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ASPS - Q2 2019 Altisource Portfolio Solutions SA Earnings Call

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## CORPORATE PARTICIPANTS

**Michelle D. Esterman** *Altisource Portfolio Solutions S.A. - Chief Financial Officer*

**William B. Shepro** *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

## CONFERENCE CALL PARTICIPANTS

**Leon Cooperman** *Omega Advisors, Inc. - President, CEO & Chairman*

**Mike Grondahl** *Northland Capital Markets*

## PRESENTATION

### Operator

Good day, ladies and gentlemen, and welcome to the Altisource Second Quarter Earnings Conference Call. (Operator Instructions) As a reminder, today's conference is being recorded.

I would now like to turn the call over to Ms. Michelle Esterman, Chief Financial Officer.

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### **Michelle D. Esterman** - *Altisource Portfolio Solutions S.A. - Chief Financial Officer*

Thank you, operator. We first want to remind you that the Earnings Release, Form 10-Q and quarterly slides are available on our website at [www.altisource.com](http://www.altisource.com). These provide additional information investors may find useful. Our remarks today include forward-looking statements, which involve a number of risks and uncertainties that could cause actual results to differ. Please review the forward-looking statements section in the Company's Earnings Release, quarterly slides and Form 10-Q, as well as the risk factors contained in our 2018 Form 10-K, which describe factors that may lead to different results. We undertake no obligation to update these statements as a result of new information or future events.

During this call, we will present both GAAP and non-GAAP financial measures. In our Earnings Release and quarterly slides, you will find additional disclosures regarding the non-GAAP measures. A reconciliation of GAAP to non-GAAP measures is included in the Appendix to the quarterly slides.

Joining me for today's call is Bill Shepro, our Chief Executive Officer. I'd now like to turn the call over to Bill.

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### **William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Thanks, Michelle. Good morning, and thank you for joining today's call.

I'm pleased with our second quarter. We continue to make good progress in streamlining Altisource and focusing on our larger opportunities. We sold the majority of the BRS inventory, began selling our investment in RESI shares, supported Ocwen's migration to a new residential loan servicing system and completed the sale of the Financial Services business. After adjusting second quarter net debt for the July sale of the Financial Services business, we reduced net debt less marketable securities by 40% from a year ago to \$167 million. With respect to our larger opportunities, we continue to win and on-board new business and develop our pipeline. As we believe Altisource is substantially undervalued and doesn't reflect the inherent value of our collection of businesses, we plan to continue to explore ways that could unlock this value.

As you can see on slide 5, we generated \$0.36 of adjusted diluted earnings per share, \$16.2 million of adjusted operating income, \$8.9 million of adjusted pre-tax income and \$23.3 million of adjusted EBITDA on \$190.5 million of service revenue. During the second quarter, our revenue, earnings and cash flow were impacted by Ocwen's migration to its new servicing platform, which delayed referral volume and accounts receivable collections. We estimate that this temporarily impacted adjusted pretax income by \$3.5 million to \$4.5 million and accounts receivable collections by \$15

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million. We believe these are largely timing items and anticipate that in the second half of the year, we will receive most of the impacted referrals and receivables will return to a more normal level.

Second quarter adjusted operating income margins of 8.5% were impacted by revenue mix from the sale of the BRS assets and the delay in referrals associated with Ocwen's servicing system migration. Excluding just the BRS sale, Q2 adjusted operating margins were 11%, similar to the first quarter. Our earnings release and 10-Q provide a detailed discussion of our second quarter operating results compared to the same period last year.

From a cash flow perspective, we generated \$39.8 million of operating cash in the second quarter. Operating cash benefited from the sale of the BRS homes and was negatively impacted by the growing receivables and the delay in referrals I just discussed. With respect to investing and financing activities, we received \$6.5 million from the sale of RESI shares and used \$6.7 million to repurchase Altisource shares, \$5.8 million to repay our debt and \$144,000 for capital expenditures. We ended the quarter with \$129 million of cash and marketable securities. With respect to marketable securities, we plan to continue to sell our shares in RESI over time and use the proceeds to repay debt.

Turning to slide 6 and our scenarios - now that the Financial Services transaction is complete, we updated our full year scenarios. As you can see on the slide, our updated scenario midpoint for adjusted pretax income is \$44 million and adjusted earnings per share is \$1.82. This primarily reflects the sale of the Financial Services business and certain overhead not included with the sale that will take time to reduce and the delay in customer on-boardings. Keep in mind that the scenarios include losses from our earlier stage businesses that we plan to separate. Adding back these investments, adjusted earnings per share at the mid-point of our scenarios would be \$3.09.

We had a very busy quarter executing on our plans to simplify Altisource. We recently completed several strategic transactions, worked to separate our earlier stage businesses and assisted Ocwen in its migration to a new servicing system.

With respect to our strategic transactions, we sold the vast majority of the Buy-Renovate-Lease-Sell properties for \$39 million less closing and transaction costs. We sold \$6.5 million worth of RESI shares, representing 566,000 of the 4.1 million RESI shares we owned, and in July, sold our Financial Services business for \$44 million. At closing, we received a \$40 million up-front payment less closing and transaction costs and are scheduled to receive the remaining \$4 million on the one-year anniversary of closing.

As to our earlier stage businesses, we plan to separate these businesses and eliminate future funding obligations while enabling Altisource to continue to benefit from the potential upside. We plan on funding Pointillist with \$8.5 million and operating it as a stand-alone business this quarter and anticipate taking a similar approach with Owners.com next year, if not sooner. We believe separating these companies and bringing in venture investors can create visibility into the value of the businesses and eliminate what has been a large cash burn.

Turning to Ocwen's migration to a new servicing system - we assisted Ocwen in transferring its loans and establishing the necessary interfaces to continue receiving referrals. We are now working closely with Ocwen to complete the housekeeping associated with its transition so that we can archive our system. This will allow us to move forward with the planned migration of our data centers to the cloud, an important component of our Project Catalyst savings.

We believe these actions to simplify Altisource will strengthen our balance sheet, bring more visibility to the value of our earlier stage businesses and increase our focus on our larger opportunities.

As you can see on slide 7, we believe our progress on our larger opportunities is accelerating. I'd like to walk you through several of our wins and recent and planned program launches that are highlighted on this slide.

We were selected by an existing customer, which is one of the largest institutional real estate and mortgage investors in the U.S., to provide pre- and post-foreclosure Field Services for a portion of their portfolio. We anticipate receiving referrals in the fourth quarter. This win is a great example of our ability to grow existing relationships as they are already a customer of Equator and a recent customer of Hubzu.

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In the first quarter, we signed an agreement with a Top 5 servicer to provide Field Services. Over the last two weeks, we went live in six states and anticipate being in ten states by the end of the month. We believe we are one of the few vendors engaged by this customer in these states.

Also, in the first quarter, we started to receive new REO referrals to provide asset management, real estate brokerage, auction and Field Services from a Top 10 servicer. During the second quarter, the customer completed the bulk transfer of its legacy REO portfolio to us.

We signed an agreement with a Top 25 servicer to provide foreclosure auction and Field Services for their FHA portfolio. We anticipate receiving referrals in the fourth quarter.

We signed an agreement with a non-bank servicer for REO auctions and began receiving referrals in July.

We began receiving referrals from a servicer to provide REO asset management, real estate brokerage and auction services and REO Field Services on their entire REO portfolio.

We also began receiving referrals from a number of other customers during the second quarter.

Finally, I'd like to explain why we believe our collection of businesses is worth substantially more than Altisource's current enterprise value. Altisource's businesses are making great progress. We have long-term agreements with Ocwen and NRZ and are winning meaningful new business with some of the largest servicers in the industry in a low delinquency environment. We anticipate that these wins are going to build attractive and more diversified revenue streams. When you combine our attractive customer base with any softening of the economy, Altisource represents a very strong counter-cyclical opportunity.

As we believe our share price doesn't reflect the inherent value of Altisource, we plan to continue to repurchase shares and explore ways to maximize shareholder value. This may include from time to time, exploring the potential sale of one or more of our businesses, third-party investments in certain of our businesses or other forms of strategic transactions.

Before opening the call up for questions, I would like to thank Altisource's leadership team and our employees for the focus and commitment they are showing as we simplify Altisource, develop our larger opportunities and provide great service and results for our customers. Our business models rely on the strength of our people. We believe that our strategy will not only benefit shareholders but also provide significant career opportunities for employees. We believe our employees' commitment to service and results is one of the reasons we are seeing an acceleration in new business wins.

I'd now like to open up the call for questions. Operator?

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question will come from the line of Lee Cooperman from Omega Family Office.

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### Leon Cooperman - Omega Advisors, Inc. - President, CEO & Chairman

It is very frustrating in terms of the amount of money you've spent on stock repurchases and the results that you've achieved. And I'm just wondering if you can go into more detail or more granularity as to why you believe the stock is mis-priced relative to the business value. That would be number one. Number two, what is the cash generation expectations for the full year that you're now looking at? And third, would you consider a sale of the entire company as opposed to divisional dispositions?



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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Let me take those in order. So with respect to the stock being mispriced, Lee, we have a collection of businesses that we believe are very valuable. We have a Field Services operation. We've got the Marketplace, which includes Hubzu and Equator. And we've got our, what we're calling origination and mortgage solutions businesses. Those businesses, we believe, are performing very well. And if you look at them individually, we believe they would trade at a higher multiple than they're currently trading for when you look at the enterprise value at Altisource today, if you look at them individually. And we also believe we're making very strong progress. The sales wins are really accelerating, as I spent time walking through those on the call. And we believe if you combine those sales wins, any softening of the economy and the collection of businesses that we believe are worth substantially more individually than we're trading for today, the stock is a very good buy, in our opinion.

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**Leon Cooperman** - *Omega Advisors, Inc. - President, CEO & Chairman*

Are you weighing in tax liabilities and dispositions? In other words, if you sold the entire company, you would be avoiding double taxation. If you sell off individual divisions, assuming you build good businesses, you have unrealized capital gains, which would trigger a tax liability as you sell individual businesses. Have you weighed that into your consideration?

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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes, we have taken that into consideration, and I'll let Michelle respond.

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**Michelle D. Esterman** - *Altisource Portfolio Solutions S.A. - Chief Financial Officer*

Yes. So I think we've thought about that and believe that what Bill said is true. We do have large NOLs in Luxembourg and believe we could structure transactions in such a way that would be tax-efficient for us.

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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

And then in terms of cash -- sorry, we...

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**Leon Cooperman** - *Omega Advisors, Inc. - President, CEO & Chairman*

Go ahead, the other questions.

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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. In terms of cash for the full year, we saw, I think, \$15 million -- we should have collected, we believe, about \$15 million more in collections on the revenue we generated in the second quarter than we did. And that was really a product of Ocwen's servicing transition and change in the way in which it pays its vendors. We're working very closely with Ocwen to bring those receivables down and anticipate making progress, very good progress between now and the end of the year. And assuming that goes well, we still think we're looking at the \$60 million to \$70 million of adjusted operating cash for the year.

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**Leon Cooperman** - *Omega Advisors, Inc. - President, CEO & Chairman*

And would you say you have excess cash in the company now?



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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. So since the end of the second quarter, Lee, we sold the Financial Services business, and we used that money to pay down our debt, as is required by our agreement. And as we sell the RESI stock, we're also required to use that cash to pay down the debt. And so again, we're comfortable with our -- very comfortable with our cash position.

**Leon Cooperman** - *Omega Advisors, Inc. - President, CEO & Chairman*

So at the low end, \$60 million cash generation, there are about, what, 16 million shares outstanding now?

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes, roughly.

**Leon Cooperman** - *Omega Advisors, Inc. - President, CEO & Chairman*

So you're generating about \$4 a share in cash?

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. And about 16.4 million shares outstanding on a fully diluted basis.

**Leon Cooperman** - *Omega Advisors, Inc. - President, CEO & Chairman*

And what about the last question? If somebody was courageous and wanted to try to buy the whole entity, is this something the Board would consider?

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

So Lee, I think as -- I don't know that we're going to say much more than we've said in our prepared remarks. Right now, we believe the collection of businesses are worth a lot more money than Altisource is trading for today. And so we're going to continue to look at our options, which include -- which may include selling some of the businesses, raising some equity in our earlier stage businesses and other options. And I think we'll just leave it at that for now.

**Operator**

And our next question will be coming from Mike Grondahl from Northland Securities.

**Mike Grondahl** - *Northland Capital Markets*

Bill and Michelle, Ocwen is switching servicing systems. Would you say that the decrease in Hubzu sales is like a 100% timing? And what kind of gives you confidence that that'll come back? And when do you think it comes back? Have you begun to see it yet?



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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. So yes, we're already starting to see the referrals pick up, Mike. But basically, if you look at our revenue per delinquent loan, and then we look at that at a more granular level inside of Altisource, we believe the reason why that's come down -- one of the primary reasons is because of the delay in referrals associated -- there's 2 reasons. One is just sort of a normal QC work that goes, it's associated with switching systems, and we're switching both the servicing system and the REO management system. And the second is there's a grace period that Ocwen provides its servicers as part of changing the servicing, the legal servicing entity that's servicing their loans. And that also resulted in a delay in referrals. We believe that cost us roughly -- Michelle, what was the number, about \$11 million?

**Michelle D. Esterman** - *Altisource Portfolio Solutions S.A. - Chief Financial Officer*

\$11 million of revenue.

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes, \$11 million of revenue. And then when we break it down by product, Mike, we got to the \$3.5 million to \$4.5 million of earnings. And yes, we are starting to see the referrals pick up.

**Mike Grondahl** - *Northland Capital Markets*

Got it. Any Field Services? And what's kind of coming from NRZ, any change in behavior there?

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

No, it's been business as usual as far as we can tell, Mike.

**Mike Grondahl** - *Northland Capital Markets*

Got it. And then with the...

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

But we are making -- by the way, what is interesting in that business is we're making a lot of progress, adding new customers. And we're starting to see the growth so far this month over the same month last year, it's beginning to accelerate. And then we added a Top 5 bank. We're going to be in 10 states hopefully by the end of this month. And we're making -- we've just landed a very, very large win with that largest owner of real estate that's going to launch, we believe, in the fourth quarter. So we're very pleased with the progress we're making in that business.

And we're also very pleased with the progress we're making inside of Hubzu. We really have seen an acceleration of clients that have actually finally on-boarded after years, in some cases, of winning a deal, negotiating agreements, getting through all the compliance and control requirements and finally on-boarding. So we're really pleased with the acceleration we're starting to see there as well.

**Mike Grondahl** - *Northland Capital Markets*

Good. In terms of the sale of Financial Services and BRS, do you have the rough 2Q contribution from both of those?



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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

So in -- with respect to the buy-renovate-sell business, Michael, we actually sold those homes at a loss. And so they had a negative impact on our margins for the quarter. I think the sales price was \$39 million. And I think today, we own 2 homes with a balance of about \$400,000 of book value that we haven't sold yet. And then on the Financial Services business, we're not breaking it out in detail, but I think approximately \$6 million of pre-tax for the year.

**Mike Grondahl** - *Northland Capital Markets*

For the year, okay. And then the mid-point -- going...

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

The gain is approximately, from the sale of that business, we anticipate in July, you'll see roughly an \$18 million gain from the sale. That's built into our updated scenarios.

**Mike Grondahl** - *Northland Capital Markets*

Okay. Your adjusted EPS under the new guidance, if you will, it looks like it dropped from \$2.23 to \$1.82. Can you kind of give us a bridge walking that down? Is it simply Financial Services and BRS? Can you just help us understand the decrease, kind of the components?

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Sure, yes. So a large component is the Financial Services business. And then think about, when you sell a business as a carve-out, there are some costs that didn't get sold that are left still at Altisource that we have to work to eliminate. So there are some additional costs related to that business that we're going to need to continue to eliminate. So it's the loss of the earnings from that business as well as some of those additional costs that we will work to eliminate.

And then it's the delay from what we originally expected in on-boarding some of these customers. We're starting to see that accelerate, but it's going to impact our full year.

And then lastly, I think we have modeled our debt balance to be a little bit lower at this point in time. And so interest expense is a little bit higher.

**Mike Grondahl** - *Northland Capital Markets*

Got it. And then could you give a little bit more update on Pointillist and Owners and kind of the trends you're seeing there? And I think you said -- did you say you're going to invest \$8.5 million in Pointillist? Is that like right now or over the course of the year? So just an update on both would be great.

**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. So with respect to Pointillist, our plan is -- we've completed all the legal documentation to establish this as a separate company. And we've worked with our Board and have agreed to essentially put \$8.5 million in the company. And then the plan is, even though we'll be consolidated on our income statement and balance sheet, they're going to run on their own and be a stand-alone. And it will be -- our plan is for it to be an unrestricted subsidiary, and anything we do with them in the future will have to be on an arm's length basis based upon our assessment of the performance of the business. And so that's the plan for Pointillist.



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They're making very good progress. They signed some attractive agreements and pilot programs during the quarter. We'll provide an update with more specificity on a later call, but they're making very good progress in terms of signing household names and have a very, very attractive pipeline that's both a direct pipeline and a pipeline through our channel partners. So we're very pleased.

The strategy with Owners, Mike, is to essentially do the same thing. It's just a little bit further behind. And with all the transactions we're working on, we're catching up, but we are working to do something similar with Owners. And Owners, we're continuing to make very good progress. We're continuing -- from a net revenue perspective, our model is changing a little bit. So our net revenue growth is still anticipated to be very attractive because under our evolving model, we're going to keep more of the commission, but the gross revenue is a little bit -- the growth is a little bit slowed down from what we had originally anticipated. But on a net basis, which is what really matters, we're very pleased with the progress we're making.

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**Mike Grondahl** - *Northland Capital Markets*

Got it. And then Project Catalyst, is that kind of where you want it to be? Is there a lot of wood still to chop there? Kind of where are you there?

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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. The largest benefit we're still going to get from Project Catalyst is going to be the data center. So for the most part, we're going to be moving completely off of our own data centers or in the data centers we lease into the cloud. And we estimate that, that could save us about \$8 million to \$10 million next year once we complete the process, so on a run rate basis, about \$8 million to \$10 million a year.

And so that's a very important component of Project Catalyst. There's still some facilities consolidation and some automation initiatives where we're building some robotics to improve the efficiencies at some of our businesses.

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**Mike Grondahl** - *Northland Capital Markets*

Got it. And one last follow-up. The \$18 million gain from selling the Financial Services business, so is that included in the \$1.82?

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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

No. So -- because we adjust out -- because that's sort of -- it's adjusted out of our adjusted earnings. So it's included in GAAP, but it's taken out of adjusted.

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**Mike Grondahl** - *Northland Capital Markets*

Okay. So the \$1.82 is sort of clean. It doesn't include that benefit. Okay, good.

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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Yes. And Mike, you'll see a reconciliation of that in the appendix.

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**Operator**

(Operator Instructions) And I'm showing no further questions at this time. I'd like to turn the call back to Bill Shepro for closing remarks.



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**William B. Shepro** - *Altisource Portfolio Solutions S.A. - Chairman and Chief Executive Officer*

Great. Thanks, everyone, for attending the call. Appreciate your support.

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### Operator

Ladies and gentlemen, thank you for participating in today's conference. This does conclude the program, and you may all disconnect. Everyone, have a great day.

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