1H FY21 Results - CEO and CFO conference call script

Stuart Irving - Chief Executive Officer and President

Good morning everyone and welcome to Computershare’s FY21 first-half results conference call.

I am joined today by Nick Oldfield, our Chief Financial Officer, and Michael Brown, from our Investor Relations team.

As usual, I will take you through the key aspects of our results and how we see the rest of the financial year.

We released a presentation pack to ASX and it’s on our website. There’s a lot of information in the deck for you. I appreciate you are busy, so I’ll focus my remarks on the opening pages of the presentation.

Nick will then take you through the slides on our financial results. Then after some concluding remarks we will open up the call for questions. As a reminder, we will be talking in US dollars and constant currency (CC) unless we state otherwise.

Slide 2 - 1H21 Results

Let’s start on page 2.

The three main points I would like to make are;

One: We delivered Management EPS ahead of plan. I am pleased that our operating business is performing. Remember the first quarter was an uncertain time and comparisons against the PCP are difficult. We delivered 21.8 cents of Management EPS for the half compared to the 20 cents per share we guided to in August.

Two; we executed well on what we can control. Issuer Services, our largest business, delivered the fastest rate of growth across our business streams and Employee Share Plans and Corporate Trust both grew fee income. On the other side, margin income was clearly hit by record-low interest rates and US Mortgage Services was impacted by the extended moratorium and volatile market conditions. These are not excuses, but the results do highlight the strength of our high-quality businesses.

Third, the 1H operating performance supports upgrading full-year earnings guidance. We now expect EBIT excluding margin income to be up around 14% for FY21. That’s up from around 10% we started the year with. We expect Management EPS to decline by around 8%. That compares to previous guidance of down around 11%. There is a lot of detail in the deck that breaks down the bridge from first half to second half EPS to deliver this guidance but in simple terms this is how I see 2H.

Start with 21.8 from the first half. Add back the one-off costs of 2 cents per share, add seasonality of 2 cents and cost savings of 3 cents. Tax and margin income take off 2 together. This gets you to 27 cents which leaves 3 cents for organic growth which is the same amount we guided to in August.

Slide 3 – 1H21 Management EPS

Back to the first half. We show a more detailed analysis of the results on page 3, the earnings waterfall.

We bridge from the 1H FY20 Management EPS of 29 cents per share through to the 21.8 cents per share for this half. There are a range of operating and one-off factors here. I’ll call out some headlines going from left to right.

Margin income was the single largest factor in the period. The drop to $55m of MI cost us over 8 cents per share against the PCP. We did a good job maintaining balances at the 2H level of $17.6bn helped by corporate actions and corporate trust balances, especially later in the half, but our annualised achieved yield on exposed balances was only 0.75%. It is the lowest in our history and well down on the 1.79% annualised yield on exposed balances we earned in the PCP.
Moving across, one off costs reduced EPS by 2.1 cents. This is the $15.2m pre tax we took above the line. It includes a range of items such as a $4.5m levy on the transfer of assets to a Brexit compliant environment and a provision for over $7m against a receivable in Class Actions.

The moratorium on foreclosure in US Mortgage Services cost us 1.5 cents. The UKAR fixed fee reduction cost us 3.5 cents of EPS in the bridge. This shouldn’t surprise anyone.

On the positive side, in green, cost savings made an important contribution to these results. Savings from our cost out programs provided 5 cents per share to EPS. BAU opex fell by 6.3% in the half.

Page 14 in the deck takes you through the details of our cost out programs and Nick will take you through that.

Finally operating earnings growth, excluding margin income, added a little over 3 cents per share to Management EPS. That’s a little ahead of where we thought we would be in August.

Now let’s move to page 4 and talk through the business performances at a high level.

Slide 4 - 1H21 Summary

Starting with Issuer Services, revenue was up 8.4% and EBIT ex MI was up 23.3%. Computershare’s largest business delivered the fastest rate of growth across the group. We saw new client wins, increased market share and growth in our entity management and Registered Agent offerings.

There’s lots of good information and new disclosure on the business lines starting on page 9. You will see we have stripped out margin income from the operating businesses’ revenue lines to give you more transparency.

In Issuer Services and excluding margin income, Register Maintenance had positive growth of 0.6%. Within Register Maintenance, shareholder paid fees are still recovering but they are still below the PCP, down 9%.

That shows the underlying growth in Issuer paid fees, the recurring revenue, which was up 4%.

The number of shareholder accounts we manage increased again, to 38.2 million. That’s a rise of around 1.5m over the past two years.

Corporate Actions also saw some recovery. We saw good activity levels in Hong Kong IPOs and UK rights issues.

Excluding margin income, revenues in Corporate Actions increased by 35%. It does show how margin income is hurting us though because including MI, revenues were only up by $3m to $76m here.

Stakeholder Relationship Management did well. Revenues ex MI increased by 95%. We completed major governance projects for Legg Mason and others. We hired over 400 temporary staff to complete this work, all working remotely. I do need to say though these projects are lumpy and not recurring so please don’t bake them into FY22.

Our new Issuer Services businesses in Entity Management and Registered Agent are going well. Revenues increased by 177%. This includes organic growth, and a full half of contributions from our two acquisitions, Corporate Creations and Verbatim. We’re really pleased with the extra capability these businesses give us. We can grow these new, large revenue pools and recent bundled client wins, which means we have got off to a strong start, and remember there is no margin income in these new business lines.

In Employee Share Plans, fee revenue excluding MI improved by 2%. We continued to win market share with a 5% increase in net new client wins. We are making good progress upgrading clients to the EquatePlus platform in Europe and the migration program will shortly move to Australia.

Transaction volumes are an important part of the revenue line here and I am encouraged to say activity is recovering as market levels rally. While transaction revenues ex MI were down over 7% for the half, we expect 2H will be stronger.
Units under Administration has increased by 9% for a second year as more customers use equity to attract, retain and reward employees.

We now have over $220bn of Assets under Administration.

I will call out in Employee Plans, Management EBIT ex MI was down by $3.6 million. As I mentioned earlier, we did include some one-off regulatory costs related to BREXIT. So if we took that out underlying EBIT ex MI increased by 5%.

We had some good operating performances in Business Services too. Excluding margin income, Corporate Trust increased fee revenue by 7.4%.

As I have said before, this has been a consistent growth business for us. You can see on page 13 of the deck, fee revenue has grown by over 6% per annum on average over the last ten years and the volume of debt we administer has increased at over a 10 year period with a CAGR of 5%

We also made excellent progress in building a foothold in the United States with a 44% increase in mandates, albeit from a modest base. This is a market where we see significant room for growth.

Bankruptcy also kicked in. This is one of our more cyclical businesses and it’s coming into its own in this environment. Excluding MI, revenues increased by over 120%. However, as the court system is fairly clogged up in the US at the moment, we do expect it to be a little slower in the second half.

The cross on the scorecard is for US Mortgage Services. The results are disappointing. EBIT ex MI fell by $26m and was negative in the half. It was clearly a volatile period but let me explain what happened.

First, the book of loans we service came down a little at $115.8bn. You’ll remember we moved to an 8 year amortisation schedule. This increased the amort charge by $6m. Loans were also being refinanced as rates fell – accelerated run off as we call it. This caused an $8.5m hit to EBIT.

We spent $45m of cash replacing amortising rights, and we invested an extra $21m on further MSR growth investments. The MSR’s we acquired added volume but the number of loans we subservice was only up by 4,000 loans to 277,000, and this wasn’t enough to maintain the overall level of the book.

Second, our ancillary revenues are being impacted with the moratorium on foreclosure being extended. This delay is not a surprise, but it did cost us $11.1m of EBIT. You can see these details on pages 11 and 12.

We originally thought the moratorium would be lifted in September. Then it got extended to December. Now, depending on the agency, the dates are likely to move again.

Foreclosure revenues have been deferred and the other incentive fees we can earn when a mortgagee avoids foreclosure by returning to a payment plan, have also been delayed. We do not expect these revenues to recover till FY22 where it will be a steady recovery.

So excluding the effects of margin income and the moratorium being extended, how did the business perform? The underlying story is better.

Servicing and related revenues are up over 8%.

Capital light UPB increased by over 3%. The pipeline of non-performing sub servicing work is excellent. We have a recognised expertise in "specialist servicing” and the amount of books being outsourced to specialists such as ourselves is shaping up nicely. It is just a matter of timing.

But clearly we took a couple of steps backwards in our return aspirations in this business.

Now putting that all together, overall we had a decent first half result, a little ahead of where we thought we would be in August.

This operating performance validates our strategy to build stronger, more efficient business with greater leverage to long term structural growth trends.

But this strength also provides us with flexibility. With $71m of free cash flow we are able to self-fund our organic growth plans and invest in technology. As the debt leverage ratio is inside the target range, it also allows us to maintain the interim dividend and look after our shareholders.
Slide 5 - FY21 Outlook

Let’s move to slide 5. This breaks out the guidance for the rest of the year. I already took you through the upgraded numbers and you can see them here along with some of our assumptions that we base that on. Let me call out some important sensitivities:

1) We expect MI of around $49m in 2H on average balances of around $16.4bn.
2) We do not expect material foreclosure recovery in 2H21 regardless of moratorium expiry dates.
3) We expect similar levels from our events based corporate actions.
4) We are seeing a recovery in employee share plan trading revenues and we recognise this in seasonality given the March to May Vesting season in Europe.
5) We expect ongoing growth in our fee-based revenues. Issuer Services have momentum, corporate trust is a consistent performer and we expect more client wins in our key businesses.

I hope this transparency helps.

Slide 6 – 2H21 Management EPS guidance bridge

On slide 6 we show more detail on how we are bridging to 2H guidance.

This should help answer the questions you may have;
Is this guidance for 2H ambitious? Is it achievable? Some of you may be sceptical if you are looking at the 38% growth in earnings 2H on 1H.

Remember the 30 cents per share for 2H is unchanged from our original guidance in August. It is 10% growth on the 2H PCP, which in itself had a couple of horror months.

So the upgrade for the year reflects the stronger first half only.

Working from left to right, we pragmatically expect a drop in margin income versus 1H. We also have the add back the $15m one-off costs we talked about earlier and we expect around 6 cents from operational earnings growth. This roughly breaks down 50/50 between revenue growth and cost savings. The revenue growth is coming from Issuer Services, Plans, Business Services and some recovery in US Mortgage Services.

And on that positive note, I will hand over to Nick to take you through the financials.

Nick Oldfield, Chief Financial Officer

Thank you, Stuart.

I will take you through our financial results, starting on slide 7.

Firstly, as Stuart has said, I will also make the distinction between operating revenues and margin income revenues.

Group Revenue ex MI was up 2.4%. Adjusting for M&A and the UKAR fixed fee, organic operating revenue growth was $27.7m or +2.8%. Increased contributions from Issuer Services and Bankruptcy underpin this rise.

Reflecting the fall in interest rates, total revenue for the group fell 3.2% over the prior corresponding period.

There’s more detail on revenue on Slides 21-23, including the new disclosure on Revenue excluding Margin Income across each business stream.

EBIT fell 28.4% to $190.3m.

The decline in EBIT is largely attributable to the $60.8m reduction in margin income, whilst amortisation expense, reflecting the larger MSR portfolio and the change in amortisation period, increased by $15.7m. Cost of sales also rose, due to a slight change in the sales mix.

Excluding margin income, EBIT fell 9.8%, by $14.7m to $135.2m.
Adjusting for those one-off costs of $15.2m, EBIT ex MI would have been slightly up.
The EBIT ex MI margin was down 180bps to 13.1% as a result of both the one-off costs and the
change in sales mix.

As anticipated, interest expense was lower, reflecting the lower rate environment.

Finally, our income tax expense was lower, at $45.1m v. $72.6m. ETR for the half was 27.7%, at the
bottom of our expected range and we expect it to be a bit higher in the second half. We continue to
anticipate full-year ETR in the 28-30% range.

The geographic profit mix and the timing of US BEAT are responsible for this difference. US profits
and taxable income are weighted more to the 2H driving higher tax expense and a higher 2H ETR.
We had a 1c benefit from the timing of BEAT in the first half and this will reverse in the second half,
with greater US profit contribution expected.

Management NPAT was down 25% to $117.8m and Management EPS was down, 24.8% to 21.8cps.

Statutory results are on slides 19 and 20. NPAT was $72.6m, with the difference attributable to the
amortisation of non-MSR intangible assets of $21.4m, acquisition related expenses of $4.7m and
$19.2m associated with our cost out programs, largely being the UK Mortgage Services restructuring.

**Slide 8 shows margin income compared to the last 10 half years.**
The margin income result was a little better than we had anticipated in the first half, at $55.5m at
actual rates.

This was driven by higher balances in the 2Q, particularly in Issuer Services where we have seen good
activity in Corporate Actions and in Corporate Trust. Exit balances at 31 December were $17.3bn but
they do tend to move around quite a bit during the year.

But as Stuart mentioned earlier, notwithstanding the higher balances, the achieved yield was
impacted. It was an all-time low in the first half at 0.63%. This reflects the impact of lower rates
globally and the current weak bank appetite for term funds.

In the 2H, we expect slightly lower margin income of around $49.5m as some of our existing higher
rate deposits roll off.

This effect should carry through to FY22, where we now expect margin income to be around $80m.
This reflects the unwind of some UK term deposits as the current DPS contract heads towards the last
year of its life. For FY22, we're applying the current yield curve and assuming balances in line with 2H
FY21.

There's more detail about balances on slides 64 - 68.

**Next, I’d like to talk about slide 14.**

On slide 14 we show the bridge in operating costs between 1H FY20 and 1H FY21. Importantly,
we've drawn out the reduction in underlying operating expense so you can see how the cost-out
programs are having an impact.

The net benefit realisation from these programs in the 1H of FY21 is $48.8m.

Let me take you through these savings:

$14.3m of these come from the finalisation of the asset migration program in UK Mortgage Services.
We are now live on one platform and the IT cost associated with the transition has come out.

The remaining $34.5m comes from our other cost-out programs, the largest of which is the
restructuring of our UK Mortgage Services business. This represented 58% of the savings.

Adjusting for some underlying inflation – for example, the first half last year did not fully reflect an
employee merit award – our adjusted operating cost base was $577.6m, a reduction of 6.3%.

So where did these savings go?

Well, first of all – there's a bit of M&A related expense. A full 6 months of Corporate Creations and
Verbatim. These add $5.5m of opex.
Then there’s the investment in growth. We’ve added capacity to meet the demand in Bankruptcy, Corporate Actions and Stakeholder Relationship Management. This added $13.8m of cost. And finally, there’s the one-off costs of $15.2m which we referenced earlier.

Total operating expense is detailed on slide 29 so you can see the usual breakdown there. I would highlight here the change in the cost of sales. This represents the two acquisitions together with the volume impact in Bankruptcy, Corporate Actions and Stakeholder Management. This has driven a slightly changed sales mix in the first half and as a result, margins are a little bit lower.

**On slide 15, we show the impact of all our cost-out initiatives.**

As you can see, we have increased our expected benefit realisation for the UK Mortgage Services cost-out program by around $14m. The total gross multi-year benefit from these programs is now estimated to be $250m.

**I’ll finish with some comments on our balance sheet and cash flow on slide 16.**

In the period, we generated $124.1m of net operating cash flow. This is down 50.4%. Operating profits were lower whilst tax payments were higher, reflecting the tax due on the interest rate derivatives unwound in the prior year.

Free cash flow was $71m.

Capex was down for the half at $8m due to lower IT related spend. We expect the 2H spend to be slightly higher.

Net cash flow is negative $46.3m, after spending $89m on dividends and around $65m on MSR. The MSR investment is split between $45.1m maintenance to offset amortisation and an additional $20.8m to grow the book and mitigate the impact of the accelerated run-off.

This investment was net of MSR sales receipts of $27.6m. In the second half, we expect net spend to be lower and total MSR investment for the full year to be below amortisation expense.

Net debt has increased a little compared to six months ago. Over the last 12 months, we have acquired Corporate Creations and Verbatim, paid two dividends and invested in the future of our business, both in terms of growth and cost out programs.

Our Net Debt to EBITDA ratio increased to 2.24x, at the top of our range. This was in line with expectations and reflects the lower earnings we have seen in the first half.

The average maturity of our drawn debt at 31st December was 3.3 years.

Looking ahead, we do expect the net debt to EBITDA ratio to sit more comfortably inside our target range at year-end, reflecting the expected improved second-half performance.

I’ll now hand back to Stuart.

**Stuart Irving - Chief Executive Officer and President**

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Thank you Nick.

And finally, onto conclusions.

A year into this “new normal” of macro volatility and uncertainty, where do we find ourselves?

In my view, the first half results are reassuring. Earnings are ahead of plan. We have growth in fee income and our cyclical businesses are kicking in. Our ongoing cost-out programs are delivering significant savings, you can see that in the numbers. We have invested in new products and technologies to expand our capability and enhance our customer service, and these investments are delivering returns. We have increased the size of our available revenue pools and laid the foundations for long-term growth. We have a pathway for US Mortgage Services recovery.

It is frustrating that the unprecedented drop in interest rates is clouding our performance. If we had delivered the same margin income as we did in 1H20, our management EPS for this half would have
been up. But let’s not get too distracted by that. Instead, we’ll keep our heads down and keep true to
the strategy to build stronger, more efficient businesses with more leverage to structural growth
trends and we look forward to reporting a better 2H.

Thank you all for your attendance and patience. I’ll now open the lines for questions.

**Post Q&A Remarks**

As always, I am always appreciative of your time and questions. We have covered a lot of ground and
I am glad we have had the opportunity to take you through the second half outlook in detail. We have
growth and we have been conservative in our assumptions around risk.

Looking forward to seeing many of you over the coming days.

Thanks again.