

EQUITY RESEARCH

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Flash Research

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DYE & DURHAM LTD.

FQ4 Results Stable; M&A Remains A Focus

Our Conclusion

DND reported encouraging FQ4 results despite concerns around a cooling housing market and the potential distraction of the lengthy, and ultimately unsuccessful, Link Group process. Lower transaction volumes in the quarter were successfully offset by price increases, minimum volume contracts and contribution from acquisitions. DND reiterated FY2023 guidance of an excess of \$350 million in adjusted EBITDA despite housing market weakness and the pending sale of TM Group. With the Link Group deal now terminated, management reiterated its growth-via-acquisition strategy and projected confidence in its deal pipeline, which includes opportunities for geographic and end-market diversification. DND is trading at 6.2x our FY23 adjusted EBITDA estimate, and we continue to believe shares could re-rate higher given the strong cash flows and the removal of the Link Group overhang.

Key Points

M&A Pipeline Outlined Following End Of Link Group Process: In the wake of the cancellation of the Link Group acquisition ([link](#)), management reiterated its growth-by-acquisition strategy. DND highlighted its track record in realizing acquisition synergies, reducing the aggregate acquisition multiple from 16.2x EBITDA at purchase to 6.7x post integration on \$1.7B in total capital deployed since IPO. DND sees opportunities both within and outside its existing geographies and, given the regulatory challenges it has faced, DND is evaluating professional and legal workflow markets beyond its core conveyancing market. Leverage finished the quarter at 3.5x on a net debt to LTM adjusted EBITDA basis, and 3.1x on a net debt to run-rate adjusted EBITDA basis, with management expressing a willingness to take leverage higher for the right opportunity. DND has ~\$500M in available liquidity to pursue M&A in the form of cash, revolver and delayed draw term loan.

Growing In The Midst Of A Slowing Market: Price increases instituted in January and minimum volume contracts (30% of Canadian customers now signed on to the new contracts) mitigated the impact of declining real estate transaction volumes, easing concerns around the impact of a weak housing market. FQ4 results showed there is ample downside protection built into the business, as both revenue and profitability held in.

EBITDA And Free Cash Flow: DND reported unadjusted EBITDA margins of 40%, below our 44% expectations given higher-than-expected M&A costs owing to the Link Group process, but in line with prior year levels. Full-year free cash flow margins of 34% were up 60 bps Y/Y and adjusted EBITDA to FCF conversion for F2022 was 58.4%, up 110 bps Y/Y.

No Update On TM Group Sale, FY23 Guidance Unchanged: Following the U.K. Competition and Markets Authority (CMA)'s order for DND to dispose TM Group, the company is still evaluating its options and expects to reach a conclusion in the near term. Guidance of \$350M+ in adjusted EBITDA was reiterated in spite of the pending sale, and we expect future M&A to contribute to meeting that target.

All figures in Canadian dollars unless otherwise stated.

Please see "Price Target Calculation and Key Risks to Price Target" information on page 2. For required regulatory disclosures please refer to "Important Disclosures" beginning on page 3.

Outperformer

DND-TSX, Sector: Information Technology

Current Price (9/26/22): C\$13.08

Price Target (12-18 mos.): C\$30.00

Financial Summary

FQ4 Results: DND reported Q4 revenue of \$129.7M, 2% below consensus and 4% below CIBCe (\$132.7M/\$135.3M, respectively). Adjusted EBITDA of \$75.2M matched consensus and was 4% above CIBCe (\$75.5M/\$72.4M).

Profitability: Q4 adjusted EBITDA margins of 58% were 100 bps above consensus and 450 bps above CIBCe (56.9%/53.5%). The company added back \$22.9M in adjustments to arrive at its adjusted EBITDA including acquisition and restructuring costs \$16.4M, and stock-based compensation of \$6.4M. Unadjusted EBITDA of \$52.3M (40.3% margin) missed our \$59.4M (43.9%) expectation, although the bulk of that difference was due to elevated transactions costs related to the Link Group scheme. We expect additional elevated M&A costs in FQ1/23 as a result of Link Group.

Cash Flows: Cash flow from operations was \$59M and the company invested \$5M in capex, intangibles, and lease payments, leading to free cash flow of \$54M. Adjusted EBITDA to free cash flow conversion was 72% in the quarter and 58% for FY22. Net debt totaled \$943M, inclusive of \$276M in convertible debt, with net debt to LTM adjusted EBITDA 3.5x.

Exhibit 1: DND – Financial Summary – FQ4/22

	Q4/F22						
	Actual	CIBCe	Cons.	Q4/F21	Y/Y%	Q3/F22	Q/Q%
Consolidated							
Revenue (\$MM)	129.7	135.3	132.7	84.4	54%	122.9	5.5%
Gross Profit (\$MM)	115.4	119.1	115.3	72.3	60%	108.7	6.2%
Gross Margin	89.0%	88.0%	86.9%	85.7%	4%	88.5%	0.6%
Unadjusted EBITDA (\$MM)	52.3	59.4	NA	36.7	43%	48.7	7.5%
Unadjusted EBITDA Margin	40.3%	43.9%	NA	43.5%	-7%	39.6%	1.9%
Adjusted EBITDA (\$MM)	75.2	72.4	75.5	49.1	53%	66.8	12.5%
Adjusted EBITDA Margin (%)	58.0%	53.5%	56.9%	58.2%	0%	54.4%	6.7%
Adjusted EPS	(0.05)	0.08	0.14	0.09	-151%	(0.10)	-50.5%
FCF (\$MM)	54.0	31.6	44.9	33.4	62%	45.9	17.6%
FCF As % Of Unadjusted EBITDA	103.2%	53.3%	NA	91.0%	13%	94.4%	9.3%
FCF As % Of Adjusted EBITDA	71.8%	43.7%	59.5%	67.9%	6%	68.8%	4.4%

Source: Company reports, FactSet and CIBC World Markets Inc.

Price Target Calculation

We derive our price target of \$30 by applying an 11x EV/EBITDA multiple to our F2023 EBITDA (ex-acquisition, integration & restructuring costs) estimate based on the current capital structure and sale of TM Group. The 11x multiple is in line with the peak trading multiple of comparable registry services providers. The 11x multiple is also a 20% discount to Canadian Consolidator peers as a result of DND's ties to the housing markets and risk to the consolidation strategy from competition authority reviews.

Key Risks To Price Target

The primary risks to our price target include the following: 1) competition and regulatory reviews impact the ability to acquire; 2) regulatory reviews and negative media coverage limit the ability to increase prices on e-conveyancing and transactional services; 3) slowdowns in housing market sales impact transactional revenues, putting organic growth at risk; 4) risks around integration of M&A given the pace of acquisition; and 5) governance concerns in the wake of the stock option grant post the take-private process.

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Note: Broader market averages refer to S&P 500 in the U.S. and S&P/TSX Composite in Canada.

CIBC World Markets Inc. Price Chart

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