions, we'd like to once again thank all of you for joining us for today's call and wish you a pleasant day. Thanks very much. Bye, bye.

Operator^ Thank you. This concludes today's conference call. Thank you for your participation. You may now disconnect.