Information Services(Q4 2021 Earnings)

March 16, 2022

Corporate Speakers:

- Jonathan Hackshaw; Information Services Corporation; Senior Director of IR & Capital Markets
- Shawn Peters; Information Services Corporation; President & CEO
- Robert Antochow; Information Services Corporation; CFO

Participants:

- Scott Fletcher; CIBC Capital Markets; Research Division, Research Analyst
- Trevor Reynolds; Acumen Capital Finance Partners Limited; Research Division, VP of Research & Equity Research Analyst
- Paul Treiber; RBC Capital Markets; Research Division, Director of Canadian Technology & Analyst
- Stephen Boland; Raymond James Ltd.; Research Division, MD & Equity Research Analyst
- Jesse Pytlak; Cormark Securities Inc.; Research Division, Analyst of Institutional Equity Research

PRESENTATION

Operator^ Thank you for standing by, and welcome to ISC Fourth Quarter and Year Ended December 31, 2021 Earnings Conference Call and Webcast. (Operator Instructions) Now it's my pleasure to turn the call to Jonathan Hackshaw, Senior Director, Investor Relations and Capital Markets. Please go ahead.

Jonathan Hackshaw^ Thank you, Carmen, and good morning, ladies and gentlemen. Welcome to ISC's conference call for the fourth quarter and year-ended December 31, 2021. 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 year. Bob will then provide some financial and operating highlights for the year as well as speak to our outlook and guidance for 2022 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. 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. I'm pleased to be here today in my new role as President and CEO of ISC, and I'm excited to bring my energy and enthusiasm for our business to the role. I'd also like to take the opportunity to welcome and introduce our new Chief Financial Officer, Bob Antochow.

Bob is extremely familiar with the company, and I'm looking forward to us continuing our work together in our new roles as we take ISC forward. 2021 was a remarkable year for ISC.

Not only did we continue to grow our Services business in the face of a global pandemic, but we also delivered outstanding results in our Saskatchewan-based registries. Much of this success was fueled by robust economic activity in the markets in which we operate, and contributions from our organic growth strategies, especially in Services.

In Registry Operations, the year was driven by a strong Saskatchewan real estate sector, resulting in increased transaction levels over the prior year. accompanied by higher average land values transacted through the registry and record high-value transactions. During the year, we also saw increases in the Saskatchewan corporate and personal property registries, again underscored by higher transaction volumes.

Services revenue was also up due to a combination of favorable economic conditions and continued organic growth across our product lines. In addition, we successfully transitioned many of our existing customers from our legacy platform to our new Registry Complete platform, giving them access to a more comprehensive suite of services.

Technology Solutions continues to be impacted by COVID-19, which slowed our progress on active projects and the commencement of potential new opportunities. As a result, we saw weaker results in Technology Solutions in 2021 as compared to prior years, but we expect that to change as we move past COVID-19 and invest in leadership for this business.

In addition to our financial success overall in 2021, we also executed on a number of key initiatives to support the business and our continued growth. We completed our integration of Paragon acquired in August 2020, and are actively optimizing the technology for an even more efficient operation and enhanced client experience.

For a second year, we very successfully continued our work-from-home program, combined with providing in-person customer support where required to ensure the health and safety of our staff and customers without sacrificing our service levels.

As part of our ongoing support of our Saskatchewan employees, in September, we ratified a new 6-year collective agreement with the membership of SGEU with respect to in-scope employees of ISC. We reinforced our balance sheet with the filing of a preliminary short-form-based shelf prospectus which allows ISC to make offerings of debt and equity instruments of up to $200 million.

We entered into an amended and extended credit facility agreement for $150 million and paid down $35 million on the outstanding portion of our facility. And finally, in September, our Board of Directors announced an increase to our annual dividend from $0.80 to $0.92 per annum. The decision to increase the dividend reflects the strength of our current business and affirms our commitment to reward shareholders as we grow.

Subsequent to the end of the year, we announced that we acquired all of the shares of a group of companies operating as UPLevel. I'm very pleased to welcome the UPLevel staff to our team as they bring extensive experience in customer touch and collateral management and will help ensure we maintain market leadership in the industry and provide our current and new customers with an expanded range of services.

Overall, it's been an extremely successful year for ISC with increases in revenue, net income, EBITDA and free cash flow. The performance of our overall business in uncertain economic environments, our ability to adapt to and take advantage of changing consumer behaviors and our relentless pursuit of organic growth were on full display in 2021 and are evident across all of our financial reporting.

With that, I'll now ask Bob to provide some further details on our financial and operating performance for the year as well as an outline of our guidance and outlook for 2022.

Robert Antochow^ Thanks, Shawn, and thank you for the warm welcome. Good morning to all of you joining us on the call today. I, too, am very excited about my new role as Chief Financial Officer. I look forward to the journey ahead as well as getting to know many of you on the call in the years to come.

As Shawn noted, 2021 was an excellent year for ISC. Overall, results for 2021 are up well over the previous year, despite the global pandemic that dominated much of 2020 and 2021. Revenue rose by 24% to $169.4 million in 2021 from $136.7 million in 2020. The increase was due to higher revenue in Registry Operations driven by robust activity in the Saskatchewan real estate sector, increases in personal property security registrations and new business entity registrations.

This was accompanied by continued organic growth in our Services segment through new customer acquisition and the use of technology, including Registry Complete, offering an integrated suite of services to our clients and a full year of operations from our new Recovery Solutions division compared to 5 months in the prior year.

Net income was $32.1 million or $1.83 per basic share and $1.78 per diluted share, up compared to $20.8 million or $1.19 per basic share and $1.18 per diluted share in 2020. The increase here was the result of increased revenue in Registry Operations and Services, lower professional and consulting expenses offset by increases in share-based compensation due to strong performance of the company's share price during the year and increased expenses in both cost of goods sold and financial services due to revenue growth.

EBITDA was $60.5 million in 2021 compared to $43.4 million in 2020, again, due to increased revenue in Registry Operations and Services, lower professional and consulting expenses, offset by increases in share-based compensation and increased costs in both cost of goods sold and financial services due to revenue growth. Consolidated EBITDA margin was 35.7% compared to 31.7% in 2020.

Adjusted EBITDA was $67.8 million compared to $49.2 million in 2020. The increase is due to a strong EBITDA and the removal through adjustments of year-to-date share-based compensation and acquisition and integration costs. Adjusted EBITDA margin was 40% compared to 36% in 2020.

Free cash flow for the year ended December 31, 2021, was $44.8 million, an increase of $8.6 million compared to $36.2 million in 2020 due to higher results of operations and strong cash flow conversion of the business. These results demonstrate the strength of our business with EBITDA up 40% year-over-year.

Turning to our balance sheet. With respect to our debt, as at December 31, 2021, the company had $41 million of total debt outstanding compared to $76.3 million at December 31, 2020. As Shawn mentioned, during the year, we made voluntary prepayments of $35 million against our long-term debt, reducing it to $41 million.

We're nowhere near our top end comfort level of a debt-to-EBITDA multiple of 4x, we felt it was prudent to pay down some of our facility and save on some interest. After all this, as at December 31, 2021, we held $40.1 million in cash compared to $33.9 million as at December 31, 2020. Further details on our debt and our credit facilities can be found in our MD&A and financial statements.

Now on to the year ahead. In February, we provided our outlook and guidance for 2022, and this is also included in our MD&A, which I encourage you to read. In summary, we expect to see continued strength in 2022 across our 2 largest operating segments, Registry Operations and services. Both have benefited from strong economic conditions in 2021, including an overall positive impact on transaction and seasonality trends during the COVID-19 pandemic.

In Technology Solutions, we expect to see continued progress and completion of solution delivery projects where COVID-19 and other related delays have resulted in certain milestones being deferred to 2022. Despite this, we're confident about the potential of this business and are investing to help drive new opportunities, including with jurisdictions that are able to refocus on moving their various technology-related projects forward post COVID.

As a result of these and other factors outlined in our MD&A, we've guided that for 2022, revenue will be between $168 million and $173 million. Net income will be between $23 million and $27 million and EBITDA will be between $48 million and $53 million.

The only additional comment I would like to make about our guidance for 2022 is around the EBITDA we are forecasting. It is expected to be lower than our EBITDA for 2021, which was $60.5 million. As you know, over the past 2 years, Registry Operations has delivered exceptionally strong EBITDA above historical levels.

This strong EBITDA has been propelled by a combination of a robust Saskatchewan real estate market, driving higher average transaction values, increased high-value transactions and slightly higher volumes in the Land Registry. While we expect continued strength in Registry Operations EBITDA margin, we anticipate it to trend closer to pre-pandemic levels. A graph depicting this trend can be found in Section 3.1 in our MD&A, if you're interested.

To be clear, we still expect that Registry Operations will continue to be a robust contributor to our results in 2022 through the strong cash flow this business generates on a consistent basis.

Before I turn the call back 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 April 15, 2022, to shareholders of record as of March 31, 2022. I will now turn the call back over to Shawn for some concluding remarks.

Shawn Peters^ Thanks, Bob. Taking on the role of President and CEO on February 1, marks a new era for me and for ISC. I thoroughly enjoyed the past 10 years as ISC's Chief Financial Officer.

And as I said, I'm excited to bring my energy and enthusiasm for our business to my new role. I'd like to thank our Chair, Joel Teal, and our entire Board of Directors for their confidence in me and would also like to thank Jeff Stusek, for his support over the years and for facilitating such a smooth transition.

Looking ahead, ISC will stay focused on what we do well: delivering excellence within our existing businesses, providing outstanding customer service to our clients and taking care of our people.

I'm enthusiastic about the opportunities ahead, and I see continued strength across our business. I'm looking forward to building upon that strength with further organic customer growth and expanded products and services while putting our balance sheet to work and executing on our acquisition strategy. With that, I'll now turn the call back over to Jonathan.

Jonathan Hackshaw^ Thank you, Shawn. Carmen, we'd now like to begin the question-and-answer session, please.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) We have a question from Scott Fletcher with CIBC.

Scott Fletcher^ Congratulations, Shawn and Bob on the new roles. I was just wondering if you could give us a little more detail on the dollar impact of the -- dollar impact on revenue from the switch to net to growth in the Services segment in the quarter.

Robert Antochow^ Yes. We can't give specifics around that figure because it's not an exact number because we're offering a volume of value-added services. So it's hard to get an apples-to-apples comparison.

Shawn Peters^ Yes. And Scott, it's Shawn. So it's a good question. It's not material to the results overall, but it is just an accounting change. So what we saw was strong organic growth in Services, but there is that bit of impact from the switch from gross to net. But we're largely through that transition now, and so that should be sort of onetime thing.

Scott Fletcher^ Okay. And maybe asked in a different way, is that -- do you see the sort of the margin level in the quarter as more of a norm given the change?

Robert Antochow^ Yes, it would be, yes.

Scott Fletcher^ Okay. That's helpful. Second question for me on -- with the M&A commentary in the guidance, I was just hoping if you could give us an idea of how you're thinking about M&A at the moment, maybe in terms of size or type of targets and whether current valuation is making M&A even more attractive at the moment?

Shawn Peters^ Sure. Yes. So as you know, we've been pretty prudent and consistent in our application of M&A. We look for companies that -- where it's the right company at the right time at the right price and where we think we can add value to them. And that's sort of paced out at about 1 a year sort of on average.

I think what you're going to see going forward, we've shown that we can execute on M&A transactions. We can integrate them well both for customers and internally. And so I think we'll be a bit more diligent in terms of looking for opportunities.

We've done a really good job of looking for places where we can help our customers and fill gaps and our acquisition of Paragon was a good example of that. And we'll continue to do that where customers are asking for services or where we think we can see them.

To couple of other questions. I think from a size perspective, we -- again, we really look for companies where we can add value. So that might be some small ones such as our UPLevel one, where we saw a real opportunity to bring that experience and sort of the early and late-stage collections part of that business into our Recovery Solutions.

Generally, though, I think we're looking for the larger transactions to make a meaningful impact on our business, but we certainly don't shy away from a smaller one, if it's positive. The last part of the question on the valuations.

We did see some -- a little bit of stronger valuations during COVID. It seems like if you've got a business that's done well during COVID and has strong customer base or strong EBIT and strong cash flow that the valuations did creep up a bit, but we haven't found that to be a problem. It just changes the economics a little bit and ensures that we focus on integration and bring that out, but it hasn't been a barrier for us.

Operator^ Your next question comes from Trevor Reynolds with Acumen Capital.

Trevor Reynolds^ Just looking at the guidance a little bit and your expected normalization of margins on the registry side of the business kind of see things dropping off there and can kind of calculate what that drop in EBITDA would be. I'm just wondering, like, is the remainder of the decrease in EBITDA margin attributable to costs and kind of if you guys can give a sense of what -- where those costs are going to be soaked up?

Shawn Peters^ Yes. Trevor, so thanks for the question. So -- yes, I think you framed it right. We do see a drop in the EBITDA from Registry Operations returning from normal from those really exceptionally high levels that we saw in 2021 from high-value transactions and just higher overall average value transaction. So there's a big chunk of it there. The balance of it does come from some reinvestment. We have been running for the last couple of years very lean.

When COVID started, we obviously put a bit of a freeze on sort of hiring and other investments because we weren't sure how that was going to play out. It's obviously played out fine, but we continue to run lean in both Registry Operations and Services for the balance of 2020 and then into 2021.

So what we're looking at now is just reinvesting in a couple of areas. One is people. So in our Technology Solutions business and in our Services business, we see opportunity to add people on both the technology and the business development side to continue to drive that organic growth.

And in our Registry Operations, we see some need for some additional technology folks in that space as we continue to maintain and develop against our registry system. So it's really down to people and technology, which are our largest 2 expense line items anyways.

Trevor Reynolds^ And then have you seen the drop-off in transaction volumes that associated with your guidance at this point in Saskatchewan?

Shawn Peters^ Yes. We remain very, very bullish on the Saskatchewan economy. We think the economy is very strong, and our guidance reflects that. We said that we would come off of 2021 and see the first half of the year pretty strong, and that anecdotally is what we're seeing. So we're seeing transactions in line with where we expected to see them. We are seeing that strength continue.

We now have had on interest rate hike, and that's one of the things that we thought might dampen the transactions a bit. And that could come to play and particularly if we get a second. So our guidance is still on track in the sense that we think the first half of the year is going to be a bit stronger and then taper off a little bit and taper off again back to normal levels, which is still very strong, as Bob mentioned, for the Registry Operations.

Trevor Reynolds^ Got it. And then just on the Paragon side of things, have you started to see that pick up with some of the government assistant programs dropping off?

Shawn Peters^ Yes, it's early stage, and it takes a few months for people to transition into that default stage, but we are seeing increased activity in that space. So I think that's -- that business is that countercyclical business and with interest rates rising, that creates the environment for that. So we're seeing early indications of that, but it's a bit early to really tell too much.

Trevor Reynolds^ Okay. And then just the last one is your free cash flow priorities here, continue to build up the cash position or, I guess, pay down debt, or are you looking at dividend increases?

Shawn Peters^ We continue to manage our cash prudently, and we'll look at -- consider debt prepayment to the extent we continue to have free cash flow but also be mindful of our M&A activities that -- or opportunities that arise.

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

Paul Treiber^ Just wanted to think about the macroeconomic environment. Obviously, there's a lot of moving parts. You mentioned interest rates. But overall, when you look at Saskatchewan and you look at all your businesses broadly, how should we think about the potential sensitivity of all your businesses to macroeconomic -- changes in the macroeconomic environment, more specifically maybe consumer spending.

Shawn Peters^ Yes, Paul, thanks for the question. So there is a lot going on sort of in the macroeconomic world. And our business does -- but overall, we can look at it. It does still split into 2 sort of distinct parts. The Saskatchewan part, as I said, we're very bullish on Saskatchewan's economy. We think it's a strong economy.

We do think with some of what's going on in the world right now that there's a chance that Saskatchewan could actually come out stronger in 2022 than even originally anticipated, particularly on the commodity side. So there's sensitivity there that we could see to the upside as more activity happens in Saskatchewan that brings people in and has them transact, whether it's land or cars or whatever it would be. So there's certainly some upside sensitivity there.

On the downside sensitivity in this, we just talked about that, the interest rates, that can temporarily sort of dampen people in doing it. But interest rates are still historically low. And so we think there's still going to be strength in this first half of the year. If we get a second or a third rate hike, that will probably dampen it just a bit. But again, it's temporary because people sort of whether the change and then 6 months later, they transact what they were going to do anyways.

In the Services part of our business, it's a bit more sensitive to overall sort of business conditions and macroeconomic that's where we would see, again, potentially some upside if the economy starts to retract and the Recovery Solutions part of our business really takes off.

But if the economy runs along strong, the Services part of our business. We'll continue to see strength as more and more activity in Ontario and Quebec markets. So that's a long answer and a really roundabout answer. But we see really benefit on both sides of the economy here for us.

Paul Treiber^ That's quite helpful. And obviously, there's a number of moving parts there. Just in terms of the Technology Solutions business, what's been the feedback from customers in terms of the project delays? And when they expect to ramp up these deployments? And then also related to that is on the new sales pipeline, how is that shaping up as you look into 2022?

Shawn Peters^ Yes. So for the first part of the reaction from clients, a lot of the -- some of the delays are client-driven actually. So if clients are having challenges working remotely, that's impacted us. So we haven't had negative feedback from the projects.

We work very closely with our clients to ensure that if there's delays that we do our best to mitigate them and we do our best to ensure that they're not impacted from them, whatever the cause or whatever for the reason. And so we work to just execute and that's been successful to date.

On the pipeline part of it, customers are -- we've had discussions with customers, obviously, and we announced an intention to invest in the leadership there. So we spend time with our customers. The reaction to that has been very positive.

We also think that other potential customers that we've been talking to are starting to see a little bit of a light at the end of this COVID tunnel and getting back to some of the things, much like we're getting back to investing in Saskatchewan in our registries, we're seeing other jurisdictions think about doing the same. And so we think there's real opportunity there to fill that pipeline, and that's why we're investing in people to do that.

Operator^ (Operator Instructions) Our next question is from Stephen Boland with Raymond James.

Stephen Boland^ Just one question about your guidance. I totally get the -- guiding to a lower number of transactions expected. Maybe you could talk a little bit about the, I guess, the high-value transactions declining as well. And I believe you have seen some good disclosure there, whether it's commercial and ag and other bold are being impacted. And why do you believe those would both be coming down the value?

Shawn Peters^ Yes, Stephen, so thanks for the question. 2021 really was an unusual year, and that's why we did increase that disclosure, as you said, to give the analysts and the market some view as to how those transactions play out.

Those are difficult to predict because they don't necessarily follow any particular cycle, commercial transactions in particular. What we see is that the unusual activity in 2021 for whatever reason, part of it is probably interest rates. We did see what we thought anecdotally was an attempt to sort of get ahead of any interest rate increases. So a lot of those transactions happen pretty quickly.

On the commercial side, again, that one is very difficult to predict. We would always predict a fairly -- we have a long-term average that we predict as part of our guidance, which 2021 has exceeded that pretty significantly.

The reason we think that they'll probably go down is partly because of the interest rate hikes, partly because a lot of those transactions are now sort of in the books and partly on the agricultural side because we've seen a fair bit of agricultural land change hands and the supply of it right now is probably going to be the challenge.

So there just isn't going to be the same amount of land to transact and change hands in 2022 as we've seen over the last couple of years. So -- but it's a very difficult thing for us to predict because there isn't really any tracking or any indicators that we can follow. But we just think that a lot has happened in 2020 and 2021, and that will need to come back down to a more normal level.

Stephen Boland^ Okay. That makes sense. I appreciate that. And then just a quick follow-up on the technology side. I mean, as COVID kind of dissipates here, things are opening up, are you starting to see governments or regions starting to look at RFPs, changing vendors, things of that sort? Is that kind of a trend do you think going to start happening?

Shawn Peters^ Yes, we are starting to see early procurement activities. So people getting back to things that they might have either started before cool hit or have realized during COVID is something that they need to upgrade or change. So we're starting to see that early activity in the procurement for sure.

Operator^ And our last question comes from Jesse Pytlak with Cormark Securities.

Jesse Pytlak^ Just to continue on the conversation with Technology Solutions, understanding that those delays have been customer driven. Can you maybe just elaborate a bit on the conversations that you are having with those clients? Do you have a better sense now on when that work might resume? Or is it still a little uncertain?

Shawn Peters^ Yes. It's still pretty early, Jesse. Like we've talked -- our in-flight projects, obviously, we're continuing, and we see some expansion in those now as a result of that. So whether that be change orders or new parts of the projects. But the other discussions we've had with clients is they're just starting to get back to that and thinking about that and certainly excited to get back to it, I think, so -- but pretty early for those discussions.

Jesse Pytlak^ I understand. And then just quickly on the UPLevel acquisition. Can you maybe just give us a sense of what the historical growth has been in that business and its margin performance? And then any commentary on its kind of competitive positioning?

Shawn Peters^ Yes. So I can give you a bit of a -- we don't -- we haven't disclosed a lot. We haven't got the results in our sort of Q1 yet as disclosed, but it's a very stable business. The growth in that has been more what we would call a lower end growth because it's got an existing book of clients, which are strong clients, some of which are ours, but a lot of which are new, and are very consistent.

So it's been a slower growth part of the business. We think that bringing it into ESC opens up those products and services to our existing clients as well as our products and services to those clients. So we see upside on the integration on the growth side. Historically, it's been a pretty stable business, which is part of the attractiveness to it.

From a margin perspective, it's a lower-margin business than our existing ones. It ties in a bit to our Services business, which has people. So it's a fairly people-centered business, the early and late-stage collections are obviously driven by people as is the customer care work which kind of aligns to our white-glove treatment that we do in ESC and those margins are in that 20 to 27 sort of percent.

These would be probably a little bit lower than that because there's a little bit more on the people side, but really something that we think is a nice add in for our customers and their customers.

Operator^ And this concludes our Q&A session. I would like to turn the call back to Jonathan Hackshaw for his final remarks.

Jonathan Hackshaw^ Thank you, Carmen. With no further questions, I would like to once again thank you all for joining us on today's call, and we look forward to speaking with you again when we report for the first quarter of 2022 later on in the year. Have a good day.

Operator^ And ladies and gentlemen, this concludes our conference call. Thank you for your participation, and you may now disconnect. Have a wonderful day.