



Real Matters Q2 2024 Conference Call - Transcript

May 7, 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

Daniel Chan, *TD Cowen*

Martin Toner, *ATB Capital Markets*

Richard Tse, *National Bank Financial*

Robert Young, *Canaccord Genuity*

Stephen Machielson, *BMO Capital Markets*

Presentation

Operator

Good morning, ladies and gentlemen, and welcome to the Real Matters Q2 2024 Earnings Conference call. [Operator Instructions] This call is being recorded on Tuesday, May 7, 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 Second Quarter ended March 31, 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 6 months ended March 31, 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 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 and 6 months ended March 31, 2024, where you'll also find reconciliations to the nearest IFRS measures.

With that, I'll turn it 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.

Consolidated revenues increased 19% sequentially in the second quarter to \$42.2 million and were up 12% year-over-year due to growth in our U.S. Appraisal and Canadian segments. We delivered positive consolidated adjusted EBITDA of \$0.7 million in Q2 mainly due to strong operating leverage in our U.S. Appraisal and Canadian segments.

The U.S. 30-year fixed rate mortgage was down approximately 50 basis points in the second quarter and we saw modest improvements in market volumes, albeit from historical lows. We estimate that second quarter U.S. mortgage market origination volumes increased 9% quarter-over-quarter and year-over-year.

Second quarter U.S. Appraisal purchase and refinance revenues outperformed the market. Purchase revenues were up 19% quarter-over-quarter compared to an estimated addressable market increase of 12% and refinance revenues were up 23% sequentially compared with an estimated addressable market decrease of 3%.

We launched 1 new lender as well as a new channel with a Tier 1 lender in the second quarter. We also posted year-over-year market share increases with 4 of our top 7 U.S. Appraisal clients. We continue to leverage our platform to improve our margin profile in the second quarter, posting another new record high for U.S. Appraisal net revenue margins of 28.3%, up 40 basis points from Q1.

Modestly improved market conditions and market share gains increased the transaction volumes on our platform while we kept our operating expenses relatively flat, demonstrating the operating leverage in the business, which fueled our U.S. Appraisal adjusted EBITDA increase of 65% quarter-over-quarter to \$4.4 million.

U.S. Title segment revenues, net revenues and adjusted EBITDA were relatively flat quarter-over-quarter as a decline in refinance origination revenues was offset by an increase in REO, home equity, diversified and other Title revenues. We launched 2 new clients in the U.S. Title in the second quarter. The change in product mix of our U.S. Title segment resulted in a decline in our net revenue margins to 44% in the second quarter from 47.3% in the first quarter of 2024.

Our focus remains on adding new clients to our Title platform in 2024. In line with the comments I made on our last conference call, the RFP cycle is active and we've moved forward as expected.

In Canada, revenues were up 15% quarter-over-quarter on modestly improved market conditions and our cost base was flat which resulted in a 26% quarter-over-quarter increase in adjusted EBITDA. We launched 2 new clients and 1 new channel in Canada in the second quarter.

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

Rodrigo Pinto

Thank you, Brian, and good morning, everyone. As Brian outlined earlier, U.S. mortgage market conditions improved modestly in the second quarter with a decline in mortgage rates due in part to a slight compression of spreads as well as a 30 basis points decline in the 10-year treasury yield.

Today, more than 24% of existing mortgages have a rate of over 5%, and this cohort continue to grow, which is very positive for our business as they represent future refinance candidates. 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 and driving towards our long-term targets while maintaining a strong balance sheet.

Turning to our second quarter financial performance. I'll start with our U.S. Appraisal segment where we recorded revenue of \$32.6 million, up 16% from the same period last year due to improved market conditions as well as increasing our market share with our clients.

As Brian mentioned earlier, we outperformed the market in the second quarter. Our purchase origination revenues were up 10% year-over-year compared with an estimated addressable market increase of 9%, and our refinance origination revenues were up 14% compared with an estimated addressable market increase of 9%.

Home equity revenues were up 38% year-over-year as we relaunched in the home equity channel with some of our existing lenders and had strong market share growth which includes the addition of this channel with a Tier 1 client that went live in Q2. U.S. Appraisal net revenue was \$9.2 million for the second quarter, up from \$7.7 million in Q2 2023. We continue to see strong net revenue margins

in the second quarter with an increase of 70 basis points year-over-year, hitting another record high of 28.3%.

Our ability to leverage our platform resulted in a solid year-over-year margin increase, pushing past the upper end of the range of our fiscal 2025 target of 26% to 28%. U.S. Appraisal operating expenses increased 5% year-over-year to \$4.9 million in the second quarter. U.S. Appraisal adjusted EBITDA was \$4.4 million for the quarter, up 40% from the second quarter of fiscal 2023.

Adjusted EBITDA margins increased to 47.9% from the 40.6% we posted in the second quarter last year as a result of an improved net revenue margin profile, partially offset by a slight increase in operating expense.

Turning to our U.S. Title segment. Second quarter revenues declined 9% year-over-year to \$2 million due to lower REO and home equity revenues. On a year-over-year basis, refinance origination revenues were up 23% compared to an estimated market increase of 13% as we launched a second channel with our Tier 1 lender at the end of September, increasing our market share with the client.

U.S. Title revenue was \$0.9 million, up 9% from the second quarter last year, and net revenue margins increased to 44% from 36.8% due to a higher proportion of refinance origination orders that closed. We reduced U.S. Title operating expenses by 18% year-over-year to \$2.5 million, and we recorded an adjusted EBITDA loss of \$1.7 million for the U.S. Title segment compared with a loss of \$2.3 million in the second quarter of fiscal 2023, an improvement of 28% due to the year-over-year reduction in operating expenses and a net revenue margin improvement.

In Canada, second quarter revenues were up 2% year-over-year to \$7.6 million due to improved market volumes. Net revenue was \$1.4 million, which was flat. However, margins expanded by 20 basis points year-over-year as we continue to leverage our platform. Canadian adjusted EBITDA was \$0.9 million compared to \$1 million in the second quarter of 2023.

In total, second quarter consolidated net revenue of \$11.5 million was up 16% year-over-year from improvements in all three segments. Consolidated operating expenses were down 6% year-over-year to \$11.2 million in the second quarter. We increased consolidated adjusted EBITDA to \$0.7 million from a loss of \$1.7 million in the second quarter of 2023.

Finally, our balance sheet remains strong with no debt and cash of \$44.4 million at March 31, 2024.

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

Brian Lang

Thank you, Rodrigo. Overall, we were very pleased with our second quarter results. We outperformed the market, gained market share, launched new clients and a new channel with a Tier 1 in U.S. Appraisal. We also hit a new record for net revenue margins in U.S. Appraisal that pushed us past the high end of our fiscal 2025 objectives.

While our Title segment continues to face strong market headwinds, we continue to perform at the top of lender scorecards and position the business for the anticipated increase in volumes and are moving toward adding customers with a focus on Tier 1s to our platform.

Our Canadian business continues to deliver steady performance and is also poised for growth due to our market leadership position. Finally, we posted positive adjusted EBITDA for the quarter, and we have the capacity to scale up with our existing cost base as market conditions continue to improve. We have a strong balance sheet with more than \$44 million in cash and no debt, and our focus remains on the long-term earnings potential of our business.

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

Question and Answer Session**Operator**

[Operator Instructions] Your first question comes from Daniel Chan with TD Cowen.

Daniel Chan

Nice results, especially considering that the Tier 1s continue to lose significant market share here. In prior quarters, we saw that be a headwind on your results, but it seems like you're offsetting it with that. What was the offset this quarter to help you with some of those market share losses from your Tier 1s?

Brian Lang

Dan, thanks for the question. I mean the big offset for us is over the last couple of years, I think we've done a great job at diversifying our customer base. So when we take a look at where we are generating revenue today, Dan, it's pretty well 50% with banks and 50% with non-banks.

So even though some of the banks had a challenging quarter, we are seeing the non-bank step in and continue to grow. So as long as we continue to win market share in both those segments, which we did this past quarter, then even if some of our banks are losing a bit of share, we're gaining share with them, and we're gaining share with our non-banks who seem to be finding some share in this current market.

Daniel Chan

That's good to hear. And then last quarter, you mentioned that you have about 3 to 4x excess capacity in your time and closing business. How is that second channel with that Tier 1 customer doing relative to your capacity expectations? And do you think you're going to need to invest for additional capacity if you win the RFPs that you mentioned?

Brian Lang

Yes. So the first part of the question is the second channel with the Tier 1 has been a little slower than we would have expected, Dan. Our original expectation was it would sort of be a 50-50 volume on either one of those channels. I think simply, it's just taken a little while for the Tier 1 to get that channel fully up and organized. So we expect over time that, that channel will grow. So that's sort of a tailwind of the future.

And then I think the second question was around investing in Tier 1s in Title as we look forward into the future. So the upfront, there will be a little bit of investment, Dan, just from a tech standpoint to make sure that we've got the appropriate integrations that we need. But beyond that, we still have on the Title side of the business, 3 to 4x the capability from a volume standpoint. So we're feeling really confident that you'll continue to see our cost base where it is with quite a bit of upside potential on volume.

Operator

Your next question comes from Richard Tse with National Bank Financial.

Richard Tse

As we wait for the inflection in volumes, I was wondering if you can maybe update us on how much incremental revenue you could support under your current OpEx in the Appraisal segment?

Rodrigo Pinto

Thank you, Richard. Again, the extra capacity that we mentioned before, stays the same. We still believe we have 30% to 40% in our Appraisal segment capacity. We can see a growth in that range that we wouldn't need to change our cost structure at this point.

Richard Tse

Okay. And then just to clarify, the title and closing RFPs what conditions are required for some of these prospects to come on board? Is it just really they're waiting for a turn in volumes as rates retrench here a bit? Or is there something else that they're looking for?

Brian Lang

No, Richard, I think it's just that. They've been waiting for, I think, an uptick in volumes. As you know, that's somewhat connected to rates. So they've been probably keeping their eye on what's

happening from a rate standpoint. The good news is, I think, at least a handful of the Tier 1s have definitely moved their mindset towards looking at the RFPs and onboarding new vendors.

So as I mentioned in my comments, we're feeling confident that, that pipeline is moving. It's moving in the right direction. And so we anticipate to see some more new customers coming on board over the next few quarters.

Richard Tse

Okay. And just a last one for me. You've obviously done a good job in terms of controlling the controllables you talked about. So as you look forward to the next 12 months, are there kind of any incremental operating priorities that you have on the table here? And if so, what would they be?

Rodrigo Pinto

Richard, as you know, this is the time of the year that we go for our strategic plan looking forward. But again, right, as we said before, we believe our cost structure, as you know, it's dependent in volumes. We continue to focus on our '25 targets, both on net revenue and Adjusted EBITDA margin line. So we again, we don't see any major changes in our cost structure. Of course, it will vary in accordance with the volumes that we start to receive from the market.

Operator

Your next question comes from Stephen Machielsen with BMO Capital Markets.

Stephen Machielsen

I have a question on U.S. Appraisals. Net revenue margins have been ticking up there. Is there anything to think that they won't persist or even increase from these levels?

Brian Lang

Yes, thanks for the question. So no, I don't think so. I think you've seen us now at the top of our long-term range that we had, 26% to 28%. So as we look forward, our assumption is that we'll continue to stay at the top end of that range. And we've built an awful lot, I think, and gained an awful lot of efficiency in that over the last year.

Stephen Machielsen

Okay. And sticking with the U.S. Appraisals, were there any one-time factors in the Tier 1 market share gains? Is it likely that you could give back some of these gains in the future? Or is there still room to move higher.

Brian Lang

Well, there's definitely still room to move higher as we -- when we laid out our 2020 plan, our goal was to get at least a couple of our Tier 1s up to over 50% market share and then 40% and 30% with the remainder of the Tier 1s. So the good news is we've achieved that already, and we've seen

another customer cross that 50% plane. So I think we're in very good shape with market share. We've continued to gain market share. We look out to the future, and we believe there's still a tremendous amount of upside. And so I think I'd leave it at that.

Stephen Machielsen

Okay. And final question for me. It's, I guess, a bit more of a broader market question. So the MBA cut their forecasts back in April. I'm just wondering how these align with your view of the mortgage market. Do you think their forecasts are still a bit too sanguine?

Rodrigo Pinto

Well, that's a very good question. Again, not trying to call the market here, but I'm sure they released their numbers just before we saw an increase on the 10-year treasury yield that happened over the last 2, 3 weeks. It's hard for me to judge their estimates, but I think they didn't have the most current market data by the time that they publish their numbers. So very likely, we will see a new revision of MBA and Fannie Mae numbers out there.

Operator

Your next question comes from Martin Toner with ATB Capital Markets.

Martin Toner

Can you talk a little bit about competitive behavior in this environment? If there's been any exits acquisitions and the like.

Brian Lang

Sure. Thanks for the question, Martin. So on the Appraisal side, there has been some sort of moving balls as far as competitors go. So -- we had -- one of our bigger competitors is Mortgage Connect. They have sold their valuations business. And so they have now joined forces with Class, which is not a competitor in our Tier 1 space. They're more of a wholesale servicer. So they would sort of compete more on the Tier 2s and 3s. So we've seen a little bit of movement there.

And on the Title side, one of the competitors that we used to talk about was Doma, and they have now gone from being a public company to private in the past quarter. And they are definitely focusing their attentions more on their tech business and becoming more of a SaaS supplier. So they are definitely taking a step back on the Title servicing side. So there definitely has been a couple of moving balls with our competitors. And I think that will only bode positive for us from a market share standpoint as we look forward.

Martin Toner

When you think about the impact of CoreLogic leaving, like 1 year on, what do you observe? I mean did you get more than your fair share of that business?

Brian Lang

We definitely got more than our fair share, I think, Martin. So I think that was helpful when I talked about crossing the chasm of 50% with one of our Tier 1s. Some of that was fueled by the CoreLogic shutdown. So I definitely -- I think where we stand now. And I think we've now got the benefit of all of that.

Operator

[Operator Instructions] Your next question comes from Robert Young.

Robert Young

Sorry, I was on mute. I was looking for maybe a little more context around the Tier 1 Title pipeline. You've said it's looking better. Last quarter, you said it was slower than expected because of the low volume, and I think you said that they're changing their way of looking at the market, irrespective of volumes.

So maybe if you could give a little more context around what that means, why they're getting more engaged? And then is the sales cycle still 3, 6 months, I think you've said in the past.

Brian Lang

Yes. So I think as we laid out, Rob, we thought that there would be some RFPs with Tier 1s. So that's one piece of the sales pipeline. And so I think I can say that we've made progress there, and so I think we're on track. But also there's the Tier 2s, 3, 4s. And so we've actually seen a little bit more activity there. I think it has been a struggle, as you know, simply because of the market conditions. But we've definitely seen the pipeline start unlocking to a degree.

So I think there's some opportunity there. I think you'll see the pipeline movement over the next few quarters. And then to address your last question, just around timing, that timing is more or less the right way to look at the timing. It does take a while to go through the RFP process and then roll it out. But our goal is to see some new orders from Tier 1s by the end of the year.

Robert Young

Okay. And then second question would be around capacity. You already addressed capacity on Title. Maybe if you could talk about Appraisal. I think you said you had 30% unused capacity last quarter and definitely saw the leverage this quarter on better volume. And so how much capacity do you have in Appraisal and do you have to scale that up? Maybe you can just give -- go a little deeper into that.

Rodrigo Pinto

Sure. So Rob, again, the increase in volumes on a sequential basis wasn't that material. So we still feel like we are close to 30% capacity in our U.S. Appraisal segment. Again, it's like I answered

before, our cost structure, we still believe it's solid. And the margins that we put as targets, right, the 60% to 65% in Appraisal, 50% to 55% in Title. Those are still our goals.

Of course, we need the volumes to get there, but we don't see major changes in our cost structure. We just need the volume to achieve those margins. Again, as you know, we did make investments in OpEx to create operating efficiencies as we saw this quarter, a result of some of the investments we made in the past. But that's basically it. Like our cost structure, we feel it's good as it is and solid.

Operator

There are no further questions at this time. Ladies and gentlemen, this concludes your conference call for today. We thank you for participating and ask that you please disconnect your lines.