



Real Matters Q3 2024 Conference Call - Transcript

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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

Gavin Fairweather, *Cormark Securities*

Martin Toner, *ATB Capital Markets*

Richard Tse, *National Bank Financial*

Robert Young, *Canaccord Genuity*

Thanos Moschopoulos, *BMO Capital Markets*

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Real Matters Q3 2021 Earnings Conference Call. [Operator Instructions] This call is being recorded on Thursday, August 1, 2024.

I would now like to turn the conference over to Lyne Beauregard, Vice President of Investor Relations and Corporate Communications. Please go ahead.

Lyne Beauregard

Thank you, operator, and good morning, everyone. Welcome to Real Matters financial results conference call for the third quarter ended June 30, 2024. With me today are Real Matters' Chief Executive Officer, Brian Lang; and Chief Financial Officer, Rodrigo Pinto.

This morning, before market opened, we issued a news release announcing our results for the 3 and 9 months ended June 30, 2024. 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 our expectations. Please see the slide entitled Cautionary Note Regarding Forward-Looking Information in the accompanying slide presentation for more details. 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 Investors 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 margins. Non-GAAP measures are described in our MD&A for the 3 and 9 months ended June 30, 2024, where you will also find reconciliations to the nearest IFRS measures.

With that, I'll turn the call over to Brian. 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. And we'll then update you on our target operating model before we take questions.

We delivered solid performance in the third quarter. Consolidated revenues increased 17% sequentially to \$49.5 million due to growth in all 3 segments. And third quarter consolidated revenues were up 8% year-over-year. We delivered positive consolidated adjusted EBITDA of \$1.7 million in Q3, mainly due to continued strong operating leverage in our U.S. Appraisal and Canadian segments. The spread between the 30-year fixed rate mortgage and the 10-year treasury yield widened by approximately 10 basis points sequentially, and the U.S. 30-year fixed rate mortgage was range-bound at around 7%, which continued to weigh on refinance volumes.

This, combined with other lingering macro market factors, muted some of the seasonal purchase origination volumes we tend to see at this time of the year. We estimate that third quarter U.S. mortgage market origination volumes increased 25% quarter-over-quarter. However, they were down 3% year-over-year, bottom bouncing in this historically low mortgage origination market.

Notwithstanding external market forces, we continue to focus on our core operations in the quarter: driving performance, efficiency and delivering strong operating leverage. Third quarter U.S. Appraisal mortgage origination revenues were up 15% quarter-over-quarter due to the seasonality of purchase transactions. We posted year-over-year market share increases with 4 of our top U.S. Appraisal clients, and we maintained our top position on lender scorecards.

U.S. Appraisal net revenue margins held strong at 27.6%, down modestly from the record we posted in the second quarter, and net revenue was up 12% quarter-over-quarter, mainly due to a seasonal increase in our purchase origination revenues. With the increase in volumes on our platform and relatively flat operating expenses, we continued to see strong operating leverage in the business and increased our U.S. Appraisal adjusted EBITDA 25% quarter-over-quarter to \$5.5 million.

Third quarter U.S. Title segment revenues were up 5% quarter-over-quarter as a slight decline in refinance origination revenues was offset by an increase in REO and home equity revenues. With the change in our revenue mix, net revenue margins were down 40 basis points sequentially, and we posted an adjusted EBITDA loss of \$1.9 million compared with a loss of \$1.7 million in the second quarter, principally due to a one-off expense recovery that benefited us in the second quarter.

We launched in 2 channels with one new client in U.S. Title in the third quarter. We continue to progress our discussions with lenders and advance the pipeline with a view of launching new Title clients onto our platform. The RFP cycle is active and moving forward. As most lenders look toward the increasing probability of lower rates and higher refinance volumes in 2025, we are well positioned to help them address that market opportunity.

So today, 14% of outstanding mortgages have an interest rate above 6%, 24% of outstanding mortgages have an interest rate above 5% and the inventory of mortgages being written at higher rates continues to climb, growing the pool of potential future refinance candidates.

In Canada, revenues were up 30% quarter-over-quarter, in line with stronger spring market activity. We hit record -- near record net revenue margins of 19% in Canada in the third quarter, and net revenue was up 31% sequentially. That, combined with a stable cost base, resulted in strong operating leverage, and we increased adjusted EBITDA by 46% quarter-over-quarter to \$1.3 million.

With that, I'll hand it over to Rodrigo. Rodrigo?

Rodrigo Pinto

Thank you, Brian, and good morning, everyone. Our third quarter results benefited from a seasonal uptick in purchase volumes. However, U.S. mortgage market conditions did not change dramatically in the third quarter and volumes remain well below pre-pandemic norms. As Brian discussed, we continue to firmly believe that the market will recover, and so we remain focused on the things we can control: ensuring that we do what's necessary to grow our client base and our market share, managing our operating efficiency to drive margin expansion while maintaining a strong balance sheet.

Turning to our third quarter financial performance. I'll start with our U.S. Appraisal segment where we recorded revenues of \$37.5 million, up 12% from the same period last year due to an increase in our market share with our clients. We outperformed the market in the third quarter. Our purchase origination revenues were up 9% year-over-year compared with an estimated addressable market decrease of 4%. And our refinance origination revenues were up to 23% compared with an estimated addressable market a decrease of 11%. Home equity revenues were up 10% year-over-year and accounted for 23% of the segment's revenue because of solid market share growth.

U.S. Appraisal net revenue was \$10.3 million for the third quarter, up from \$9.2 million in Q3 '23. We continue to see solid net revenue margins in the third quarter with an increase of 10 basis points year-over-year to 27.6%, which is at the upper end of our target operating model range.

Third quarter U.S. Appraisal operating expenses increased 10% year-over-year to \$4.8 million. We posted U.S. Appraisal adjusted EBITDA of \$5.5 million, up 15% from the third quarter of fiscal 2023. And adjusted EBITDA margins increased to 53.2% from the 52% we posted in the third quarter last year as a result of increased net revenue, partially offset by a slight increase in operating expenses.

Turning to our U.S. Title segment. Third quarter revenues declined \$500,000 year-over-year to \$2.1 million. On a year-over-year basis, refinance origination revenues were down by \$200,000 or 23% compared to a market decline of 5%. The U.S. Title net revenue was \$0.9 million, down 21% from the third quarter last year, and net revenue margins decreased to 43.6% from 45.2% due to a change in revenue mix.

U.S. Title operating expenses were relatively flat year-over-year, and we recorded an adjusted EBITDA loss of \$1.9 million for the U.S. Title segment compared with a loss of \$1.6 million in the third quarter of fiscal 2023, principally due to lower net revenue margins.

In Canada, third quarter revenues were flat year-over-year at \$9.9 million as lower market volumes in Appraisal and lower insurance inspection revenues were offset by year-over-year market share gains with 2 of our largest Appraisal clients. Net revenue was up 7% to \$1.9 million. And as Brian mentioned earlier, we posted near-records net revenue margins of 19% in the third quarter as we continue to leverage our platform. Canadian adjusted EBITDA was \$1.3 million, on par with the third quarter of 2023.

In total, third quarter consolidated net revenue increased 8% year-over-year to \$13.1 million, mainly from improvements in U.S. Appraisal. Consolidated operating expenses were up 11% year-over-year to \$11.9 million in the third quarter. We recorded consolidated adjusted EBITDA of \$1.7 million, in line with our results in the third quarter of 2023.

Our cash position decreased in the third quarter due to the timing of collections. We received a client payment of \$5 million 2 days after quarter end, which will be a source of cash in Q4 this year. Our balance sheet remains strong with no debt and cash of \$41.4 million at June 30, 2024.

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

Brian Lang

Thank you, Rodrigo. Our business delivered solid performance in the third quarter. Revenues were up quarter-over-quarter in all 3 segments. We benefited from mild seasonal market tailwinds. Market share gains helped bolster our results, and we outperformed the market on a year-over-year basis. We continue to leverage our network to improve year-over-year net revenue margins in U.S. Appraisal and Canada, and these more mature businesses delivered strong operating leverage, which allowed us to increase our adjusted EBITDA in these segments.

Our strategy has been to position our business to thrive in the peaks and to withstand valleys of the cyclical mortgage market. And we've been successful in growing the business through a number of these cycles since the company was founded 20 years ago. What remains outside our control is the inherent uncertainty in calling interest rates and corresponding mortgage market volumes during any given period.

As we outlined in our news release, we are establishing a simplified target operating model that is not time bound with the same net revenue and adjusted EBITDA margin target ranges that were outlined in our fiscal 2025 targets, contingent on our mortgage origination volumes irrespective of market size or market share.

Under the target operating model, our U.S. Appraisal segment has the potential to deliver \$50 million to \$65 million in adjusted EBITDA, and our U.S. Title business could generate \$30 million to \$45 million of adjusted EBITDA. To be clear, our target operating model is not a terminal value of what we can achieve, but simply a reflection of the profitability of our business at higher volumes with scale. There is no prescribed limit to the amount of market share we can win within our clients or in the market. We remain confident that the U.S. mortgage origination market represents a significant growth opportunity for our business and our operations are well positioned for a market recovery.

We look forward to leveraging our model to continue to demonstrate the through-cycle earnings potential of our business in line with our focus on scale and market share growth. We will continue to focus on our model, delivering industry-leading performance and aggressively pursuing market share and new clients, particularly in our Title business. We will also continue to make decisions that support the long-term success of our company, and creating value for all of our shareholders.

With that, operator, we'd like to open it up for questions now.

Question and Answer Session

Operator

[Operator Instructions] And your first question comes from the line of Gavin Fairweather with Cormark Securities.

Gavin Fairweather

Maybe just starting on the Appraisal business as share gains and market outperformance have continued to impress here. If you look at the share that you've won lately with some of your bigger customers, curious if you got the full benefit of that in Q3? Or is some of that going to flow into Q4? And maybe you can just discuss any visibility you have on additional share awards in Q4 and beyond.

Brian Lang

Great question, Gavin. Thanks for that. So we did have some strong market share wins. As I mentioned, 4 of our top customers we gained market share with. And so, Gavin, it just depends on when we're granted the market share within the quarter as to how much of it's represented in the quarter, but some of it, of course, was in quarter wins. So you should see some of that happened in this quarter, but we will see that, of course, roll into the upcoming quarters.

Gavin Fairweather

And then just secondly, on the Title units in your target model. I guess if we assume a more normalized kind of market backdrop, I'm curious how many Tier 1s do you think you'll need to kind of get live and reaching decent share to achieve that kind of level of volume.

Brian Lang

Thanks again, Gavin. So the way that we've taken a look at the model, which we did, as you remember, back in 2020, looking out to 2025 and the target that we had, we really had a handful of those top Tier 1s that we currently have on our Appraisal business. So that's the way we looked at it, and they come in, of course, at different times throughout the model. But that's really when we land at sort of the point for us anyways back in 2020 of 2025. We had a majority of them on the platform, but not all of them.

Gavin Fairweather

Okay. That's helpful color. And then maybe just lastly, I think it's been a couple of quarters since we checked in on kind of purchase title. I know that you're doing some piloting work, and there is some volume that's kind of running through the platform. And I know one of the challenges has been that a lot of the title orders within the banks are kind of decentralized and managed at the bank level. Is there any kind of update that you can provide on that initiative? Are you seeing any changes to how the banks are managing things internally?

Brian Lang

Sure. Well, it's a good question. Fairly technical, Gavin, but it's a really good question in that there is a real focus right now with lenders in the U.S., a lot of it driven sort of from the top down, to look at the more underserved communities within the U.S. And so to your point, they are trying to centralize a good portion of that purchase market, especially focused on the underserved because they feel they can drive the cost down to a degree for that underserved community. So as you mentioned, there is a pilot that's ongoing right now in the U.S. around centralizing purchase title. It's sort of been our strategy, was to work with lenders and sort of get ahead of it within the mortgage process so that we could, over the long term, start centralizing more of that purchase market.

Operator

And your next question comes from the line of Martin Toner with ATB Capital Markets.

Martin Toner

Can you talk -- tell us a little bit about the lender you won in Title?

Brian Lang

Sure. I mean, as you know, Gavin, we are continually moving the sales pipeline along. And so we were very focused on the top tier, the Tier 1s. And so we've talked about RFPs this year when it comes to breaking in and moving some of that Tier 1 pipeline along. But at the same time, the sales team continues to stay focused on Tier 2s to 4s as it makes sense. And so within this market, we brought in a player that's in that Tier 2 to 4 range. And with someone that we think over the long-term, there's definitely some significant upside. But in the current market, we're going to get a small but reasonable amount of new orders.

Martin Toner

And can you give us any more color on the possible timing of Tier 1s? I mean, have there been -- are there like active RFPs out there? If not, when might they -- when might they happen?

Brian Lang

Yes. So the update on that is that there are a couple of RFPs in the market with Tier 1s, and they're both in progress. So that, frankly from our standpoint, is a real positive. And we think that there's a chance that that will help, again, unlock more of those over the next couple of quarters. But as far as timing goes, Martin, we'll have to see. They are RFPs. But as I say, they're active and they are progressing well.

Martin Toner

Can you talk a little bit to -- and you've talked about this before, I just want you to kind of remind everyone about how much capacity you think you currently have given the rationalization of the cost base over the last couple of years?

Rodrigo Pinto

Thanks, Martin. Yes, so again, same story. Appraisal, we see 30% to 40% capacity in the system today. In Title, we expect to see 3x to 4x the capacity of the volumes we are seeing today.

Martin Toner

And I noticed that in the target operating model, you didn't include anything for corporate costs in the EBITDA numbers. I'm assuming those numbers are before corporate costs.

Brian Lang

They are. So the idea was, Martin, with the operating model was to focus on the 2 main drivers of the long-term EBITDA opportunity within the organization, so U.S. Appraisal and U.S. Title. And those EBITDAs that flow through the margins in the business, those are sort of stand-alone for both of those segments. So -- because Canada is such a steady, robust business and frankly, there's very little deviation, it just sort of grows incrementally every year, we've kept that out. And then as you mentioned, corporate costs right now, that would be an incremental if you were going to get down to our consolidated adjusted EBITDA.

Operator

And your next question comes from the line of Thanos Moschopoulos with BMO Capital Markets.

Thanos Moschopoulos

Brian, how do you see the waiver dynamic evolving next time the cycle gets going? So if we were to look at what happened last cycle, would that perhaps be representative or might not that be a good indicator given unique circumstances such as COVID happening and [inaudible] and so forth?

Brian Lang

Good questions, Thanos. Again, a little bit of a technical question, i.e. last time that we saw the waiver rates go up, Thanos, I think it was a reaction to the overwhelming amount of volume that came in so quickly and so significantly. So as we talked about way back when the lenders were in a bit of a bind just because there's no way they could upgrade their operational business to deal with that type of demand in the market. So frankly, the supply just wasn't there with those big lenders. So the GSEs step in, they take some of that pressure off of the lenders. And hence, we saw the rates spike up fairly quickly. And then over time, as the volume started to run off, not surprisingly the waiver rates slowly reduced over time.

So I think it totally depends on what happens in the market over the next quarters/years as far as refinance volume building up over that time. If it's a slow build, our view would be that it might be a very slow waiver increment, if any. But if there is a significant spike in the market, then no doubt we'll see something at least along the lines of the GSE stepping in to help out.

Thanos Moschopoulos

And then in terms of the HELOC driven revenue, how do we think about that as rates come down? It's also a function of, I guess, what happens with housing prices, is it not? Or what would be your expectation for HELOC volumes with rates going down?

Rodrigo Pinto

Yes. So again, HELOC is not as sensitive, Thanos, to interest rates, right, as originations. To your point, it depends how much equity borrowers have in their houses or house price or how the price appreciation will impact volumes. So it's not that co-related to interest rates. And then fortunately, it's a market that you don't have a lot of public available information out there also to estimate. So it's very hard to give you a number in how you would behave with movement in mortgage rates.

Operator

And your next question comes from the line of Rob Young with Canaccord Genuity.

Robert Young

First one for me is maybe a simplification. I think you've already answered a little bit on this. But the spreads remain high against the 10-year for -- I mean, the 30-year mortgage rates are kind of flat you've noted. But my sense is that your Tier 1 customers in Appraisal may be getting a little more aggressive. And so I was wondering if you could just dig into that dynamic a little bit. Are you seeing the Tier 1 customers getting more aggressive engaging more in this market? Or is it still flat? Just a little more there would be very helpful.

Brian Lang

Sure. Good question, Rob. So if we take a look at the quarterly reporting from the big banks in the U.S., the big lenders, I think you'll see that the folks like the Wells, the Chases, the U.S. Banks, Bank of America, the big players, you will see that they had very significantly up quarters. So it's a point in time for me, it's one quarter. It's not a trend line yet. We hope that that continues over the upcoming quarters. But it looks like, Rob, at least in Q3 of this -- our Q3 of this year, that there's definitely been some progress made by Tier 1s in reclaiming some of that market share. So as I say, we've got to see what happens over the upcoming quarters, but definitely, there's some progress from our standpoint in movement towards more Tier 1 volume.

Robert Young

And I guess, maybe a bit of confusion might be around just why the spreads haven't come down if they are seeing more success. Is that just something that happens over a longer period? Is it something that doesn't show up in the way the spreads are calculated? Or anything there that you can help to my understanding of why the spreads haven't started to come in if they're getting more aggressive?

Brian Lang

Yes. No, I think there's -- I think it comes down to market certainty versus uncertainty, Rob. And so even the Fed's announcement yesterday, I think, again, should start giving people more comfort that it looks like inflation is slowly coming down, things are starting to square up for a potential cut. And it definitely looks like that's the type of language that they're coming out with. So again, Rob, I think that sort of puts a little bit of a tailwind behind the Tier 1s so they can start thinking about, okay, maybe this is the right time for us to start wading back into the market.

So again, what we'll have to see, as you know, it's going to be a very busy fall season in the U.S. market, both sort of economically, financially and politically. So I think it will be very interesting to watch. But right now, as I say, it was a good quarter for the Tier 1s.

Robert Young

I appreciate that. I know that's a hard question to answer. Maybe next question would be just to try to put a little bit of context into the volume targets you've given in the change in the way you're looking at the targets. Is there a way to put that into context for investors around? Is that a good year or a bad year, a middle year? I know there's already some -- you already addressed this a little bit on the call, but I was trying to get a sense of how that maps to the previous market share targets if there's a way to think of that. Is it consistent with the previous market share targets? Or is it dependent on -- like, how do we think about that as looking forward if the market is correcting higher? Or I'm just trying to get a sense of how to normalize.

Brian Lang

Sure. I mean, to be quite honest, Rob, it's fairly straightforward for us. We went back to the 2020 Investor Day presentation, looked at what we laid out in 2025, both from a total addressable market and market share targets that we laid out. And we frankly just did the math on that. And as you remember, we set what we thought it was going to be in 2025, a what we call normalized market, i.e. if we look at the average the last 10 years, average the last 20 years below that, but what we thought was a reasonable market. And we just applied the share that we thought we would gain across both the Appraisal and Title businesses and those were the units.

So they're not terminal units. Those are just units on a sort of a hypothetical, what we would think of as a more normalized market. And so, we'll see that when the market comes through and when we hit some of the market share targets.

Operator

[Operator Instructions] And your next question comes from the line of Richard Tse with the National Bank Financial.

Richard Tse

Just wondering if you can maybe comment a little bit about the competitive environment and specifically you are particularly kind of interested in sort of companies like UWM who seem to be kind of aggressive here in the market these days.

Brian Lang

Sure. So, Richard, if we take a look at the market, we've talked a little bit in the past around the Tier 1s and their position in the market versus some of the nonbank lenders. And I think you know across our portfolio, we've had a real focus on making sure that we're diversified. And so for us, where we sit right now, our revenue is more or less split between the 2 of them. So depending on the dynamics that are going on, we've kind of tried to take a lot of that out of the mix for us in particular. Your comment on United Wholesale is right. They have been picking up some market share through this downturn. And as we've mentioned, I think, in some past calls, a lot of what happens in a downturn like this is it becomes very price sensitive. And so there's a lot of sort of underbidding from a price standpoint.

And so I think United Wholesale has benefited a little bit from that. As you know, one of our biggest players in this space is Rocket, which is sort of a head-to-head competitor with United Wholesale. But that's -- I mean, that's what I think we've seen, Richard. The Tier 1s have given up a little bit of share in a market like this that's so price sensitive to some of the bigger nonbank lenders. And I think our view is over the upcoming quarters, years, I think we should see a little bit of that move back in the direction of some of the banks versus the nonbanks, longer term.

Richard Tse

And then I think most of the consensus can probably agree that it's just really a timing thing before things begin to normalize. But as you think about this business strategically, I'm not sure at a Board level or just the executive team, what are you doing in the background? Are you doing anything in the background to sort of, I guess, maybe I don't know future-proof is the right word, but potentially open up new markets or drive other efficiencies beyond everything we're sort of doing now? Is this kind of waiting -- like, are there other things that are kind of at work here that we should be aware of that you may be pursuing?

Brian Lang

I'd say, Richard, what we've done in the past few years and that we are doing definitely today is, especially as the market has -- the volume has dropped and the market has suffered a little bit from a volume standpoint is within the mix of products that we look at with customers, we have expanded those. So as you've seen from our results, you've seen some good results on HELOC and REO. In a normalized market, those are things we don't actually spend much time talking about, but we are winning customers in some of those spaces. And on the Title side of the business, we're winning customers in those spaces, frankly, because we want to get them into the origination channel.

So I think the team has been very flexible in trying to find opportunities where we can all with the long-term concept of, of course, getting them into the origination channels. But I think the team has done a good job both on Appraisal and Title to make sure that we're covering the right products that our customers want with that long-term focus on origination.

So I'd say that's sort of the answer around the core business, Richard, what we laid out in 2020 again was some work around data. That's something that, of course, we keep our eye on. It's the third leg of the stool. There is some work that goes on in the background around that, and that's something that we look at out in the future. But that's really the core focus, I think, for the business right now, Richard, is to make sure that we are deep in our customers. We're continuing to drive the performance that we are, stay at the top of their scorecard. And as you mentioned, when the market starts rebounding back, we plan to take advantage of all of them.

Richard Tse

And then finally, with respect to the topic everyone is sort of talking about these days, GenAI and these other ones, what do you see? Or is there an opportunity for Real Matters, whether it be from kind of incorporating into your products or using it to sort of gain further operating leverage in the business?

Brian Lang

Yes. Great question, Richard. So I would start with -- the first thing that we have done, which we have now completed for both the U.S. Appraisal and U.S. Title businesses is moving those businesses into the cloud, which may sound like maybe not necessarily a very difficult first step, but for us, with all the Tier 1s that we have and all the regulatory and compliance type work that we need to do to get on there, I think we are at the front edge of that in the Appraisal and Title space, getting both the businesses set up completely on the cloud. Because once we're on the cloud, we have access to quite a few AI capabilities with both the likes of Google and Microsoft.

So our team has been doing proof of concepts this past year where there's, I think, a significant amount of leverage, Richard, both for the operations of the business, but also for us to be able to do things somewhat differently than what we've done in the past. And longer term, of course, this impacts our data play and how we look at our data play longer term because it gives us a much more, I would say, interesting view on our data, and it actually provides capabilities that would fast track some of the things that we've been thinking of doing in that space.

So lots of opportunity in the core business. We're already starting to use some of it in the proof-of-concept work that we're doing to kind of run the operations of the business, but also as we look longer term, there's some opportunity with our data play.

Operator Thank you. And those are all the questions that we have. Thank you all for joining. This concludes today's conference. You may now disconnect.