ISC Q2 2022 Earnings Conference Call and Webcast

August 4, 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; Analyst
- Trevor Reynolds; Acumen Capital Finance Partners Ltd.; Analyst
- Stephen Boland; Raymond James Ltd.; Analyst
- Jesse Pytlak; Cormark Securities Inc.; Analyst
- Paul Treiber; RBC Capital Markets; Analyst

PRESENTATION

Operator^ Good day, and thank you for standing by. Welcome to the ISC Earnings Conference Call for the Second Quarter 2022. (Operator Instructions) Please be advised that today's conference is being recorded.

I would now like to hand the conference over to your moderator today, Jonathan Hackshaw, Senior Director of Investor Relations and Capital Markets. Please go ahead.

Jonathan Hackshaw^ Thank you, Daniel, and good morning, ladies and gentlemen. Welcome to ISC's Earnings Conference Call for the Quarter ended June 30, 2022. On the call with me today are Shawn Peters, President and CEO; and Bob Antochow, Chief Financial Officer.

This morning, Shawn will start us off by taking you through an overview of the quarter as well as comments about the update to our annual guidance for 2022. Bob will then provide some financial and operating highlights 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 Peters^ Thank you, Jonathan, and good morning to everyone joining us for today's call.

Similar to this time last year, 2022 year-to-date has been a good first half for ISC and has been consistent with our expectations. As we commented earlier in the year, we expected both our Registry Operations and Services segments to be strong in the first half of 2022 than they have been, both performing well irrespective of the prevailing economic environment.

As expected, this has been due to continued strength and momentum coming off of 2021 in the real estate sector in Saskatchewan coupled with active and successful new customer acquisition and the expansion of transactions within -- with existing customers and services.

Again, as expected, in some areas of Registry Operations, transactions have started to return to more normalized pre-pandemic levels. We had forecasted a rising interest rate environment and while acknowledging that the rate hikes have been more aggressive than expected to combat inflation. We expect the Land Registry will simply normalize to pre-pandemic levels during the second half of 2022 but will still be above 2019 levels.

We expect only modest fluctuations for revenue from the Personal Property Registry and the Corporate Registry, while additional revenue from our new Property Tax Services line in Registry Operations will contribute positively to revenue for the remainder of 2022. In general, Registry Operations remains a solid contributor to our results due to the strong cash flow this segment generates on a consistent and regular basis in all economic environments.

In Services, during the quarter, we began integrating UPLevel customers into our core divisions, including PPSA customers onto Registry Complete in our Regulatory Solutions division as well as the collection and accounts receivable management services into our Recovery Solutions. Year-to-date, Services continues to be the largest revenue contributor of our three operating segments.

Looking ahead, we expect Services to continue to deliver customer and transaction growth in 2022, fueled by continuous technology advancements driving operational efficiency and new product innovation. This new product innovation includes the rollout of a pilot of our new Recovery Complete technology solutions in our Recovery Solutions division in the third quarter.

Recovery Complete is expected to deliver similar integrated benefits for recovery clients that our search and registration clients have experienced after moving over to our Registry Complete platform. We expect this solution will provide improved customer experience and operational efficiencies.

As with elsewhere in the business, a continued focus on investments in people and technology to advance our growth is underway. It will be important in expanding our product offerings to existing customers and acquiring new customers on an ongoing basis.

In Technology Solutions, we expect to continue to complete -- to continue and to complete a number of solution delivery projects, some of which were delayed in 2021. Subsequent to the end of the quarter, I was pleased to announce the appointment of Susan Bowman as Head of our ERS. The creation of this new role is expected to enhance business development, growth and performance as well as elevate the development of new registry and registry-related products and services.

Again, as with our other segments, we'll be working with Susan to invest in people and technology, specifically in our sales and technology development teams to support the business development and growth we are pursuing.

We're also pleased that the focus of clients and potential clients is returning to business as usual, and therefore, procurement activity and additional support work is underway, which should translate into new contracts for this segment in the near term. The result is that we expect our core Registry Operations results to be consistent with our original guidance, but the combination of our acquisitions and the emergence of new business development opportunities in our Services segment are expected to enhance our results for the balance of 2022.

We've therefore updated our annual guidance for revenue to be between $188 million and $193 million, net income to be between $29 million and $33 million and EBITDA to be between $59 million and $64 million in 2022. When compared to our original guidance for 2022, which we provided in February, this represents an increase at the low end of the guidance range of 12% for revenue, 26% for net income and 23% for EBITDA, which demonstrates the strength of the acquisitions we are making as well as our focus on organic growth.

With that, I would now ask Bob to summarize our financial and operating performance for the quarter.

Robert Antochow^ Thank you, Shawn, and good morning to everyone.

As Shawn said, our second quarter results were extremely strong driven by a number of factors, but more specifically, revenue was $50.9 million for the quarter, an increase of 14% compared to the second quarter of 2021. This was due to continued customer and transaction growth in Services, specifically in the Regulatory and Corporate Solutions divisions, as well as by $1.7 million of revenue contributed from the UPLevel business, which was acquired in February of this year.

Registry Operations also contributed to increased revenue as a result of one month or $1.2 million in Property Tax Services revenue. Traditional Registry Operations revenue has remained relatively consistent year-to-date with strong results achieved in 2021, including strong high-value transactions revenue of $1.8 million in the second quarter.

Net income was $11.7 million or $0.66 per basic and $0.65 per diluted share compared to $6.5 million or $0.37 per basic share and $0.36 per diluted share in the second quarter of 2021. The increase is due to increased revenue in Services, additional contributed revenue from Registry Operations following the acquisition of Reamined accompanied by reductions in share-based compensation due to a decline in the Company's share price during the quarter.

EBITDA was $20.5 million compared to $13.5 million for the same quarter in 2021, again, due to increased revenue accompanied by reductions in share-based compensation expense, resulting in strong margins across all segments and a consolidated EBITDA margin of 40.2% for the quarter compared to 30.4% in 2021.

Adjusted EBITDA was $19.2 million for the quarter compared to $18.5 million in 2021. The increase is due to stronger results from operations once share-based compensation and acquisition and integration costs are removed. These stronger results are driven by increased revenue offset by increased cost of goods sold and salary expenses. Adjusted EBITDA margin was 37.8% compared to 41.5% in 2021.

Free cash flow for the quarter was $15.5 million, an increase of 73% compared to the second quarter of 2021 due to higher results of operations supplemented by a reduction in share-based compensation resulting from the decline in ISC's share price.

Turning to our balance sheet. With respect to our debt as at June 30, 2022, the Company had $81.5 million of total debt outstanding compared to $41 million as of December 31, 2021. This increase was a result of additional borrowings related to the acquisition of Reamined during the quarter. Debt of $0.5 million was acquired as part of the Reamined acquisition and is due to former shareholders of Reamined.

The debt is unsecured and is noninterest bearing with no specific terms of repayment. It is our intention to repay this amount during the next fiscal year. Further details on our debt and our credit facilities can be found in our MD&A and financial statements.

After all this, as at June 30, 2022, we held $27.1 million in cash compared to $40.1 million as at December 31, 2021. Compared to our cash position of $23.4 million at the end of the first quarter, you can see that our cash position is starting to grow again due to the strong free cash flow nature of our business.

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, 2022, to shareholders of record as of September 30, 2022.

I will now turn the call back over to Shawn for some concluding remarks.

Shawn Peters^ Thanks, Bob.

As I noted in my opening remarks, the business has performed extremely well so far in 2022. Again, while we acknowledge that we are currently in an environment of rising interest rates to combat inflation, we've demonstrated time after time and quarter-after-quarter the strength, the resiliency, the efficiency and the opportunities for growth of this business in nearly any economic environment.

Our Services segment is maturing and is providing us continued diversification such that we are no longer entirely reliant on one main segment for our performance. Services will continue to advance through new customer acquisition as well as through the expansion of the products and services that we provide to existing customers.

Registry Operations, now expanded with the addition of Property Tax Services, remains an important part of our business. And it has proven to be an exceptionally robust business in varying economic environments. The results speak for themselves, and this business will continue to produce enviable bottom line results in the years to come.

Not forgetting Technology Solutions, I'm excited about the potential for this segment. And with expanded and focused leadership and a business development environment that appears to be shifting back into our favor, I look forward to realizing the growth we are pursuing in the quarters and years to come.

The updated guidance for 2022 we announced yesterday is not by chance. It's a direct result of our pursuit of growth opportunities, our diversified range of services and our focus on customer service, which has positioned us well for success in the short and long term.

To wrap up, I'd reiterate that there's much for our stakeholders to be excited about. We have an enviable foundation upon which we have built a healthy business, and we are optimistic about the future as we pursue our strategy to make each segment more efficient and to grow organically and more aggressively through the acquisition of accretive, complementary or value-adding businesses.

With that, I'll now hand the call back over to Jonathan.

Jonathan Hackshaw^ Thanks, Shawn. Daniel, we'd now like to begin the question and answer session, please.

QUESTIONS AND ANSWERS

Operator^ (Operator Instructions) Our first question comes from Scott Fletcher with CIBC World Markets.

Scott Fletcher^ I wanted to spend some time on Reamined. And I'm just wondering if you could start by giving us an overview of what attracted you to the business and why you decided to move into that market. And then secondly, if you could maybe dig a little further on the growth and margin profile of the business going forward.

Shawn Peters^ Scott, thanks for the question. It's Shawn. Yes, what attracted us to the business is really the similarity to our existing Registry Operations business, it's long-term relationship with government, providing key services that really help the economy move forward. They're also fairly economic resistant, which as we've seen in our Registry Operations is consistent with that business.

So it's really the same type of business that we pursue in Registry Operations and just a different way for us to grow that business. We've traditionally and continued to look at outsourcing arrangements for running registries, but this is just another arm of that where we're helping governments in long-term relationships. That's really what attracted us to it. And the stable business and the margin profile are also attractive, which I'll maybe let Bob chime in on that part of the question.

Robert Antochow^ Sure. Yes, just to add on Shawn, yes, the growth is really stable. Stable growth, so -- and then from a margin profile, it's -- the reason we included in our Registry Operations segment has a very similar margin profile to that operating segment.

Scott Fletcher^ Okay. Maybe I'll ask another question on the guidance. Sort of with the guide implying the EBITDA margins and EBIT is accelerating faster than revenue in the second half of the year, can you sort of help us understand where that maybe operating leverage is coming from or how the business is expecting to generate additional EBITDA and improve margins?

Shawn Peters^ Yes. Again, maybe I'll start, Scott. Part of that is the Reamined, as Bob just mentioned, it does have a strong EBITDA profile consistent with our Registry Operations, so the new EBITDA that we're bringing on to that is at a strong margin.

Some of that is also related to other opportunities we see in the business, we think, are both high EBITDA margin profile. And as always looking at actively controlling our expenses, we do plan and continue to -- we have been and continue to invest in people and technology, but that doesn't mean that we don't watch our expenses. And so some of our updated EBITDA in the guidance is also focused on expense management.

Scott Fletcher^ Okay. Maybe I'll finish with one last one. In the MD&A, the Reamined -- the commentary around cc2 revenues mentioned that it was expected to come in evenly throughout the year. Is that something we can just extrapolate the one month in the current quarter can sort of extrapolate that going forward? Is that a reasonable way to approach it?

Robert Antochow^ Yes, that's a reasonable way to approach it, Scott.

Operator^ (Operator Instructions) Our next question comes from Trevor Reynolds with Acumen.

Trevor Reynolds^ Just wanted a little bit of additional color on the recovery side of the business. We've seen a little bit of a pickup year-over-year, but what are you guys seeing, I guess, with rising rates? Are you starting to see things pick up a little bit from what we saw in Q2?

Shawn Peters^ Trevor, yes, good question. We talked about this a little bit in the first quarter, too. We had started to see a little bit of an increase in transactions but pretty early. We're still at that view. We're only the second quarter into this rising interest rate environment. It's still a bit early.

We are still seeing increased values in the recovered assets, and that's certainly helping. But the number of transactions, we haven't seen that trend yet shift into a real strong sort of environment. But that is potential to come as the interest rates take hold a little bit more and we get a little further into the year. But it does take a little bit of time for that trend to develop.

Trevor Reynolds^ Got it. And then just in terms of the performance for the first half of the year like -- and where you guys had guidance, like is this a significant outperformance of what you guys had modeled in for the first half of the year? Or is this just kind of wondering where the first half has come in relative to your expectations.

Shawn Peters^ Yes. No, it's actually we're pretty much right on where we expected. We -- as I mentioned, we expected the first half of the year to be strong with a bit of momentum from 2021, and that's exactly what's happened. We expected that in our Saskatchewan Registry business, transactions would start to normalize towards the middle part of the year, and that's exactly what's happening.

We're seeing that. We've already seen that start to happen in the second quarter. And we expect that will continue through the rest of 2022, as I said, normalizing more back to pre-pandemic levels but above 2019. So actually, we're pretty much right on where we thought we would be from a guidance perspective and from a performance perspective.

The change in guidance is really the addition, the acquisitions, the Reamined acquisition. And we are seeing a little stronger transaction activity and growth in the services part of our business. So it's really the combination of those two things that's resulted in us changing the guidance.

One last comment which I maybe should have mentioned. As I said, we do see Registry Operations pretty much right on track where we thought it would be. Having said that, high-value transactions are hard to forecast. And so we did see a little bit more of high-value transactions in the first half of the year, and so that's probably got a little bit extra in there for that. But other than that, transactions are largely playing out the way we thought.

Trevor Reynolds^ Great. And then I'll ask one more here, I guess, before I pass the line over. Just on the technology side of the business, obviously, this continues to recover, I guess, from COVID. But just wondering like ultimately where do you guys see this in a year or two. Does this get back to kind of where we saw the highs for this division in the past? Or is this -- what's your kind of outlook on the technology side?

Shawn Peters^ Yes. So we haven't obviously provided any specific guidance on that, but I think you've summarized it well. We were getting some real a traction right before COVID hit. We've seen good wins, good contract wins. We were seeing development really underway. And then as you said, we're now still recovering a little bit from that COVID. But the addition of the new head of ERS was Susan in there with a direct focus on growth in customer and development. We really do see that coming back to where we were and going further.

And as I said, combined with that, we are seeing increased procurement activities and active RFPs out in the market now, which we haven't seen for a couple of years during COVID. We really do think that there's an opportunity to get that back pretty quickly.

Trevor Reynolds^ Perfect. And then I guess just one last one here on the M&A pipeline and your available capital on the debt side of things and where you'd be willing to take leverage up to on any acquisitions.

Robert Antochow^ It's Bob here. So as you know, we've got a $150 million credit line. So with the $80 million in debt we have now, we have some additional room on that line. Plus we -- with the shelf prospectus we filed the other year, we do have $200 million of capital available through that for, I guess, kindling if opportunities do arise.

Trevor Reynolds^ Great. And then, Shawn, maybe just what you're seeing in terms of the pipeline?

Shawn Peters^ Oh, sure. Yes, sorry. Yes, we remain active in the M&A space. We've done two acquisitions this year. Our focus always is to make sure that we integrate those well. We talked a little bit about the integration of UPLevel in the quarter, and we'll be working on Reamined, although it's a bit more stand-alone. So we're focused right now on good integration but always looking for other opportunities where we can add value or enhance our customer experience.

So the pipeline is still robust. The same methodology will always apply that it will have to be the right Company at the right time, the right price. But we are active in this space, and we're excited about what we see in that pipeline.

Operator^ And our next question comes from Stephen Boland with Raymond James.

Stephen Boland^ Was there any part of the Registry business that was a positive surprise to the upside? The one I'd point out is the large transaction, the land title, that number seemed to be, I think, from our discussions, that was going to level down. Like it was sort of a pent-up demand, and it stayed pretty sticky to the last couple of quarters, that one especially. But is there anything in the Registry business that was a surprise to the upside?

Shawn Peters^ Yes, I'll start, Stephen, and Bob can jump in as well if there's anything I missed. I mean you've captured and we've talked about that. The high-value transactions are a bit hard to predict, and those have, as you said, remained a bit sticky through the last couple of quarters.

So those are probably a little higher than we thought. It seemed like a lot of those were pent up, and we've seen a lot of them in 2021, so we weren't sure how those would continue. So those are a little stronger. I would say the rest of the business is actually performing as we expected. The one thing that's probably stayed, pricing has stayed up fairly well in Saskatchewan. Volumes and transaction levels are sort of where we expected. They are starting to normalize.

And Saskatchewan real estate, the forecast right now, we're seeing obviously a decline year-over-year, and that's not unexpected given 2021 was kind of a record year. But we're not forecasting or any of the associations forecasting 20% or 40% drops in transactions in Saskatchewan. That's just not how it's going to happen.

So I think transactions are where we expected, but the positive upside, to answer your question, is really the high-value transactions and maybe the fact that pricing has stayed up relatively well through this period.

Stephen Boland^ Okay. That's good. And maybe you could just go to the credit facility. Can you remind me, one, who holds -- who is it with? And the terms are extremely favorable to you guys in terms of unsecured, noninterest bearing, no specific terms of repayment, but you have this intention of paying that down, the $40 million, I think, that you just used. What's the rationale behind that to be part of -- I guess, part to that question?

Shawn Peters^ Yes, I can start on that maybe, Stephen, just from the history perspective and then let Bob jump in. If I think I got your question right, you said what's the -- what's sort of the terms that are in our favor. I would say that's what two of our large banking partners, and they see the stability in the business. And so the favorable terms that we have on that are because of the really strong, stable business.

It's a great asset to lend against, and that's really helped us on the term side. And so our intention is to repay it, as we have in the past, fairly quickly because of the strong cash flow but no specific repayment terms, I think, because both banks are very comfortable with the business. So is that -- does that answer what you were asking?

Stephen Boland^ I'm just curious like if it's noninterest bearing, like how do they make like -- like what's going on, I guess, is the point.

Robert Antochow^ Yes, Stephen, it's Bob here. Yes, it's just the additional debt that we took on with Reamined that's noninterest bearing. Our facility is -- our credit facility is interest bearing. So sorry, maybe that didn't come out clear in the previous section. So -- and then in terms of our credit facility, you'd asked a question about the term of it. So we did renew it last year for five years. So we're just into the first year of that now. So --

Stephen Boland^ Okay. And you said it's two Canadian bank partners, if that's correct.

Robert Antochow^ That's correct. Yes.

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

Jesse Pytlak^ Just on the Services business, you've obviously had very strong organic growth there. Can you just give us a sense on how much of that is coming from new customer wins versus just larger share of existing base?

Shawn Peters^ Yes, good question. I would say it's a pretty good mix of the two. We are seeing fairly continual and regular new customer acquisition in that space. But we're -- as we converted over the last year, our customers to the Registry Complete platform, that platform does offer them a wider range of services. And so we are seeing some good pickup from existing customers on those additional products and services. I don't have a specific percentage to quote you, but it would be pretty balanced, I think, between the two.

Bob, I don't know if you have any other thoughts.

Robert Antochow^ Yes, I'd agree, it's pretty balanced, Shawn.

Jesse Pytlak^ Okay. And then just as a follow-up on that, like were there any really chunky customer wins this quarter in particular?

Robert Antochow^ No, nothing that we would talk specifically about. No.

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

Paul Treiber^ Just wanted to focus in on Registry Complete. You mentioned your rollout last year. How penetrated is that product within your installed base? And then secondly, related to that is how much uptake has there been of adjacent services through that platform, meaning what's the opportunity remaining to go to sell additional services through that platform.

Shawn Peters^ Yes, good question, Paul. So I would say that the platform is now pervasive across all of our customer base. We may be 100% at this point or very close. Yes, very close to 100%. We might have a couple of customers that haven't yet migrated over to it.

We're still early in that. Like a lot of that migration has happened over the last year. So we do think there's still additional uptick from existing customers on the products and services. But a lot of those are also transaction-based. So it's a new product and service, and we just -- we're picking up all of their transactions in that new product and service.

So I couldn't answer you with a specific percentage on how much uptick is left in the customers, but we do see that there is still continued growth there. And we'll be -- as I said in my comments, we'll be looking to add additional products and services over the course of time to make sure that, that continues.

Paul Treiber^ Okay. That's helpful. And then looking at Recovery Complete, is that a similar strategy as Registry Complete? And do you think you would also see similar cross-selling of adjacent products and services as upgrades to Recovery Complete happen?

Shawn Peters^ Yes, it absolutely is the same strategy, Paul. We see a couple of things in that. One is operational efficiency. The Recovery Solutions business is already a very high-margin business and pretty efficient, although we still had a lot of people -- like a lot of places where people would interact with the system. And what Recovery Complete is going to do is try to automate some of that particularly around the reporting to our customers.

So it's going to improve reporting to customers. That will improve the ability for customers to interact with their files and get data out of that, which we hope will ultimately result in additional transactions coming our way. But it also does have the additional products and services, the accounts receivable management, so sort of the residual balance, either front-end collections or residual balance that we hope some of the customers will pick up on as well.

Paul Treiber^ And just a small one, just on the accounting for Recovery Complete. Is there -- is it gross? And is there the same dynamic with gross versus net like you saw with Registry Complete?

Robert Antochow^ Recovery Complete -- sorry for the -- Recovery Complete, most of the business in Recovery Solutions is -- a good chunk of that revenue is commission-based. So it's really a net, if that helps.

Paul Treiber^ And it will remain that way even with Recovery Complete?

Robert Antochow^ Yes, that will be -- well, we will see some shift, but the largest portion will be the -- related to the commission earned on the sale of the recovered assets or on the collection of receivables.

Operator^ Thank you. I would now like to turn the conference back to Jonathan Hackshaw for closing remarks.

Jonathan Hackshaw^ Thank you, Daniel. With no further questions, we'd like to once again thank everybody for joining us on today's call, and we look forward to speaking with you again when we report our next quarter, being the third quarter. And wish you all a good day. Bye-bye.

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