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ASPS - Q3 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

Ladies and gentlemen, thank you for standing by, and welcome to the Altisource Third Quarter 2019 Earnings Conference Call. (Operator Instructions.) Please be advised that today's conference is being recorded. (Operator Instructions)

I would now like to hand the conference over to your speaker today, 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-Q 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 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, Altisource's Chairman and Chief Executive Officer. I would now like to turn the call over to Bill.

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

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

During the third quarter, we made good progress with our core businesses while continuing to streamline the Company. Were it not for the temporary financial impact we continued to experience from Ocwen's transition to a new servicing system, the third quarter would have been business-as-usual. This morning, I'll discuss our financial performance, ongoing focus on streamlining Altisource and progress we are making on growing our core businesses.

As you can see on slide 5, we generated \$0.25 of adjusted diluted earnings per share and \$4.4 million of adjusted pretax income on \$133.8 million of service revenue. Service revenue was lower than the second quarter for three primary reasons: (1) We sold the majority of the Buy-Renovate-Sell assets in the second quarter and the Financial Services business on July 1st, (2) REAL Servicing license fees declined as a result of Ocwen's servicing system migration, and (3) Ocwen's servicing system migration continued to have a temporary negative impact on default related referral volume and REO inventory conversion rates.



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We estimate that the lower REO inventory conversion rates reduced third quarter revenue by approximately \$7.8 million. Pretax earnings were negatively impacted by a similar amount since our cost structure would have supported this anticipated revenue. Absent this impact, we estimate that our third quarter adjusted operating income margin would have been greater than 11%. We believe the lower conversion rates are a timing item and anticipate returning to normal conversion rates over the course of the next couple of quarters.

We used cash from the sale of the Financial Services business and the sale of RESI shares to repay \$39 million of debt during the quarter. We also used \$6.7 million to repurchase Altisource shares and a nominal \$270,000 for capex. We anticipate that our capex requirements will remain low, and we plan to continue to reduce debt and repurchase shares. We estimate that cash from operations would have been \$27 million higher if it were not for the temporary revenue and receivables impact Ocwen's servicing system migration had on us. We ended the quarter with \$107 million of cash and marketable securities and net debt less marketable securities of \$187 million.

Our earnings release and 10-Q provide a detailed discussion of our operating results compared to last year.

Turning to slide 6 and our scenarios - adjusted earnings per share for the first three quarters of the year is 63% of the midpoint of our scenarios. We currently anticipate that we will end the year at the low end of the range of our EPS scenarios due to the timing of the recovery from the impact of Ocwen's servicing system migration that I just discussed.

With our strategic focus and progress we are making on streamlining Altisource and diversifying and growing our revenue base, we believe we will have a concentrated group of very attractive businesses that operate in large markets.

Slide 8 highlights the progress we've made in streamlining Altisource. Since July of last year, we sold our Rental Property Management business, Financial Services business, BRS inventory and a portion of the RESI stock. We used proceeds from these sales to repay \$110 million of debt. We also created a separate Pointillist entity which we anticipate will position it to raise equity capital and, in October, began winding down and closing the Owners.com business. During the first three quarters of 2019, Owners.com and Pointillist generated a combined \$19 million of losses, and we invested an additional \$8.5 million of cash into Pointillist when we moved it into a separate entity. With the closing of Owners.com and the separation of Pointillist, we are eliminating the cash burn associated with these earlier stage businesses. We are optimistic that Pointillist will raise equity capital from others in 2020 and, provide an attractive exit for Altisource in the future. The Company has an option, but no ongoing obligation, to participate in Pointillist's future funding rounds.

We've also made very good progress on-boarding customers and growing revenue from customers other than Ocwen and NRZ in our core businesses, which are Field Services, Marketplace, and Mortgage and Real Estate Solutions.

As you can see on slide 9, third quarter revenue was 16.5% higher than the second quarter and 12.3% higher than the same quarter last year. We anticipate this trend, on a seasonally adjusted basis, to continue.

Slide 10 highlights progress with select customers. We had a strong quarter of client program launches and have a solid pipeline of new business scheduled to launch later this year and the first quarter of next year. During the quarter, we began receiving Field Services referrals in ten states from a Top 5 servicer. We believe we are one of a few vendors engaged by this customer in these states. We began receiving REO auction referrals from a top tier non-bank specialty servicer in the third quarter. We expanded our REO Field Services engagement with a bank servicer to also include pre-foreclosure Field Services referrals.

In the fourth quarter, we anticipate launching pre- and post-foreclosure Field Services for a portion of the portfolio of an existing customer, which is one of the largest institutional real estate and mortgage investors in the U.S. In the first quarter of 2020, we expect to begin receiving FHA foreclosure auction and Field Services referrals from an existing top 25 servicer client.

Several of these program launches are with existing customers and demonstrate our ability to expand relationships based upon performance and our scalable suite of services.



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With the longer term benefits we anticipate from streamlining the Company and the diversification and growth of our revenue base, we believe Altisource represents an attractive entry point for investors interested in counter-cyclical businesses. We are one of the largest providers of residential field services, one of the largest online residential real estate auction providers, and the manager of the Lenders One cooperative, whose members collectively represent more than 15% of the residential loan origination market. In a declining delinquency environment, we're winning default related business and continuing to develop a very attractive and growing customer base with some of the largest servicers and a GSE. We also have a large customer base of middle market residential loan originators, which includes members of the Lenders One cooperative. We believe with our market position and scale, we are in a strong position to grow both our default and origination related businesses and convert our attractive pipeline of opportunities to wins. When delinquencies rise, we should also benefit from more volume from our attractive customer base.

Before opening the call up for questions, I would like to recognize a founding member of Altisource's leadership team. As you may have seen from our recent 8-K filing, Kevin Wilcox, our Chief Administration and Risk Officer, is leaving the Company following a transition period. Kevin will always be a friend of the firm, and I'd like to thank him for his leadership, commitment and many contributions to Altisource. Kevin built a very strong bench of talent in his organization, and I'm confident this team will continue to build on the work Kevin has done.

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

QUESTIONS AND ANSWERS

Operator

(Operator Instructions) Our first question comes from Lee Cooperman with Omega Family Office.

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

I could not locate your supplement. But what is the earnings guidance that you put into the supplement?

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

On page 6 is our scenarios. And what we said is we anticipate, given the impact from Ocwen's servicing system migration, Lee, that we'll be on the lower end of the adjusted EPS on Page 6.

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

Which is what? I can't find the supplement.

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

Looking, give me a second. \$1.59.

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

\$1.59. And any comment about 2020?



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

So when we think about 2020, we've had some puts and takes. We've closed some businesses. We've sold some businesses, but at the same time, we're also going to get some savings from moving to the cloud, of \$8 million to \$10 million moving our data center to the cloud. We've eliminated or eliminating the losses in the earlier stage businesses, which was a pretty large number this past year, and we think we're going to keep growing Ocwen and NRZ. So with the puts and the takes, we're still finalizing, Lee, numbers for next year, so this is very preliminary. We think we can largely offset a lot of those declines with the savings in new business.

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

Would you expect to have a better year or a worse year or about a flat year?

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

It's very preliminary. We haven't finalized our numbers for the year, as you can imagine. We've made a lot of changes at Altisource, including over the last couple of months, so we're still finalizing next year. But when I look at a preliminary, we think we can do something similar even after selling off some of those businesses.

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

Okay. The second question, on this Pointillist, which I don't really know much about, you're looking to raise equity capital. Why are we doing that? You're buying stock back every quarter, so it must mean we have excess capital. Why are we taking capital from the outside rather than using our own money? I assume the capital coming here from the outside will probably be more expensive than your own capital.

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

Yes. So Lee, the way we think of Pointillist is a sort of a fintech SaaS business model, and we think it would benefit quite a bit from bringing in seasoned venture firms that have an expertise in this type of product. They could help us.

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

So not so much looking for their money, you're looking for their expertise?

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

Yes, they can help us develop business, they can help us grow the business, help us accelerate, yes.

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

Okay. I get that. And then lastly, you guys have been a persistent buyer of your own stock and the results have continued to disappoint. What do you think you're buying back when you buy your shares? As you step back in the boardroom and your board goes along with this buyback, forget about where we did it over \$100 a share. But in the last few years, the results have consistently disappointed, yet you persistently continue to buy back stock. So what do you think you're buying back when you buy back stock? I think you owe an explanation to your shareholders. You've chosen not to pay a dividend, and you keep buying back stock. What's the value of the company, in your view, that you're buying back?



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

We believe we've got a set of really attractive businesses. The three businesses we're in, Lee, and we believe they have strong growth prospects. We're starting to get to see the benefit from our sales efforts and the new customers we brought on this quarter with very attractive growth in all three of our core businesses, both sequentially and year-over-year, and we think it's going to continue next quarter and into next year. So we're creating three businesses that are very attractive. We've got a strong relationship with Ocwen and a long-term agreement that goes out until August 2025 and the same with the CBA with NRZ that could bring in a tremendous amount of cash flow, and we think the company is undervalued.

Operator

(Operator Instructions) Our next question comes from Mike Grondahl with Northland Securities.

Mike Grondahl - *Northland Capital Markets*

Bill and Michelle, with the delay in referrals, do you believe that's all just Ocwen getting on this new servicing system? And is that what caused the delay? Just kind of an update there.

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

Sure. So what we did was we just said if we had converted the beginning of the inventory, the inventory balance at the beginning of the quarter and rolled that forward through the quarter, and if we had sold at the same percentage of beginning inventory as we have historically in the same season in the prior years, our conversion rates, absent the servicing system migration, would have been higher to the tune of about \$7.8 million in the third quarter. We started feeling the impact in June, it continued in the third quarter. And so we have the inventory. We just didn't convert the percentage of beginning inventory at the same pace as we have historically, and we believe that's largely related to Ocwen's servicing system migration. And because we have the cost base in place, that \$7.8 million would have all fallen to pretax.

Mike Grondahl - *Northland Capital Markets*

Got it. So you're still getting all the inventory you anticipated getting. It's not like you're losing out on anything.

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

So from a referral basis, we believe there were some foreclosure holds. When you switch servicing systems, and we didn't anticipate this, and you change the name of the servicer, my understanding is the servicer is obligated to do a de-boarding letter and an on-boarding letter, and they have to put foreclosure actions on hold. So that had an impact and continues to have an impact on the referrals. So we are seeing that. We're also seeing, we think, we're not sure, an early indication that maybe a greater percentage of some of the homes are being sold at the foreclosure sale, but we're not certain what the impact is from that. We know there was an impact from -- on referral volumes into REO from the foreclosure holds. We're less sure what the impact was from potentially more homes being sold at the foreclosure.

Mike Grondahl - *Northland Capital Markets*

And just to expand on that a little bit, I think NRZ, a quarter or so ago, announced kind of they were working with auction.com to do foreclosure sales. So do we need to kind of think through that and say, if they're able to sell it at foreclosure, the loan, then you might get less REO sales. What are you seeing there?

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

Yes. So no, we're paying attention to that. We typically model our expected inflow based on the historical percentage of foreclosures that gets sold at the REO sale and what comes into REO, and that's how we estimate and put together our scenarios. So we have to pay close attention. If it turns out a greater percentage of the loans are sold at the foreclosure sale, that could reduce our inflow. We have had conversations with NRZ about performing that work for them. But at this point, we're not doing that.

Mike Grondahl - *Northland Capital Markets*

Got it. Okay. Yes, clearly, that's something to watch closely. And then could you just comment, Owners.com, maybe a little bit of a surprise. I don't know that people are arguing with you for kind of shutting that down, but the growth just wasn't happening or wasn't happening fast enough?

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

Yes. Mike, here's the way we look at it. We were transitioning the business model from using 1099 real estate or independent contractors to real estate agents that were employees, and we had seen very positive results from our testing of that. But that was going to require us to make a much longer investment in the business before we're going to be able to ultimately bring in other equity capital. And as a result, we made the strategic decision, in consultation with the board, that we're better off leveraging the Owners technology where we can at Hubzu and bring some benefits there, but reduce or eliminate the cash burn associated with the business. And so we're going to leverage some of the technology from Owners and inside of Hubzu, but at the same time, we're working to eliminate the cash burn associated with that business.

Mike Grondahl - *Northland Capital Markets*

Sure. Okay. And then any other non-core businesses besides Pointillist that could be monetized? What's left kind of as you continue streamlining ASPS?

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

Yes. There is a slide we put in the deck. We're very focused on two objectives, strategically on two objectives. One is streamlining the organization and aligning our operating infrastructure to the smaller organization, Mike, and the second is growing the revenue base with non-Ocwen and non-NRZ customers. And as we've talked about in the prepared remarks, we think we're making very good progress on both fronts. There are not many other -- outside of the three core businesses at this point, there's a few very small businesses that exist that we could evaluate, but we're really focused in now on those three businesses, and there's not much else to sell. But look, having said that, if we believe we can add additional shareholder value through the strategic sale of one or more of our businesses, we would consider it. But right now we're very focused on the growth of the three businesses. And then the other thing I'd point out, Mike, is with Ocwen moving off of REALServicing, we're going to essentially mothball that system. And once that's complete, along with moving the buyer of our NCI business, also where we're providing some transition services, including leaving the technology in our data center for a period of time, once those two activities are complete, that will allow us to move to the cloud, and we estimate that will save us. And we hope by the third quarter of next year, we'll start getting the run rate savings of about \$8 million to \$10 million a year. So that's an important initiative for us as well.

Mike Grondahl - *Northland Capital Markets*

Got it. And just following up on that \$8 million to \$10 million, is that sort of the last piece of Project Catalyst that you have left to implement and kind of ring the savings out from? Or is there more still in process with Project Catalyst?

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

Yes. I think when you look at the sales and the closing of some of these businesses, Mike, we still have work to do to align the organization to the businesses we have in place. So we do anticipate there'll be some more streamlining of the Company. And -- but of course, very large savings will come from that data center migration to the cloud.

Mike Grondahl - *Northland Capital Markets*

Got it. That's a big chunk that's left. And then just a couple more. So I think you clarified it, but the midpoint of your guidance had sort of spoken to a robust 4Q, even up year-over-year, but you're kind of saying with the Ocwen migration still happening, focus on the low end. So kind of -- still a little bit down year-over-year. But did I catch that right?

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

That's right. We're anticipating because of the impact on the conversion rate of REO. Absent that impact, we think we would have been right in line. And by the way, look, we always try to beat ourselves up when we don't get our scenarios right. And a servicing transition is something that probably takes place every couple of decades, and we just didn't fully understand or grasp, I guess, the impact that that transition was going to have on the earnings. But the good news is it's largely a timing question. It's not about whether you'll make the money, it's when.

Mike Grondahl - *Northland Capital Markets*

Okay. And then investment spend back in '17 was roughly \$60 million. Last year, it was like \$45 million. At one point, it was going to be \$30 million this year. What's it on pace to be this year? And any initial read on 2020?

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

Yes. So Mike, with us closing the earlier stage Owners.com and winding it down, and we look at the Pointillist now as being completely -- we're going to account for it from an accounting perspective, and it's on the balance sheet still, but we aren't planning on funding that any further and it's going to raise equity in the future. So the investment spend is going to come down almost to \$0.

Mike Grondahl - *Northland Capital Markets*

In 2020. Okay. I felt like that was the direction it was going. Okay.

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

Just to be clear, we are making normal course investments in the businesses that will show up in the business level P&Ls.

Mike Grondahl - *Northland Capital Markets*

Okay. And then lastly, as you guys are adding these non-Ocwen, non-NRZ kind of Hubzu customers, if you will, is the margin profile the same, better or a little bit worse for the non-Ocwen, non-NRZ Hubzu sales?

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

Right. So first, I think if you look at the slides -- Michelle, what page is that?



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

16.

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

If you look on Page 16, you'll see we're up close to 100% in sort of number of sales for non-Ocwen and non-NRZ REO year-to-date this year compared to last year and probably double what it was in 2017. And our inventory also continued to grow on non-Ocwen. So Mike, in terms of the fees we're paid, for like services, we're paid the same or more money for other customers. So then the question really becomes what's the average size of the -- what's the sales price. And right now I think the sales price is lower, on average, than what the average sales price is on the Ocwen and NRZ portfolio. But in terms of the fees we generate, the fees are the same or better. And it's a very, very high-margin business, and we're pretty pleased with our success in growing that business.

Mike Grondahl - *Northland Capital Markets*

Great. Thanks a lot.

Operator

(Operator Instructions)

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

Operator, just one thing I want to clarify, I think in response to Lee's question, I said we anticipate growing Ocwen and NRZ. I intended to say we anticipate to grow non-Ocwen and non-NRZ business. So just to clarify that.

If there's no other questions, thank you for attending the call, and we look forward to speaking with you.

Operator

Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect.

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