Computershare

FY2019 Results

CEO and CFO conference call script

Stuart Irving, Chief Executive Officer and President

Good morning everyone and welcome to Computershare's 2019 full-year results conference call. We are pleased you can join us today.

Mark Davis, our current Chief Financial Officer is with me, along with Michael Brown, from our Investor Relations team.

On this call I will take you through the key aspects of our results and provide an update on how we are executing on our strategies. It's been a busy and productive year as you'll see.

As usual, there is a new presentation pack released to the ASX. This deck includes both updated material and new information. We are happy to increase our disclosure to help you better understand Computershare and our outlook. We've also added this presentation to the investor relations section of our website, Computershare.com.

We won't bother you with a page turn. I will focus my remarks on pages two, three and five of the presentation. Mark will then take you through the slides on our financial results. Then, after some concluding remarks, we will open up the call for your questions.

Also, as a reminder, we will be talking throughout in US dollars and in constant currency (CC) terms unless we state otherwise.

Slide 2 – FY19 Executive Summary

Okay, let's start.

There are three points I want to emphasise today.

One – we are pleased to deliver strong results for the year, slightly ahead of guidance. As you will see on Slide 2, Management EPS increased by 12.8%, EBITDA increased by 10.2% and return on equity once again exceeded 26%.

All our major business lines delivered improved performance. There's operating leverage and further margin expansion in the business. That's the "quality industrial" Computershare that I talked about at Investor Day.

The second point, this was a year when the optionality inherent in Computershare converted into profitability, enhancing our results. In 1H FY18 we benefitted from three large events which added over $60 million of one-off event-based revenues. They created a high hurdle for this year's comps. This year, two other parts of our optionality fired: balances from Corporate Actions in the first half and a rising US rate environment, and this helped us beat our initial guidance. Margin income increased by 40% to over $250 million. While our operating performance was solid, this significantly enhanced our results and goes towards funding higher returns for shareholders. Today we announce a new AU$200 million on-market share buy-back, plus a 10% increase in the final dividend.

And the final point: execution. In plain language, we all know exactly what we need to do at Computershare. Our priorities are very clear.

It's encouraging to see that when we lay out long-term growth plans and we execute well, we can deliver good earnings growth and consistently high returns. In the deck you'll see two new slides – our execution score card for FY19, and our key group priorities for FY20. I will let you read them in your own time, but these are what we will all be focussing on to drive sustained growth. I share these priorities regularly with all of my colleagues across our global organisation. Everyone here knows them. It's that shared alignment that underpins our execution strength and drives our results.

Slide 3 – Executing strategic priorities continues to deliver strong returns

Moving to page 3. Let's talk about what we did this year.

Starting with Share Plans, Equatex was the second largest acquisition in Computershare's history. I am pleased to say it has outperformed our initial expectations and has already made a decent contribution to these results with stronger than expected transactional revenues. Equatex increases our scale, upgrades our technology and capabilities, balances our industry exposure and improves our earnings. It also enables us to continue to upgrade the customer experience and to provide data insights to help our client companies attract, retain and reward their key employees.

Integration is on track. We have commenced moving clients to the EquatePlus platform, and we reaffirm the $30 million of synergy cost benefits across the combined business that we detailed last May.

US Mortgage Services is tracking to plan too. Now I'll remind you, we do not originate loans, we are just a servicer and we do not take credit risk. Pleasingly, the business had a strong second half performance as US market conditions improved. By the end of the financial year, UPB had surpassed the $100 billion placeholder that we laid out in our initial plan. It was good to see PBT margins track higher through the half, closing at 20%. That's an achievement we are all quietly proud of. There is scope to carry on and continue to carefully grow this business for years to come.

And finally, we have moved Issuer Services to the growth column on this page, where previously it was in the profitability column. Our initial strategy was to drive efficiencies and margin improvement while we developed new initiatives and products for the future.

Now we are bringing these new services to market and our largest business is experiencing real growth. We have a new global management structure focussed on continuously driving new product development and improved customer satisfaction.

Our Net Promoter Scores in Issuer are between 50 to 70 across all our regions. We view these as a lead indicator of future performance. It's the first time we have disclosed these scores; they are fantastic numbers.

Our largest business, US Register Maintenance, delivered an excellent result. Revenues grew by 5.3% and notwithstanding the weaker corporate actions market as we anticipated, margins for the combined segment overall continued to climb to 35.8%. We increased the number of shareholders we serve with some high-profile new clients such as Microsoft and Amcor. These wins recognise our technical expertise and capability in complex transactions. We are trusted to do the tough jobs well.

We are now leveraging these core capabilities and customer relationships with company secretaries into new complementary revenue pools. We talked about this in detail at Investor Day. We are making good progress. We are well placed to grow in these large markets, including Entity Management, Registered Agent, and Private Markets. There are positive structural growth trends here, such as rising compliance and regulatory reporting requirements, and the number of subsidiaries owned by large companies is growing too. We see the opportunity to provide a differentiated and superior service to customers and the scope to deliver sustained growth.

Moving now to profitability, these strategies are driving growth in group margins. The EBITDA margin for the year increased by 130 basis points to 28.4%. Over the last ten years, Computershare's EBITDA margin has been in a consistent range of between 24.1% and 29.4%. It has been below 26% in only two of those half year periods. Again, that's the "quality industrial" I talk about.

Our cost-out programs are clearly part of this performance. These programs delivered over $30 million of gross savings this year. We are around $5 million ahead of plan versus initial FY19 expectations, so good progress is being made. Over the last three years, we have now realised over $80 million of gross savings with another $60 million to come over the next four years.

These savings help us manage our costs. As you will see later in the deck, total operating costs increased by 2.7% compared to revenue growth of 4.8%. Excluding acquisitions and disposals, total operating costs decreased 0.2%.

I'll turn now to the disappointing and costly issue of the delay in the final migration of third-party loans onto our UK Mortgage Services platform. We went through this in detail in April. Nothing has changed since then, but our engagement with these clients continues to be positive as we jointly progress through to the new agreed migration dates. We absolutely expect to on-board these loans by May 2020, albeit a year later than planned.

However, I do want to say again how disappointing this isolated, one-off issue is for us, and I'm sure for you too. On behalf of Computershare, I apologise to all of our shareholders.

Finally, on this page I will call out our strong balance sheet. Having funded the Equatex and LenderLive acquisitions, invested over $100 million in MSR's and spent $18 million on a new data centre in the US, our net debt to EBITDA leverage ratio remains conservative at 1.84x. This is below the midpoint of the target range providing headroom for growth.

I will now move forward to page 5 and our FY20 Outlook

Slide 5 – FY20 Outlook

I'd like to be very clear in explaining our outlook for FY20.

In constant currency, for FY20 we expect Management EPS to be down by around 5%.

To provide some context, if we exclude the one-off impact of the delayed migration of UK loans to CPU's platform and the adoption of IFRS16 accounting for leases this year, Management EPS would increase by around 5%. The IFRS16 non-cash accounting change issue, which is effective from 1 July, is around a couple of percent impact.

We also expect margin income revenue this year to be similar to FY19 levels. That's based on our views as we see the world today on interest rates, cash balances and the benefits of our recent hedging initiatives that Mark will talk more about. We assume balances will stay around second half levels or slightly higher, our view on rates is guided by the futures curves you see, and our numbers factor in rate cuts. The difference on what you may have been thinking on margin and our guidance is these Treasury initiatives and they enhance our yield.

Now I know all this sounds complicated. I am simply trying to demonstrate that the rest of the business continues to perform well and should deliver ongoing profitable growth this year.

I will finish my comments by putting this outlook into the context of what we are planning and building here. We continue to lay the foundations for growth with sound execution, disciplined investments in our growth engines, tight cost controls and selective complementary acquisitions.

I'll now hand over to Mark to go through the financials in more detail.

Mark Davis, Chief Financial Officer

Thank you, Stuart.

Slide 11: FY19 Management Results summary

As usual, I will commence with a summary of our management results.

Let me begin by reminding you that last year's number benefited from over $60 million of event-based revenues that came from three large jobs that somewhat mask the strength of the FY19 results.

Notwithstanding this high base, revenue increased by 4.8% to $2,411 million.

Management EBITDA increased to $686 million, a rise of 10.2% aided by the improved revenue mix coming from margin income in particular as you can see on the slide.

Depreciation and amortisation rose $5.5 million and $12.2 million respectively, reflecting increased capex and investments in Mortgage Servicing Rights that we amortise over the P&L.

Pleasingly, for the first time, we have reported over $600 million of EBIT.

Interest expense rose due to the combination of higher debt on the back of the Equatex acquisition as well as higher interest rates during the period compared to last year.

Our effective tax rate for the year was 26.5% which was a little lower than expected in our original guidance assumptions. As we noted at the half, there was a favourable settlement of a legacy tax matter, around $3 million, which was a major part of the benefit.

Management EPS was up 12.8% and statutory EPS was higher again at 76.57c, up almost 40% on last year. This number included the gain on sale from the disposal of Karvy.

Slide 12 - Management revenue bridge

Turning now to slide 12 where we discuss the management revenue bridge.

First of all, we highlight in the text box the $65.9 million of large one-off event revenues in the PCP. As you can see on this slide, the revenue decline in corporate actions and stakeholder relationship management in particular - was against these higher benchmarks.

We saw growth contributions in particular from US Mortgage Services, Employee Share Plans with the acquisition of Equatex and of course margin income.

Revenues for the year were a little over $2.4 billion. The negative FX impact was as a result of the US Dollar strengthening against all operating currencies as you can see in the appendices at the end of the deck.

Slide 13 – Management revenue by business stream

I'll now turn to slide 13 where we break revenue down by business stream. All major business streams performed well in FY19. A few points to call out on this slide:

In Business Services, overall growth of 5.7%, includes mortgage services growth of 11.5% and another strong performance in corporate trust. We have started to expand this strong business into new markets.

We also completed the sale of the Karvy business in India in 1H meaning that we only recognised less than 6 months contribution compared to the full contribution in the prior period.

We had another pleasing performance with ongoing revenue growth in Register Maintenance. Corporate Actions revenues were $6.9 million higher, although were down excluding margin income as we had foreshadowed.

Slide 14 – Margin Income

On slide 14 I'll now unpack margin income given its significance.

This slide as always has been presented using actual FX rates and we were pleased to deliver $121.2 million in the second half which was broadly similar to the first half and a little better than what we anticipated in February.

While 2H balances were lower at $16.1 billion impacted by weaker corporate actions activity, the achieved yield was stronger. We expect balances to be broadly similar in FY20.

Slide 15 – Profile of fixed rate deposits and swaps

Slide 15 has usually appeared in our appendices but given our guidance assumption that we expect margin income revenue to be similar in FY20 to last year's levels, I'd like to highlight our recent treasury initiatives which assist to enhance our yield.

This slide shows the change in the fixed rate deposits and swaps in the second half of the year.

Firstly, you will see that we have meaningfully increased the amount of our longer-term fixed rate positions to enhance our protection compared to the position as at 31 December when you last saw this chart.

We have done this by a combination of measures including:

- reinvesting both fixed and floating deposits that matured into new fixed rate positions;
- renegotiating some existing floating rate deposits into fixed rate; and
- replacing some of our maturing swaps.

Slide 16 - EBITDA and margins by business stream

We highlight EBITDA and margins across our business on slide 16.

Group margins expanded to 28.4% up 130bps.

Revenue growth and the benefits of structural cost out programs helped add $63.3 million of EBITDA to the total.

We recorded solid increases in Business Services EBITDA +6.2%, register maintenance and corporate actions +10.2% and employee share plans +31.6% where Equatex contributed $17.2 million for the 8 months of ownership.

Karvy contributed $9.3 million of EBITDA prior to its disposal which was of course down on the prior period where we owned it for the full 12 months.

Slide 17 - EBITDA and margin income by business stream

Turning to slide 17, where we break down the detail of margin income by business stream.

This slide also shows EBITDA ex margin income.

Margin income is of course an inherent part of our business model and by way of reminder it is the entire revenue model in some of our businesses.

The margin income contributions were most significant in business services at $116.8 million and Register Maintenance and Corporate Actions at $117.7 million. Margin income in employee share plans was slightly lower given the exposure to UK rates and there is no margin income in Equatex.

We also revised our treasury policy framework for managing margin income balances with minimum hedging levels now extended to 4 years.

Slide 18 - Operating costs analysis

Turning to slide 18, this is a pleasing slide and shows our disciplined cost controls. Total operating costs increased by 2.7% with our cost to income ratio falling by 150bps to 71.5%. The most pleasing number on this slide is the 0.2% decrease in total operating costs excluding acquisitions and disposals.

Equatex contributed $51.7 million of operating costs and Karvy's costs were naturally not included since disposal.

We have seen some wage inflation particularly in the US. We continue to work on our site rationalisation and we delivered over $10 million of savings in the year versus the prior period.

Slide 19 - Cash flow summary

Turning to our cash flow slide 19 where there are a few points to note.

Firstly, we again generated strong cash flows with $585.2 million in net operating receipts and payments. While FX had some impact on the year, the bigger factor was the growth in our receivables. We were also impacted by the timing of payables.

Net interest and dividends increased by $12.4 million due to higher interest costs on the back of rate rises and increased debt amounts to fund Equatex.

The higher cash taxes paid was driven by the US where we have now utilised historical tax losses.

We spent $55.6 million on capex for the year which is a higher than the normal capex run rate driven largely by the costs associated with the build out of a new US data centre and a technology hub in the UK.

We split out the capex for MSRs between maintenance and growth investments. We spent $43.1 million on maintenance to offset amortisation and, as you can see towards the bottom of the slide, we spent an additional $57.3 million to grow the book.

We invested a further $27.6 million to fund additional advances, with the balance of the increase in advances funded via our non-recourse debt facility.

The last comment on this slide is that investing cash flows include the acquisitions net of cash acquired and the Karvy disposal proceeds.

Slide 20 - Balance sheet

Finally, for me on slide 20.

The balance sheet remains in good shape and well placed to fund our growth strategies and increased shareholder distributions. The leverage continues to be below the mid-point of our target range.
This is in the context where, during the period, we funded both the Equatex and smaller LenderLive acquisitions, prior period acquisition earnout payments, growth investments, higher capex and we

have increased both the FY18 final dividend and FY19 interim dividend. Total dividends distributed up over AUD 21 million on the prior period.

As we noted at the half, we also extended the duration of our debt during the year with the refinancing of our US private placement. The duration is now 4 years.

And finally, on our return ratios.

Both ROE and ROIC have been impacted by the higher equity, driven substantially from the gain on sale of Karvy and the higher invested capital following the debt funding of Equatex. We note that adjusting for profit on sale from the Karvy disposal, ROE would have been 28.4% and both these numbers continue to be at very healthy levels.

Before I wrap up I would like to add my special thanks to all of our staff throughout the globe, many who are listening in, for their excellent work and efforts in helping the group deliver these strong results.

I'll now hand back to Stuart for our closing remarks.

Stuart Irving, Chief Executive Officer and President

Now, let's finish on slide 22 of the deck.

Slide 22 – Conclusions

As I said at the start, I am pleased Computershare delivered another year of solid results in FY19. Delivering on our commitments, and doing what we said we would do, are important to us.

The highlight for me was the improved performance from all our major business lines. The growth comes from laying down long-term plans, carefully investing capital, managing costs, building our moats, developing new products, raising customer satisfaction levels, leveraging our competitive strengths into new complementary revenue pools and increasing our optionality. That's how we deliver profitable growth with high returns.

Margin income clearly made a large contribution, and our cost-out programs and a reduced tax rate helped as well. Optionality converted into profitability in FY19.

Our execution scorecard has positives and one negative. We are honest and transparent about that. Equatex is outperforming and upgrades our Share Plans business. US Mortgage Services achieved its target margins at the end of the year and has lots of scope for continued growth. It's a good news story. Issuer Services, our largest business, is re-energised. We have much larger revenue opportunities to build into now. But successfully completing the migration of the UK loans onto our platform remains critical.

Computershare's balance sheet remains strong. We are well placed to fund organic and inorganic growth investments as well as the new share buy-back program and increased dividend we announced today.

Now I would like to end by also saying a few 'thank-you's.

We appreciate all the interest, feedback and support that our shareholders give us. Thank you, and we look forward to seeing many of you on the road over the next few days.

And finally, thank you to all our staff around the world, whose hard work and dedication to delivering great outcomes to our clients is at the core of these results.

Now, on to questions.

POST Q&A

Thanks for listening.

See many of you on the road where we can talk about the major business lines in more detail and our plans for next year.