Information Services(Q1 2024 Earnings)

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Corporate Speakers:

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

Participants:

- Scott Fletcher; CIBC; Analyst
- Natalya Davies; Edison; Analyst
- Jesse Pytlak; Cormark Securities; Analyst
- Paul Treiber; RBC Capital Markets; Analyst
- Trevor Reynolds; Acumen Capital; Analyst
- Andrew Murphy; Edison Research; Analyst

PRESENTATION

Operator^ Good day. And thank you for standing by. Welcome to the ISC Q1 2024 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 first speaker today, Jonathan Hackshaw, Senior Director, Investor Relations and Capital Markets.

Please go ahead.

Jonathan Hackshaw^ Thank you, [Shannon]. And good morning to everyone joining us today.

Welcome to ISC's conference call for the quarter ended March 31, 2024.

On the call today are Shawn Peters, President and CEO; and Bob Antochow, Chief Financial Officer.

This morning, Sean 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 our outlook and guidance for 2024 before passing the call back over to Sean 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 plus 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 plus 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.

Following a very successful 2023, the first quarter of 2024 was in line with our expectations for the beginning of the year. Revenue and adjusted EBITDA for the first quarter were up 15% and 34%, respectively, compared to the first quarter of 2023.

The robust year-over-year growth was due to strong operating results across all of the company's segments.

In Registry Operations, revenue and adjusted EBITDA were up 15% and 37%, respectively. The fee adjustments implemented in July 2023 in connection with the extension agreement, and annual CPI adjustments in the Saskatchewan registries continue to have a positive impact on revenue despite volumes in the land registry that were consistent with the prior-year period.

As a reminder, the first quarter of the year is typically our slowest in the Saskatchewan registries.

Our Services segment continues to deliver solid customer and transaction growth, mainly in Regulatory Solutions division, where financial institutions and auto finance customers continue to enhance their due diligence processes in an environment of higher interest rates and increased regulatory oversight. Revenue was up 9%, while adjusted EBITDA was consistent with the prior year period.

Technology Solutions saw the impact of continued execution of third-party solution definition and the implementation contracts with an increase in revenue of 64% and positive adjusted EBITDA compared to the first quarter of 2023 coming in at just under $1 million.

Expenses were up by $11.3 million compared to the first quarter of 2023.

However, $5.8 million of that was due to an increase in share-based compensation as a result of an increase in the company's share price during the first quarter of 2024 compared to a decrease in the company's share price in the same year in the prior period. All other expenses were in line with our expectations.

Towards the end of the quarter, and as I mentioned in our 2023 4th quarter conference call we announced a goal to double the size of ISC on a revenue and adjusted EBITDA basis based on 2023 results over the next five years through a combination of organic growth and M&A. With the key ingredients in place to deliver organic growth, the first quarter of 2024 marks a strong start towards the execution of that goal.

I'll now turn the call over to Bob to discuss some financial highlights in more detail before providing some closing thoughts.

Robert Antochow^ Thank you, Shawn. And good morning, everyone.

As Shawn mentioned, 2023 was a successful year for the company with the first quarter of 2024 continuing with strong results and in line with our expectations. This performance was driven by a number of factors, which I will now highlight to you. Revenue was $56.4 million, an increase of 15% compared to the first quarter of 2023. Growth was due to fee adjustments within the Saskatchewan Registries division made in the third quarter of 2023 pursuant to the extension and annual CPI adjustments.

Customer and transaction growth in Services Regulatory Solutions division and the advancement of project work on existing and new solution definition and implementation contracts in Technology Solutions. Net income was $0.4 million or $0.02 per basic share and $0.02 per diluted share compared to $6.9 million or $0.39 per basic and $0.38 per diluted share in the first quarter of 2023.

Strong operating results were offset by increased share-based compensation expense due to a rise in the company's share price during the quarter compared to a decrease in the prior year quarter. Alongside increased interest expense and amortization associated with the extension agreement executed in July 2023.

Net cash flow provided by operating activities was $10.5 million for the quarter, an increase of $4.7 million or 82% from $5.7 million in the first quarter of 2023. The increase in net cash flow was primarily due to an increase in cash from changes in noncash working capital. Adjusted net income was $8.5 million or $0.47 per basic share and $0.47 per diluted share compared to $6.8 million or $0.38 per basic share and $0.37 per diluted share in the first quarter of 2023.

The growth in adjusted net income reflects strong operating results, offset by increased financing costs associated with the additional borrowings that were used to fund upfront payment for our Saskatchewan extension agreement. Adjusted EBITDA was $19.4 million for the quarter compared to $14.5 million in the first quarter of 2023.

The increase is due to the impact of fee adjustments in registry operations, Saskatchewan Registries division pursuant to the extension agreement and annual CPI adjustments. Technology Solutions adjusted EBITDA also grew compared to the prior year quarter due to increased revenue from existing and new solution definition and implementation contracts. Adjusted EBITDA margin was 34.5% compared to 29.5% in the first quarter of 2023, driven by pricing increases, as discussed previously.

Adjusted free cash flow for the quarter was $11.6 million, up 18% compared to $9.9 million for the first quarter of 2023 due to stronger results in our operating segments. This was partially offset by an increase in costs associated with the extension agreement including interest on increased borrowings to fund upfront payment and an increase in interest rates. Voluntary prepayments of $4 million were made towards ISC's credit facility during the quarter, demonstrating the ISC's plan to deleverage towards a long-term net leverage target of two to 2.5x.

Turning to our balance sheet. With respect to our debt, as at March 31, 2024, the company had $173.4 million of total debt outstanding compared to $177.3 million as at December 31, 2023 mainly due to the borrowings associated with the extension agreement signed in July 2023.

As part of the extension, the company increased its credit facility and entered into an amended and restated credit agreement, fund upfront payment to the government of Saskatchewan of a $150 million. The company is focused on continuing sustainable growth and deleveraging its balance sheet towards a long-term net leverage target of two to 2.5x. The prepayments described in management's discussion and analysis for the fourth quarter and year ended December 31, 2023, are a reflection of the deleveraging plans.

Further details on our debt and our credit facilities can be found in our MD&A and financial statements.

Additionally, capital expenditures have increased as expected, albeit remaining relatively insignificant overall.

Sustaining capital expenditures including registry enhancement capital rose to $2.1 million for the first quarter of 2024 from $0.3 million in the corresponding period in 2023.

After all this, as at March 31, 2024, we held $20.2 million in cash compared to $24.2 million as at March 31, 2023.

In February, we provided our outlook and guidance for 2024, and this is also included in our MD&A, which I encourage you to read.

As a reminder, we've maintained our annual guidance for 2024, which is that revenue is expected to be between $240 million and $250 million. Adjusted EBITDA is expected to be between $83 million and $91 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 July 15, 2024, to shareholders of record as of June 30, 2024.

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

Shawn Peters^ Thanks, Bob.

As we look to the rest of 2024, in registry operations, we expect transactions to be largely flat with revenue growth through realization of a full year of extension and CPI fee adjustments. The Saskatchewan real estate sector has seen challenges with inventory in the first quarter, and the Bank of Canada has held its key interest rate at 5% since July of 2023.

We expect these to continue to be factors in the Saskatchewan land registry, and we'll continue to monitor interest rates and other economic conditions, which can impact the real estate activity.

Overall, our Registry Operations segment is anticipated to remain a strong free cash flow and adjusted EBITDA contributor in 2024 and the robust nature and diversity of our business means we are well positioned to deliver on our expectations for 2024 and beyond.

Consistent with that, and with our growth plan, our Services segment will continue to be a significant part of our organic growth with a forecasted increase in transactions and number of customers. The current trend of enhanced due diligence in an environment of higher interest rates and increased regulatory oversight is expected to continue.

Our Technology Solutions segment is also forecasted to see double-digit growth as we deliver on existing and new solutions delivery contracts in 2024.

Our expenses will continue to be focused on driving our organic growth and supporting the enhancement of the Saskatchewan registries as well as positioning us for targeted M&A, which as you know has been underpinned by our prudent and proven approach.

Putting that all together, we expect our performance in 2024 to remain robust, and our business to do what it has become known for, performing well and generating strong free cash flow in a sustainable fashion despite external ups and downs.

As we focus forward, I'm excited about our next phase of our growth, and I look forward to continuing to share our progress with you.

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

Jonathan Hackshaw^ Thanks, Shawn.

[Shannon], 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 from CIBC.

Scott Fletcher^ Shawn, you touched on this in your closing comments there, but with inventory levels remaining are looking to be challenged in Saskatchewan, is there a risk of transaction volume shifting into negative growth into the back half of the year? It seems like you're sort of still looking for flat, which is consistent with the prior commentary.

Shawn Peters^ Yes.

Scott, thanks for the question.

As you said, we are looking -- we do expect them to be flat.

I think they've been sort of consistent year-over-year in the quarter.

But there are inventory challenges, particularly in that mid-market.

It's something we're watching fairly closely.

What's happening, though, is we are getting transactions on either side of that mid-market.

And to the extent they are higher value, like on the top end of that mid-market, we're actually getting transactions of a higher value.

So it's not impacting revenue the same way, but it's something we're going to keep a close eye on for sure.

We've seen economic cycles here in Saskatchewan and even as transactions come down a bit, it typically performs very well.

Scott Fletcher^ Okay. That's helpful context. And then -- is there anything you can share on how much in the quarter from a dollar perspective that the new MSA fees would have contributed just to get a sense of how much organically their business is growing?

Shawn Peters^ Yes. Not specifically.

I think when we announced the extension, we gave sort of a $17 million of revenue in and roughly the same with the EBITDA as a figure annualized figure.

But we don't -- didn't specifically disclose in the Q1, what it was in an actual basis.

But you could use that sort of imply --

Scott Fletcher^ And then I'll close with one question just on the services.

On the demand environment there, your -- you sort of mentioned in your comments that things are looking good, the regulatory complexity and the higher for longer rate seems to be impacting demand there.

Is that -- is it notably better through the first four months of the year? Or is it sort of consistent with what you saw in 2023?

Shawn Peters^ Yes. I can start, and then I'll let Bob jump in.

I think we're seeing it relatively consistent.

We don't see the same seasonality in that sort of thing.

So from quarter-to-quarter in parts of the services business it's fairly consistent.

So -- and Bob, I'll let you jump in as well.

Robert Antochow^ No. I think you answered it well Shawn there.

Operator^ Our next question comes from Natalya Davies from Edison.

Natalya Davies^ Could you provide a bit more color on the Technology Solutions business pipeline and any margin targets for this division in the long term?

Shawn Peters^ Sure, Natalya. Thanks for the question. Yes.

As we started talking about in 2022, we started to see a return to procurement in that space, and I think we experienced that fairly strong through 2023 and made a couple of announcements. That continues to be the environment that we're operating in.

We're seeing a lot of procurements coming.

We don't comment too specifically on the forward pipeline, but I would tell you that it remains consistent and fairly strong.

From a margin perspective, as we rebuild that business post pandemic, as we talked about in earlier calls, the pandemic did have an impact on that business.

So as we rebuild that we'll be looking for our typical margins, which would be sort of in that 30%.

But as we're starting to grow the business, we're making sure that we're -- we've got an eye on profitability of that segment.

Operator^ Our next question comes from Jesse Pytlak from Cormark Securities.

Jesse Pytlak^ Just on the asset recovery business, you pointed to some acceleration in excitement in the quarter.

I guess, can you maybe just speak to how confident you are that this will be sustained?

Robert Antochow^ Yes.

It's -- thanks for the question, Jesse.

We are seeing some increased activity, right? It's hard to predict what's going to happen in the future.

But -- it's been positive in Q4 of 2023 and Q1 of 2024 with those increased assignments and -- so we feel that it's going to continue on.

We are seeing more activity in that area.

But again, we don't have a perfect crystal ball on that.

Jesse Pytlak^ Okay. And then maybe just switching over to Technology Solutions. You were very successful last year with a number of contract wins, as these move into the deployment phase now I guess, how would you characterize how far along are you with these deployments?

Robert Antochow^ Yes. The contracts typically are -- can be one to three years. And so a number of -- so it's -- you could just call it, we announced a number of them at the end of

-- a couple at the end of 2022 and then a number in beginning of 2023 and then some towards the tail end of 2023.

So if you use that sort of 2-year mark, some of them were half -- halfway through.

Others were just have started on them.

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

Paul Treiber^ I just wanted to hone in on the services growth and, I guess, opportunity there. The -- what -- you've seen good customer growth, what's your view on the longer-term customer opportunity? Like how penetrated do you see that? And then secondly, related to that, your wallet share at customers. How -- what's the opportunity that you see there?

Shawn Peters^ Yes. Paul, thanks for the question. A couple of things on that. When we look at the acquisitions we've made, we've talked about this before that we tend to acquire companies that are sort of a distant second or third in the market.

So there's lots of runway for growth.

That was the case with ABS in sort of the case of Paragon, which was the challenger and a champion challenger model.

And so that gives us a fair bit of room to continue to grow.

Now we've been executing against that over the last couple of years and continuing to win customers and market share.

I think there's still room left for us to do that. There are still large players in both those spaces. And so our wallet share would be probably under 50% on any of those lines of business, which still gives us room to continue to grow.

Paul Treiber^ Okay. That's helpful. And then related to the services business, like just on the margin side, do you expect or is there like to drive out economies of scale through synergies of those businesses as you integrate them bringing them together as you bundle more into customers, should we expect the margins to continue to trend up over time?

Robert Antochow^ Thanks, Paul.

I think definitely, as we work on our technology platform and we bring that together, there should be some economies of scale at this point, not I wouldn't call it significant, but there is obviously with the maintenance of different systems and so forth, there is savings from that aspect.

But I still think that 22% margin.

At this point, it's not going to significantly move from that level, maybe a small incremental increase but not significantly up from that level, if that makes sense.

Shawn Peters^ And just to add to that, Paul, just from a historic perspective, remember that the businesses that we've acquired have been very different and so putting them together for synergies hasn't been a huge focus.

We've acquired them for their growth and their potential. And as Bob said, there are synergies coming through some technologies, and we're certainly using it on the sales generating side to the extent they're common customers.

But the product set, while complementary was fairly different. And so that's why some of the expenses have stayed fairly consistent.

Operator^ Our next question comes from Trevor Reynolds from Acumen Capital.

Trevor Reynolds^ Just looking for a little bit of clarity on the stock-based compensation in the quarter and whether there's any cash component to that? And just kind of maybe just looking for a little better understanding on that what we should be forecasting for that moving forward?

Robert Antochow^ Yes. Trevor, to understand your question from a -- the main LTI components are share appreciation rights and performance share units.

From an expense perspective, the share appreciation rates, they vest -- vest over four years. They can be exercised after they vest after each tranche bets.

So the part of the trouble rate that is it depends when the individuals exercise those, right? So that's hard to predict that. And then in terms of the performance share units, the cliff fast after three years. And so that essentially is every three years, there would be a cash payment associated with those.

So typically, that depends on when they're granted when that 3-year period expires.

So I don't know if that helps you.

Operator^ Our next question comes from Andy Murphy from Edison Research.

Andrew Murphy^ I've got just the one.

I'm just wondering if you could talk a little bit more about the market opportunities for M&A activity, whether we can maybe expect something in the next 12 months or so? And then following on from that, I was looking at the presentation you have updated presentation on your website, just interesting amount of debt headroom that you have.

And you said on the presentation, you have a shelf prospectus of $240 million and credit facilities of $250 million.

From that, can I assume that you've got total percentage of $490 million of which about a $173 million is utilized leaving the effects of the M&A headroom of just over $300 million.

Is that the correct way to read that?

Shawn Peters^ Yes, roughly. Yes.

Robert Antochow^ Yes.

Now when it comes to our bank facilities, we do have covenants that we have to maintain.

So the difference between the $250 million total credit facility in the $174 million we have left there, depending on where our covenants are, then you'll got the impact how much of that we can exercise.

So.

Shawn Peters^ Yes. And coming back to the first part of your question, Andy, on M&A.

As we outlined in our Q4 call our goal is to double the size of the company over the next five years through a combination of organic growth and M&A. The guidance that we've given for 2024 is based on organic growth, and we've been very focused on that, getting that ramped up and going.

But we're continually looking at our pipeline for M&A.

And as always, we'll execute a transaction.

But when it makes sense when we find the right company at the right price that fits for us.

So that will -- that is certainly part of our 5-year plan.

But I would just reinforce the guidance this year is based on just the organic growth component of that.

So any M&A would be in addition to that.

Operator^ Thank you. This does conclude our question and answer session.

I would now like to turn it back to Jonathan Hackshaw for closing remarks.

Jonathan Hackshaw^ Thank you, [Shannon]. With no further questions, we'd like to once again thank all of you for joining us on today's call and we look forward to speaking with you again when we report our second quarter later in the year.

Have a great day.

Operator^ Thank you for your participation in today's conference. This does conclude the program.

You may now disconnect.