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ASPS - Q4 2018 Altisource Portfolio Solutions SA Earnings Call

EVENT DATE/TIME: FEBRUARY 26, 2019 / 1:30PM GMT

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CONFERENCE CALL PARTICIPANTS

Mike Grondahl *Northland Capital Markets*

PRESENTATION

Operator

Good day, ladies and gentlemen, and welcome to the Altisource Portfolio Solutions Fourth Quarter and Full Year 2018 Earnings Conference Call. (Operators Instructions)

I would now like to introduce your host for today's conference, Ms. Michelle Esterman, Chief Financial Officer.

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-K and quarterly slides are available on our website at www.altisource.com. These provide additional information investors may find useful. Our remarks today include forward-looking statements which include 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, as well as risk factors identified 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 would now like to turn the call over to Bill.

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

Good morning and thank you for joining today's call. 2018 has been a productive year for Altisource. From a financial perspective, we substantially exceeded the mid-point of our adjusted pre-tax income and adjusted earnings per share financial scenarios, and generated strong adjusted operating cash. Operationally, we began to exit certain businesses and established Project Catalyst, to streamline our organization, focus on our larger opportunities, and help us achieve our longer term financial objectives. We also continued to work closely with our largest customers to strengthen and grow our relationships with them, and won new business with leading financial institutions. Leveraging the work we've done in 2018, we believe we are turning the corner. The $54 million mid-point of our 2019 adjusted pre-tax income scenarios is $2 million better than what we anticipated achieving in 2018 and sets the stage for continued earnings growth in 2020. This morning, I will provide an update on each of these items and discuss our 2019 financial scenarios.

As you can see on slides 6 and 7, driven by a strong fourth quarter, we generated $2.43 of adjusted diluted earnings per share and $62 million of adjusted pre-tax income in 2018, significantly outperforming the mid-point of our scenarios. 2018 adjusted pre-tax income was stronger than anticipated and higher than the mid-point of our scenarios because we achieved cost savings from Project Catalyst in the fourth quarter that we didn't expect to achieve until the first quarter of 2019. Notably, fourth quarter adjusted pre-tax income, which is typically seasonally slower than the second and third quarters, was the second strongest quarter in 2018 and 50% higher than the fourth quarter of 2017.

Turning to slide 8, from a capital perspective, we refinanced our term loan in April of 2018, extending the maturity date from December 2020 to April 2024. Throughout the year, we continued to deleverage, reducing debt by approximately $75 million - from $414 million at the beginning of the year to $339 million at the end, representing a 43% reduction in our debt from the peak balance of $592 million. We ended 2018 with $244 million of net debt less marketable securities and $204 million after further reducing for the book value of homes in the buy-renovate-sell business. We also repurchased $40 million of Altisource stock, bringing the number of outstanding shares to 16.3 million at the end of 2018.

During 2018, we generated strong adjusted operating cash flows of $79 million and spent a modest $4 million on capital expenditures. Our capital requirements have continued to decline as we simplify the organization and reduce our footprint.

We also established Project Catalyst in the second half of 2018 to focus on our larger opportunities, streamline the organization, and help achieve our longer term financial objectives. As part of this effort, we began to exit certain businesses. In August 2018, we sold our property management business to Front Yard Residential and, in the fourth quarter established a plan to exit the buy-renovate-sell business. We anticipate selling the majority of the remaining homes in the buy-renovate-sell program during 2019.

To streamline our operations, we continued to aggressively reduce costs and were able to achieve savings in the fourth quarter that we didn't expect to achieve until the first quarter of 2019. This was evident in our results. Fourth quarter 2018 adjusted operating income of $24.3 million was 36% higher than the fourth quarter of 2017 and adjusted pre-tax income of $17.6 million was 50% higher. Certain other elements of our cost savings plan, including the data center migration to the cloud and automation initiatives, will be implemented toward the end of this year, benefiting 2020 financial results.

Turning to our customers, throughout last year we worked closely with Ocwen and NRZ to strengthen and grow our relationships with them. With Ocwen, we executed an agreement last week, primarily to (1) facilitate Ocwen's transition to PHH's servicing system and cover some of our costs related to the transition, (2) establish a process for Ocwen to review and approve the assignment of one or more of our agreements to potential buyers of Altisource's business lines, (3) permit Ocwen to use other service providers for up to 10% of referrals from certain portfolios, and (4) affirm Altisource's role as a strategic service provider to Ocwen through August 2025. We are pleased to sign this agreement with Ocwen, and believe that it will support Ocwen's growth which should be very good for Altisource.

With respect to MSRs acquired by NRZ from Ocwen, we provide REO brokerage and auction services under the Cooperative Brokerage Agreement with NRZ that we executed in 2017. We continue to provide all other default related services on these portfolios under our agreements with Ocwen. Both agreements extend through August 2025.

In 2017, we executed a letter of intent to enter into a direct Services Agreement with NRZ to provide the other default related services on servicing rights NRZ acquired from Ocwen. Entering into a direct agreement with NRZ has the potential to establish Altisource as the service provider irrespective of subservicer, avoid a dispute, and provide Altisource with other business from one of the largest MSR acquirers in the industry. After extending the LOI multiple times, it expired on December 15. Since the expiration, we believe we have continued to receive the business on an uninterrupted basis, and our position is that our agreements with Ocwen establish Altisource as the provider of services on the Ocwen-serviced portfolios transferred to NRZ. We look forward to the opportunity to further develop and grow our relationships with Ocwen and NRZ.

Turning to slide 9 and our other customers, in 2018 we continued to win business with some of the largest financial institutions in the United States. I'll highlight some of the more notable wins. We executed an agreement with one of the largest institutional real estate and mortgage investors to provide REO, foreclosure and short sale auctions and began receiving REO and foreclosure referrals during the second half of the year. We expect to begin receiving short sale auction referrals this quarter. We also made progress onboarding two large customers. The first customer engaged us to provide REO asset management and related services, and we began receiving referrals last month. The second customer engaged us to provide field services, and we expect to begin receiving referrals in the second quarter of 2019.

As noted on slide 4, we experienced 64% growth in Hubzu foreclosure and REO auction inventory from customers other than Ocwen, NRZ and Front Yard Residential in 2018. We anticipate this growth trend to continue as we expand with existing customers, begin receiving referrals from newly on-boarded customers and convert pipeline opportunities to wins.

Turning to Owners.com, our technology enabled real estate brokerage, we continue to make great strides. 2018 service revenue grew by 82% and the number of transactions by 61% compared to 2017. From an operational perspective, we continue to focus on streamlining the consumer experience and enabling our real estate agents with differentiating tools. We expanded our bundled offerings in most markets to provide savings to buyers and sellers that choose our closing services. We are also experiencing strong agent adoption of our newer tools. For example, over 75% of our customers that tour a home received a professional home tour report from our agents through the Owners.com agent app.

We ended the year working with approximately 5,300 customers, a 130% increase from the 2,300 we were working with at the end of last year. We currently anticipate that Owners.com's 2019 revenue growth rate will be in the high double digits again and the operating loss will be modestly lower.

Last quarter, I highlighted Pointillist, a potentially disruptive SaaS customer journey analytics platform that maps the customer journey and uses artificial intelligence to enable enterprises to optimize their customer experience, reduce churn, and increase lifetime value. In the fourth quarter, Pointillist signed agreements with three new enterprise customers and was recognized as an industry leader by Forrester in two Wave reports, one for Customer Journey Visioning and the other for Customer Journey Orchestration. The recent sales wins and Forrester recognition provide Pointillist with market credibility that is helping drive an increase in sales leads from large enterprises. With this validation, we are expanding our Pointillist sales team to accelerate growth.

Given Owners and Pointillist's progress, our short term strategy and 2019 scenarios reflect that we continue to incubate and grow these businesses. In the medium term, we anticipate that Owners and Pointillist will raise capital and run on a stand-alone basis. This should allow us to continue to benefit from potential up-side while reducing, if not eliminating, Altisource's cash burn.

Turning to slide 11 and our 2019 financial scenarios. At the mid-point of our scenarios, we established 2019 service revenue of $679 million, adjusted pre-tax income of $54 million, adjusted earnings per share of $2.23 and adjusted operating cash flow of $60 million - $70 million. We anticipate that GAAP operating cash flow will be higher from our sale of BRS inventory.

2019 service revenue is anticipated to be lower than 2018 from the normal run-off of the Ocwen/NRZ portfolios, the discontinuation of the buy-renovate-sell business, the 2018 sale of the Rental Property Management business, and fewer referrals from RESI's diminishing NPL and REO portfolios. The impact is partially offset by the full-year impact of clients we boarded in 2018, clients we are in the process of on-boarding and continued momentum from Owners and Pointillist.

As we've communicated on prior calls, we believed that 2019 adjusted pre-tax income would be equal to or better than 2018. As you can see on slide 11, the mid-point of our adjusted pre-tax income scenarios for 2019 is $54 million, or $2 million higher than our 2018 scenario mid-point shown on slide 7. Primarily because we achieved accelerated benefits from Project Catalyst in the 4th quarter that we did not expect until early 2019, our 2018 performance was $10 million better than the mid-point. Slide 12 provides additional assumptions used in developing our 2019 financial scenarios.

From a capital allocation perspective, in 2019 we plan to continue to take a balanced approach by reducing our debt, investing in our business, and, based on market conditions, buying back stock.

We believe our projected 2019 performance and the full year impact of the Project Catalyst savings positions us to grow earnings in 2020.

In conclusion, 2018 was a good year for Altisource, and we are actively taking steps to position the Company for a solid 2019 and an even better 2020. We are winning business from strategic customers, rationalizing non-core businesses and streamlining the organization to focus on larger opportunities. We continue to generate very attractive cash flow and deleverage the company, and believe we are in a strong position to benefit from a softening economy.

Through the Project Catalyst process, we've had to make the very difficult decision to part with some of our valued team members. We wish these team members the best in the next phase of their careers. We believe these difficult choices will position Altisource as a stronger company and will support the Company's longer term competitiveness and growth. I'd also like to thank and recognize Altisource's leadership team and employees who have remained incredibly focused on providing our customers with high quality services.

I'd now like to open up the call for questions, operator?

QUESTIONS AND ANSWERS

Operator

[Operators Instructions) Our first question comes from Mike Grondahl with Northland Security.

Mike Grondahl - *Northland Capital Markets*

What are the two or three takeaways from the agreement with Ocwen? And then, how do we interpret an update on the LOI or what's going on with NRZ? The opportunity or the challenges with NRZ?

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

Mike, I think it's very clear we're working with Ocwen now to transition them off of REALServicing, which is a benefit for Ocwen. We've now formalized the ability for Ocwen to approve our sale of individual business lines, which is a benefit to Altisource. Ocwen is covering a large portion of our costs related to its servicing transition, and we've reaffirmed ourselves as Ocwen strategic provider through August 2025. And there's a very modest impact; we're giving up a little of the referrals that we've historically received, but the impact to our revenue this year, putting aside the REALServicing transition, which we built into our financial scenarios, we think, will be about approximately $6 million. So it's very modest impact to our revenue this year. It helps Ocwen grow. And obviously, to the extent Ocwen is able to grow, it's very good for us.

Mike Grondahl - *Northland Capital Markets*

Got it. That's helpful. And NRZ, so I think you're saying there you didn't come to an agreement on an LOI, but you still have your previous agreement in place, and they're still sending you referrals after 12/15. If you could, just provide a little clarity there?

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

Yes, just a little background. We signed the Cooperative Brokerage Agreement with NRZ back in 2017. And that dealt with REO assets on NRZ owned or to be owned MSRs, that are serviced by Ocwen or someone else. We have a separate agreement with Ocwen that provides us to do all the other default-related services on those portfolios. And we believe, Mike, that those agreements with Ocwen establish Altisource as the provider of downstream services on the Ocwen-serviced portfolios. We separately have signed an LOI which expired on December 15th with NRZ because there are some benefits to having a direct deal with NRZ. For example, if Ocwen was no longer the servicer, we would still be providing the services, if we did a direct deal. It's also very good to sign a deal with one of the largest buyers of MSRs in the industry. So there are some benefits. That agreement expired. We've had some conversations with NRZ since the expiration of the LOI, and we remain open to formalizing the relationship. But in the meantime, we believe, our agreement with Ocwen controls and we're the provider of services to Ocwen on those portfolios. And we've continued to receive the referrals on an uninterrupted basis, we believe, since December 15th.

Mike Grondahl - *Northland Capital Markets*

Project Catalyst. What do you think the expense savings is in 2019?

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

Mike, we're looking at it a little bit differently now. If you recall, I think, we originally said, we thought we could save, on an annualized basis, $60 million to $90 million. There's been a lot of, sort of, moving parts at Altisource where we've exited certain businesses. We're now getting off of, we're permitting Ocwen to get off of REALServicing sooner. So we're looking at Project Catalyst now as what's allowing us to achieve or helping us to achieve these scenarios that we put out today, which is basically $2 million higher than what the mid-point was for 2018. And so we're looking at it from that perspective. But if you take the time and go through our slides, I think you're going to see that even though the mix of our business is changing a little bit, we're increasing our margins across the Company or overall Company-wide and we're really on our way in our view towards turning the corner for growth this year over what we thought we would do last year and even additional or further growth in 2020.

Mike Grondahl - *Northland Capital Markets*

Got it. And last question, it looked like you had some nice signings in 4Q 2018. What does the pipeline outside of what you have listed on slide 9 look like?

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

First I'd say that those deals that we signed, I think, most of which we reference on that slide 9, are super exciting, and we don't believe we're close to getting to a normalized level yet with those customers. They're just getting going. Also, from a sales pipeline perspective, we're feeling really good about how the pipeline is developing so far in 2019. There are a couple of REO transactions, REO asset management and REO auction that we're working on. We think that could generate more than 100 referrals a month collectively at very attractive fees. On the field services side, we continue to get a lot of traction and are developing the pipeline with both large and small customers, and we're in the middle of several RFPs that we're optimistic about. So we're feeling very good about how the pipeline is developing.

Operator

[Operators Instructions) I'm not showing any further questions at this time. I'd now like to turn the call back over to Mr. Shepro for any closing remarks.

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

Thanks, operator. We appreciate everyone joining today's call. Have a great day.

Operator

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