



Real Matters Q1 2024 Conference Call - Transcript

February 1, 2024

Corporate Participants

Brian Lang, *Chief Executive Officer*

Rodrigo Pinto, *Executive Vice President and Chief Financial Officer*

Lyne Beauregard, *Vice President, Investor Relations & Corporate Communications*

Other Participants

Richard Tse, *National Bank Financial*

Daniel Chan, *TD Cowen*

Thanos Moschopoulos, *BMO Capital Markets*

Robert Young, *Canaccord Genuity*

Gavin Fairweather, *Cormark Securities*

Martin Toner, *ATB Capital Markets*

Presentation

Operator

Welcome to the Real Matters Q1 2024 Earnings Conference Call. [Operator Instructions] This call is being recorded on February 1, 2024. I would now like to turn the conference over to Lyne Beauregard. Please go ahead.

Lyne Beauregard

Thank you, operator, and good morning, everyone. Welcome to Real Matters' Financial Results Conference Call for the first quarter ended December 31, 2023. With me today are Real Matters' Chief Executive Officer, Brian Lang; and Chief Financial Officer, Rodrigo Pinto. This morning, before market open, we issued a news release announcing our results for the 3 months ended December 31, 2023. The release, accompanying slide presentation as well as the financial statements and MD&A are posted in the Investors section of our website at realmatters.com. During the call, we may make certain forward-looking statements, which reflect the current expectations of management with respect to our business and the industry in which we operate. However, there are a number of risks, uncertainties and other factors that could cause our results to differ materially from expectations. Please see the slide entitled Cautionary Note regarding forward-looking information in the accompanying slide presentation for more detail. You can also find additional information about these risks in the Risk Factors section of the company's annual information form for the year ended September 30, 2023, which is available on SEDAR+ and in the Investor Relations

section of our website. As a reminder, we refer to non-GAAP measures in our slide presentation, including net revenue, net revenue margins, adjusted EBITDA and adjusted EBITDA margin. Non-GAAP measures are described in our MD&A for the 3 months ended December 31, 2023, where you will also find reconciliations to the nearest IFRS measures. With that, I'll now turn the call over to Brian.

Brian Lang

Thank you, Lyne. Good morning, everyone, and thank you for joining us on the call today. I'll kick things off by going over the business highlights of the quarter. Rodrigo will then follow up with a brief discussion of the financial highlights before we take questions. We delivered solid results in the first quarter against the backdrop of a bottom bouncing mortgage origination market. Consolidated revenues were down 7% year-over-year compared with an estimated U.S. mortgage origination market decline of 18%. Consolidated net revenue was relatively flat, and we reduced our adjusted EBITDA loss by 2/3 to \$1.1 million as a result of improved net revenue margins across all 3 segments and a lower cost base. We continue to leverage our platform to improve our net revenue margins while driving our performance advantage, which is key to increasing market share and winning new clients. While the mortgage market continues to hover around historical lows, our focus remains on setting the business up for long-term success, building market share, winning new business and positioning the company for improved financial performance when market conditions improve and we start to see growth in volumes from these historical lows.

First quarter U.S. Appraisal purchase and refinance revenues outperformed the market year-over-year. Purchase revenues were down 10% compared to an estimated market decline of 21%, and refinance revenues were down 5% compared with an estimated market decline of 8%. We launched 1 new client in the first quarter, increased our market share on a sequential basis with 2 of our top clients. We posted record-high net revenue margins of 27.9% and a year-over-year adjusted EBITDA increase of 16% in U.S. appraisal in Q1. In U.S. Title, centralized title revenues were flat year-over-year compared with an estimated market decline of 10%. As we discussed on our last conference call, we launched a second channel with our Tier 1 lender at the end of September, increasing our market share with that client. U.S. Title net revenue was up 18% year-over-year, and we reduced our adjusted EBITDA loss in the segment by 44% to \$1.6 million in the first quarter. The focus for Title remains on readying ourselves to scale for growth as the market recovers and market share increases. We continue to work the pipeline with a view to adding new clients in 2024.

In Canada, we saw lower market volumes for appraisal services, which we were able to offset in part with market share gains. Revenues were down 12% year-over-year. However, a 90 basis point increase in net revenue margins helped temper the decline in net revenues. We launched 2 new clients in Canada in the first quarter.

During the first quarter, our sales team was highly engaged with existing and potential new clients at the annual Mortgage Bankers Association Convention, discussing how we can leverage our capabilities to better serve their needs and strategically expand our relationships, particularly in Title.

Our focus remains on leveraging our current performance and various strategies to onboard new clients and build franchise value for the long term. With that, I'll hand it over to Rodrigo. Rodrigo?

Rodrigo Pinto

Thank you, Brian, and good morning, everyone. As Brian outlined earlier, the U.S. mortgage market declined on a year-over-year basis in the first quarter. While it's typical to see some sequential decline due to seasonality, U.S. mortgage rates peaked above 8% in October, which further reduced origination volumes, particularly on the purchase side. Fortunately, rates slowly start to come down from their peak towards the end of the first quarter, and the industry outlook is improving. Should mortgage rates drop either through rate cuts or spread compression, we see the potential for market volumes to recover from their historical lows. This includes the refinance market. Approximately 15% of current mortgages have an interest rate above 6%, which translates to approximately 7 million refinance candidates when rates come down. We continue to firmly believe that the market will recover over the mid to long term. And so we remain focused on things we can control, ensuring that we do what's necessary to grow our client base and our market share, managing our operating efficiency and driving towards our fiscal 2025 targets while maintaining a strong balance sheet.

Turning to our first quarter financial performance. I'll start with our U.S. Appraisal segment where we recorded revenues of \$26.8 million, down 5% from the same period last year as lower market volumes were partially offset by new client launches and the increase in our market share with our clients. As Brian mentioned earlier, we outperformed the market in the first quarter. Our origination revenues were down 8% year-over-year compared with an estimated addressable market decline of 19%. Home equity revenues were up 7% year-over-year as we relaunched in the home equity channel with some of our existing lenders in fiscal 2023 and had strong market share growth, further entrenching those client relationships.

U.S. Appraisal net revenue was \$7.5 million for the first quarter, relatively flat compared with \$7.6 million in Q1 '23. We continued to see strong net revenue margins in the first quarter with an increase of 90 basis points year-over-year, hitting a record high of 27.9%. Our ability to leverage our platform resulted in a solid year-over-year margin increase and kept us at the high end of the range of our fiscal '25 targets of 26% to 28%.

U.S. Appraisal operating expenses declined 10% year-over-year to \$4.8 million in the first quarter. U.S. Appraisal adjusted EBITDA was \$2.7 million for the quarter, up 16% from the first quarter of fiscal 2023. Adjusted EBITDA margins increased to 35.8% from the 30.4% we posted in the first quarter last year as a result of an improved net revenue margin profile and the reduction of operating expenses.

Turning to our U.S. Title segment. First quarter revenues declined 14% year-over-year to \$2 million due to lower refinance origination volumes. As Brian outlined earlier, revenues from centralized title services, the core of our long-term business in title, were flat year-over-year compared to an

estimated 10% market decline. U.S. Title net revenue was \$1 million, up 18% from the first quarter last year, and net revenue margins increased to 47.3% from 34.7%, mostly due to a higher closing rate for incoming order volumes and the decline in lower-margin home equity volumes.

We reduced U.S. Title operating expenses by 31% year-over-year to \$2.6 million, and we recorded an adjusted EBITDA loss of \$1.6 million for the U.S. Title segment compared with a loss of \$2.9 million in the first quarter of fiscal 2023, an improvement of 44% due to the year-over-year reduction in operating expenses and a net revenue margin improvement.

In Canada, first quarter revenues were down 12% year-over-year to \$6.6 million due to lower market volumes. Net revenue decreased to \$1.2 million from \$1.4 million we recorded in the first quarter of 2023. However, margins expanded by 90 basis points year-over-year as we continue to leverage our operator network in a lower market environment. Canadian adjusted EBITDA was down \$160,000 year-over-year.

In total, first quarter consolidated net revenue of \$9.7 million was relatively flat compared to last year as margin improvements in all 3 segments helped offset the decline in consolidated revenues. Consolidated operating expenses were down 12% year-over-year to \$11.6 million in the first quarter. We reduced our consolidated adjusted EBITDA loss year-over-year to \$1.1 million from a loss of \$2.9 million in the first quarter of 2023. Finally, our balance sheet remains strong with no debt and cash of \$45.1 million at December 31, 2023, up from \$42.3 million at year-end, mainly due to working capital changes during the period.

With that, I'll turn it back over to Brian. Brian?

Brian Lang

Thank you, Rodrigo. So in summary, we were pleased with our performance in the first quarter relative to a bottom bouncing mortgage origination market. Our U.S. Appraisal purchase and refinance revenues outperformed the market decline. We posted record net revenue margins in U.S. Appraisal, increased net revenue in U.S. Title and we reduced our cost base by 12% from the first quarter of 2023. These factors allowed us to reduce our adjusted EBITDA loss by 2/3 on a year-over-year basis.

Looking ahead, we remain focused on preparing for scale. Our operations are optimized and we have the capacity to scale up with our existing cost base when market conditions improve. We have a strong balance sheet with more than \$45 million in cash and no debt. Overall, I'm very confident about our financial position and our ability to continue to grow market share and launch new clients. Our focus is on long-term growth as it always has been. We believe in the long-term earnings potential of our business, and we remain focused on our fiscal 2025 objectives. With that, operator, we'd like to open it up for questions now.

Question and Answer Session

[Operator Instructions] Our first question comes from the line of Richard Tse. of National Bank Financial.

Richard Tse

With respect to title and close RFPs under what conditions do you see them kind of moving ahead more aggressively? Is it just sort of a turn in broad volumes? Or is there something more discrete there?

Brian Lang

Appreciate the question. And I think you've sort of underlined what I think one of the big changes is the momentum of the market actually sort of rebounding off of these historic lows that we've been at. So our title pipeline for us has been slower than expected, simply, I think, due to the fact that we are at such historically low volume levels. That said, there's definitely, I think, a pivot now in the market, where lenders were pulling back on their spending and capacity, and now they are definitely, I think, starting to look forward. The sentiment is shifting towards a more positive view of the spring market coming up as well as, I think, the Fed's positioning now around stabilizing rates and having them now starting to move down. So that, for us, I think, continues to keep us very optimistic, Richard, on the RFPs with Tier-1s, I think this quarter, our expectations are high that we'll see one and as well as continue to focus on the Tier-2s and Tier-3s in our pipeline.

Richard Tse

Okay. And I guess related to the title and close RFPs, how many competitive bidders would be kind of in that market today? And my guess is that your incumbency on the appraisal side definitely gives you an edge. Is that still the same as it was before?

Brian Lang

Yes, Richard, I think that is a big differentiator for us is not only the fact that we have relationships on the appraisal side, but the fact that we performed well and continue to increase share with those players. So I think that will do us very well. We've, of course, got our master services agreement. And so in our view, the RFP process, at least for us, we've been through this with all of them in the past. It should be something that we can move forward with with some pace. So I think that's what we're looking at. And to your question around competitors, the competitors remain in the title space, the big title insurers, which, again, in our view, we compete incredibly well against them. And then a couple of other players that no doubt will be in play. But there is really only a handful of strong national providers, Richard. So again, I'm very optimistic about where we will stand on the RFPs.

Richard Tse

Okay. And just one last quick one for me. Wondering if you can maybe update us on how much incremental revenue you could support under the current OpEx in each of appraisal and title? And that's it for me, thanks.

Brian Lang

Thanks, Richard. Appreciate it. When we look at capacity right now in order to continue to fulfill the needs of the Tier-1s that we're working with, especially on Title, we do have a fair bit of excess capacity right now, Richard. So our view is that we could take on 3x to 4x the volume, which, to your revenue comment, is more-or-less akin to that, 3x to 4x. And on the appraisal side, we've got about 30% still of excess capacity. So the benefit for us, it means as the market does start to torque and we start seeing the upward climb in volumes, I think we're very well positioned to manage with our capacity until the market really takes off, then we'll have to look at our OpEx. But I think we're in good stance for the short term.

Operator

Our next question comes from the line of Daniel Chan at TD Cowan.

Daniel Chan

You mentioned that the RFP process can move pretty quickly. Can you just remind us how long you think that could take from inception to revenue contribution?

Brian Lang

Sure. So Dan, I think our view is we're looking to have some revenue by the end of the year. So that RFP then could take anywhere from usually 3 to 6 months, but being conservative, if we say 6 months, that sort of gets us to the end of our fiscal.

Daniel Chan

Great. That's helpful. And then you mentioned that some of the lenders are getting a little bit more positive. Is that just a broad statement across all your customer base? Or is that more specific to the larger bank lenders because when you look at the bank lenders, they've continued to lose share this quarter. So just wondering if they're indicating to you whether they're ready to start ramping back up?

Brian Lang

I mean if we split sort of bank to non-bank, the non-banks are definitely very competitive in an environment like this when there is volatility in the rates stand and the banks tend to like a market where the rates are a little steadier. So I definitely think there's been a sentiment change now with the banks. And so I think they are more engaged. They frankly spent most of last year taking costs out of the business. And so I think and the way they're communicating with us, they're now looking at the other side of that ramp. So as I said, I think the sentiment's shifting, I think there's an optimistic

sort of view to the second half of our fiscal year, spring market. I think there's some expectations around that coming back and us starting to see some more refinance volume in the second half of the year.

Operator

Our next question comes from the line of Thanos Moschopoulos at BMO Capital Markets.

Thanos Moschopoulos

With respect to the net revenue margins for title, can you remind us how that should progress in a recovery? I know there's some moving parts there. I mean, firstly, in terms of total volumes you're doing currently but secondly in terms of current mix. So how would you expect that to progress as long volumes tick up?

Rodrigo Pinto

Sure. Like, again, we are in a different market, right? When you see the mix of products that we are dealing with today. It's very different than what we used to see historically. We do expect that it will go back to where centralized title services is the core of the business and will be a very high portion of our title revenues. When we get to that point, it's then where we believe we'll get close to our fiscal 2025 targets of 60% to 65% net revenue margins.

Thanos Moschopoulos

That's helpful. And I know that over the last while, you've been doing some work from an R&D perspective to better leverage AI and analytics. Is there anything of note to report there as an update or not especially?

Brian Lang

Well, I think we continue that transition that we've shared, Thanos, in our move to the Cloud. So the majority of our business is now sitting in the Cloud. And there's some capabilities that we now have access to, which are, I think, really valuable for the operations of the business, two in particular, around the large language models as well as photo recognition. So our team has been pushing through proof of concepts. We're actually going to launch some of that capability at the back-end of this quarter. And so there's value for us and that it helps us all on the performance side. So again, sort of helping us around our turnaround times, but it also helps us from a cost standpoint in managing our capacity around some of the areas where these models will really help the business. So that's really been, I think, the key focus for us makes it a little more streamlined Thanos, as well as allows us to deliver better service for the customers.

Operator

Our next question comes from the line of Robert Young at Canaccord Genuity.

Robert Young

You noted spreads coming down and people are hopeful that rates will come down. And so I'm just curious what you see in the current quarter, maybe just for modeling purposes, understanding if the spring market starting at the end of March is a catalyst, how should we be thinking about Q2? And then is that spring market a catalyst to think about how Q3 performs?

Rodrigo Pinto

Sure. So Q2, again, we can't call the market, right? But MBA and Fannie are calling for a fairly flat market sequentially. Outside of that, we are going to see an increase of about \$0.5 million in our OpEx for Q2. And that's due to usual payroll taxes seasonality as we have to pay CPP, EI, social insurance. That's basically how we are seeing for Q2. Going to second half of the year, again, we can't call the market. But yes, there's estimates from Fannie, MBA, where it's interesting because the range is really wide right now. So you have on the refi side, expectations of 50% to 100% increase in volumes for the second half of our fiscal year. And on the purchase, again, you have from flat to 10%, 12% increase in purchases for the second half of the year. That's basically what we are reading out there in the market right now.

Robert Young

Okay. That's really helpful. And then if I just dial in a little deeper on the spreads coming down just here in the beginning of the year, is that the Tier-1 banks getting more aggressive? Or is there some other dynamic at play? And then maybe if I just extend that one step further, like is there a catalyst that investors can look at? Like would the spreads coming down? Or obviously, a Fed rate change would be a positive thing. But are there any other catalysts to look at around this potential upswing?

Brian Lang

Yes. And I think that's mean there are other macro elements, as you know, Rob, that are sort of got people interested and engaged right now with inflation and consumer spending. But we look at the Fed. And so the Fed, I think, has been very clear and then, of course, Bank of Canada here that rate cuts are done, sorry, rate increases are done. So I think that has definitely helped with the big Tier-1s. They want no volatility or very limited volatility. And so I think it's taken that out of the equation for them. And now it's a matter of when some of the rates are going to start coming down. But to your point, I think that there's some compression in the spread that we've seen to start the year. And I wouldn't be surprised if we see some more of that over the next couple of quarters as the Tier 1s become much more comfortable and confident that there'll be less volatility in the overall rate environment.

Operator

[Operator Instructions] The next question comes from the line of Gavin Fairweather at Cormark.

Gavin Fairweather

A couple for me on the appraisal business. Nice to hear that you're continuing to gain share with some of your larger clients there. I think it was last quarter where you said there was a second client where you went over 50%. So just curious if your view on kind of the share ceiling with clients is changing or the way that clients are thinking about kind of vendor diversification is changing?

Brian Lang

Yes, again, I don't think we've changed our view on that. I think we stated in 2020 that we thought we could get a couple of the Tier-1s above 50%. And to your point, I think we've done a good job of that share in the gain in share. And there's still, of course, opportunity now with, I think, both those Tier-1s and others to continue to expand that share opportunity, Gavin. I think the focus of our team, and it's clear in some of the scorecards we're seeing that the focus on continuing to expand our performance differentiation against competitors is where the team is wholly focused. So I think as we continue to expand that competitive differentiation that we've got and performance on our scorecards, I think there's continued opportunity for us to expand share across the board.

Gavin Fairweather

Okay. And then just on U.S. net revenue margins, you're kind of right at the top end of your 26% to 28% range that's baked into your targets. Could we potentially see some upside beyond that level? Or is this kind of partly aided by a bit of a slower market and skinning up the network? Just be curious for your perspective on how to think about that going forward?

Rodrigo Pinto

Sure. So Gavin, our view is that you're going to see very similar net revenue margin profile that you saw in Q1 across the year, right? Again, we do believe we will stay in that range of 26% to 28%, which is our fiscal 2025 target. Yes, we have some small ups and downs as volume changes, but we are confident about our net revenue margin profile as is.

Operator

And we currently have one further question in the queue. That's from the line of Martin Toner at ATB Capital Markets.

Martin Toner

Most of the questions have been answered, but I just would like you to comment on your customers a little bit. This market can move really quickly and your lender customers need to be forward-looking. Just wondering if you can comment on what they're doing to be prepared as this market kind of like gets back to business?

Brian Lang

Thanks, Martin. As I mentioned a little bit earlier, I think they spent an awful lot of last year kind of catching up on managing capacity down. And so frankly, the work that we are doing with them

right now is they have tasked us to really focus ahead with them on if volumes were to go up 50%, 100%, how would we continue to support them and drive the type of performance we're seeing today in a market that's quite a bit more robust than it is today. So they're definitely looking forward. I mean I think that's where I'm suggesting there's some change in the sentiment. They're definitely looking forward in talking about how we would manage in a more robust market. So, we'll have to see the devils in the details over the next couple of months and quarters on where we see both rates and consumer sentiment. But definitely, they are focused on the increase in volume that they foresee in the next couple of quarters.

Martin Toner

That's great. In this past quarter, did share shift much from large banks to small banks?

Brian Lang

Did share shift much amongst the banks. Is that the question from big to small?

Martin Toner

Yes, correct.

Brian Lang

Yes. I mean, again, if you take a look at the public disclosures of the Tier-1s, they definitely had a tough quarter this past quarter. But remember, they've had a tough year. So it's not something different. It's nothing new that we're seeing. And I think this is something that they very much have done on purpose, right? So they've taken a step back, Martin, in a market like this because it becomes very rate competitive and with some of the volatility, as I mentioned earlier, around some of the 10-year treasury type rates. So our view is they are now starting to reposition themselves. And as I say, with less volatility in the overall macro, I think they will now start stepping back in and going beyond just their customer base and looking for new customers.

Operator

And that was the final question in the queue. So with that, this now concludes the conference. Thank you all very much for attending. You may now disconnect your lines.