

INTELLIGENT SYSTEMS CORPORATION

Moderator: Strange, Leland

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Operator Ladies and gentlemen, thank you for standing by and welcome to the Earnings Release and Investor's Conference Call. At this time, all participants are in a listen only mode. After the speaker's presentation, there'll be a question and answer session. To ask a question during this session, you'll need to press star and then one on your telephone. Please be advised that today's conference is being recorded. If you require any further assistance, please press star zero.

I would now like to hand the conference over to the speaker today, Matt White, Chief Financial Officer. Please go ahead, Sir.

Matt White Thank you. Good morning, everyone. As Leland noted in our press release this morning, our revenue and profitability results met our expectations, as our platform continues to be validated by leading corporations. Revenue for the third quarter 2019 was \$9,522 million compared to revenue for the third quarter of 2018 of \$5,415 million, an increase of 76%. The components of our revenue for the third quarter consisted of license revenue at \$2,225 million, professional services revenue of \$4.579 million, processing and maintenance revenue of \$2,235 million and third-party revenue for \$483,000.

I'd now like to talk to the important components of our revenue. As we've mentioned in previous statements, our license revenue will vary from quarter-to-quarter. The third quarter increase in license revenue was driven

by the retail launch of a new product related to our largest customer. As a reminder, we receive license revenue primarily when our customers achieve new active account tiers. Once a customer achieves a new tier level, they receive a perpetual license up to that number of accounts. Inactive accounts do not count towards the licensed here.

In addition, we charge annual maintenance to our licensed customers, which is reflected in our processing and maintenance revenue line. Maintenance revenue increases when customers reach new license tiers. The contract with our largest licensed customer includes a maximum tier level, which because of the significant number of accounts allows them to utilize the software for any number of active accounts once the maximum tier level is achieved. We would expect it to be several years, if ever, before they hit the maximum tier level. This large customer currently uses the software for a single institution. Additional license fees apply if multiple institutions are added.

Looking further into the revenue detail provided; professional services revenue continues to comprise a significant portion of our overall revenue for the third quarter at the 9-month period of 2019. However, as we previously stated, we expect that to decrease as a percentage of total revenue over time, as our customers utilize the new features, we've developed to add active accounts to their system, which is ultimately reflected in our license revenue and processing and maintenance revenue lines.

Additionally, we continuously create new functionality for our customers. And as such, we charge annual maintenance fees for our professional services, which is also reflected in our processing and maintenance line. As a reminder, we do not perform any professional services for third parties that are not licensed or processing customers. And lastly, for revenue, our third-party revenue generally has a very low margin and constitutes services we provide on behalf of our customers, which we charge at or slightly above cost. We recognize this revenue growth for accounting purposes.

And now I'll turn to some other highlights of our income statement. We reported significantly higher income from operations of \$4,200 million for Q3 2019 compared to \$1,736 million for Q3 2018. This resulted in operating margin of 44% for Q3 2019 compared to 32% for Q3 2018 and

35% for Q2 2019. The year-over-year improvement was driven by our license revenue, contributing significantly more to total revenue. We achieved a sequential increase in margin for the third quarter of 2019 compared to both the first and second quarters of 2019. This improvement again was driven by higher license revenue, partially offset by higher general and administrative expenses related to legal and hiring costs, and also higher research and development expenses, related to accrued employee bonuses.

Our year-to-date 2019 tax rate was 24.7% compared to 4.6% in the comparable 2018 period, due to the utilization of net operating loss carried forwards since 2018. And finally, earnings per diluted share for the quarter was \$0.34 compared to \$0.21 for Q3 2018.

And with that I'll turn it to Leland.

Leland Strange Okay thanks, Matt. Matt talked about the actual financial numbers, but I'll be adding commentary. And everything I say, and anything Matt just said that was not an actual financial reporting fact should be considered in process as what is commonly known as a forward-looking statement. We're saying what we think and believe as we sit here today, and you should process all of it as just that. It's what we think and believe and not a promise or prediction.

I wish we didn't have to format every conversation this way but given our litigious society and our recent experience with the legal system, it's a required warning and caveat.

I guess staying on the subject of litigation or legal matters, there's actually nothing material to report. I will note, regarding the claims from the shorts, that a lead plaintiff has been affirmed by the federal judge and a hearing has been scheduled later in November. The independent INS Directors have also asked the firm to provide them an independent report on the claims and that is in process. Earlier I thought these issues would be resolved this year, but now counsel has advised it will probably linger on into the next year. As I stated on an earlier call, we believe there is no substance to any of the claims.

I'll be glad when I can report this litigation is behind us, but it is not today, and it does have cost to both dollars and management time. We do not

expect to pay anything out to the claimants. Counsel has advised against being more specific about costs, but they are not large. I'll even guess them to be under \$500,000 as for unreimbursed by insurance to the company. On the other hand, our insurance costs have gone up both as a result of these actions and the higher revenues and valuation of the company.

Now to what really counts: results from operations. The quarter pretty much played out as we expected. The license revenue was always going to be difficult to project and it came in towards the middle of the road, although I surmise some expected a much larger number. I earlier said, there could be what I characterize as pops in licensing revenue. Was this a pop in my vernacular? No. I will reiterate it was middle of the road from our perspective and resulted from one of the most successful launches of a new credit card product ever.

Our clients and partners in this particular endeavor are very happy with the results, although there were and still are plenty of bumps in the road. Talking a little bit more about that, every day we have more cards on our system than we had the day before. That means we can expect to see new problems continually pop-up that need to be resolved. This is not new for us and is exactly what has happened for the last many years. We certainly do not think we're ready to immediately process 10 or 20 million accounts with the system exactly as it is today, but we are confident that we see a path to get there, and every day we move further down that path.

There will not be an "Aha!" moment when it is, quote, "Done." It's a continuous, evolving process, that's best undertaken with close cooperation between our exceptional CoreCard team, and the expertise and experience of our clients and partners. We are laser focused today on building a solid infrastructure to enable CoreCard to eventually take on the very largest clients that the giants in the industry currently serve. That includes parallel development to eventually have a Linux offering.

One of our advantages is our ability to add new functionality rapidly. And that word rapidly needs to be taken contextually within how it's understood in the industry. Owning the functionality is just the beginning of the process, as different functionality places different stresses on the operating infrastructure components such as database hits or CPU utilization.

It also often requires substantial rewriting of reports. I bring this up just to emphasize what I've stated before: this is a very, very complex software undertaking, which is why there have been a very few new entrants in the open loop credit card space in the past 20 years. I should add here, however, that I do expect new competition. Many of the prepaid card processors are spending large sums to get into the credit game. They will definitely eventually get there, but their early customers can expect some really, really rugged periods as they find it is a magnitude - perhaps times 10 - more difficult than prepaid. What you don't know, you don't know.

If I had any surprise for the quarter, it'd be the amount of professional services we delivered. It was higher than I expected, and I would not expect a number this high the next few quarters, although the numbers will still be very solid and very good. It's too early to have any better visibility or good handle on 2020, as most of our current clients are now focusing on getting through this holiday shopping season.

We are hiring new employees at rapid clip, both internationally and in Atlanta. I probably would not have expected the current growth projections for new employees in Atlanta, but it's currently needed to provide the needed expertise for our current and projected business needs. We expect at least 30 new hires for the second half of 2019, but we will also experience normal attrition in our India offices. This growth in resources should speak to our belief as to the stability of our professional services.

Our base underlying business, both processing and licensed customer revenue sources, continues to grow. I just want to make the point that we continue to grow our current base of business from existing customers. We're not just relying on new opportunities to provide growth. There are new opportunities that will also add to our revenues next year, although I'm uncomfortable trying to project how quickly they will come online.

I know investors always want us to talk pipeline. It's not easy in our present situation to explicitly frame opportunities that way. We think strategically for longer term contribution as to what new business we bring on. And we do it day by day depending on what we see. To help you understand that, we have inbound requests for discussions about providing our processing services every single week. Now, we don't see large opportunities weekly, they may just come in every month or so, and when we decide to pursue one of these it may be three to nine months before they contribute

meaningfully to revenue. These have to be embedded against what current customers want to do to expand their business, and in most situations, we'll choose to develop more resources to current customers.

The reason investors want us to talk about pipeline is that they could be used as a proxy for future results. We don't give what is generally called guidance, but we do try to give a general sense of what we believe will happen for the next few quarters. Our current belief is that fourth quarter would not be as strong but still good as the third quarter for professional services revenues and that license revenue is likely to be similar to the third quarter. Certainly, the fourth quarter this year will be better than the fourth quarter of the 2018 year. For 2020, we see continued growth, but not at the pace we had for the full year 2019 over 2018. But we do expect to grow and see the 2020 year as the one to catch our breath, while hardening our infrastructure to line up for higher growth in the future years.

That pretty well sums up both the third quarter, and how we see the future. I think we'll spend most the rest of our time talking about questions. And operator; you can take questions, and we also have some that were faxed in that I will deal with.

Operator As a reminder, to ask a question you'll need to press star and then one on your telephone. to withdraw your question, please press the pound or hash key. Please stand by we compile the Q&A roster.

Leland Strange Okay. While she's compiling Q&A, I'm taking a list of questions that some of you have faxed in. And I'm going to take what I consider the funniest one first. So, please, as I read this and answer this - everyone in this room has got a smile on their face as I do - so here's what it says. I'll skip the first part; it says something about "I don't want you to retire but you could do whatever you want. You don't need this job. In 2009" - hey, everybody understand, so this investor went all the way back to 2009 to read what I said, that's somewhat scary - but he said, "-in 2009 you mentioned that you were too old to be talking about 10 years. Now we are in 2019, how long would you be happy to be the CEO of Intelligent Systems?"

I actually vaguely remember somebody asking me a question a long time ago, saying "What do you see out in 10 years," and I'm sure I said, "I'm not even going to look out there because that will be somebody else doing it." And lo and behold, I'm still doing it. So, I'm not going to answer how long.

I guess as long as it's fun and as long as we're making progress, but I thought that was a real interesting situation that someone went all the way back to there.

Operator, do you have any questions? Otherwise I will take some others that I have here that were emailed in.

Operator Your first question comes from the line of Ishfaque Farouq from Sidoti & Company. Your line is open.

Ishfaque Faruk Hi, good morning Leland and Matt. Just a few questions from me - and congrats on the really strong results across the board. Your license revenue really surprised to the upside. And it's just not me as I think a lot of people feel that your license revenue was higher than many anticipated. Leland, you briefly touched on that. You expect Q4 license revenues to be similar to Q3, but going forward - when you look out into 2020 and 2021 - do you feel as good about license revenues being at these "new normals" from prior quarters?

Leland Strange Well, I've always said it's going to be lumpy. And going out further, I don't expect every quarter to be similar to this quarter or what I said would be fourth quarter. I don't know whether the first quarter will have much license revenue in it or not. I'm not saying it won't; I just don't know.

And remember, license revenue depends on how well other people do, not what we do. And they don't know either how well they'll do, so, it's just really hard to project that. We will continue to have - I will suspect - significant license revenue in 2020. I just don't know how it will break out quarter-by-quarter.

Ishfaque Faruk Okay, and as a follow-up to that and -- can you give us a sense for what percentage or what chunk of the license revenue in Q3 was from this major new customer? And if you had any new ones?

Leland Strange No, I really can't. That would be disclosing more than we're allowed to disclose from a customer perspective. Sorry, I can't do that. I may can say that most of it came from there, how about that?

Ishfaque Faruk Yep yep. That works for me. Okay, in terms of professional services, Matt told me previously that professional services was expected to sort of taper off in Q3, but it was much higher than I expected. Matt or Leland, can you give me a sense of what happened during Q3 and do you expect that to sort of roll into Q4?

Leland Strange Well, I think it's a good example of how it's so hard to predict. Here we are already in Q4 and I can't tell you whether they'll be the same or more. I could tell you I expect them to be less...

Matt White They were actually less for Q3 if you look at it compared to Q2...but it was a pretty minimal decline.

Leland Strange it's really hard for two reasons. One is we don't know exactly what the current demand would be, and second there is the issue of GAAP accounting. You finish a project and then you can put \$300,000 in that quarter or you don't finish that project and it goes into the next quarter. Well, that's the two reasons, it's really is very difficult.

I think what should be important to advisors is the sense of how solid it is or is it going to vaporize? And I think what we're telling you - we expect and we believe that it's going to stay pretty solid.

Now, our bet is that's probably middle of the line for the next year, meaning it could go up or it could go down. We won't be surprised to see it deviate from the line some, in fact, I don't want to project any closer than that but it's going to - its solid; it's recurring in every sense of the word - repeating in every sense of the world is a better way to say it.

Ishfaque Faruk Okay, and since we are talking about recurring. When I look at your recurring revenues, it's around low 20% 23% or so I believe. But when I look at like you know large established processing companies, let's say for example, FIS; their recurring revenue base is around like 82% or so. When you look out in the long-term, what's your take? What's the recurring revenue can grow up to in the future for INS?

Leland Strange I would say when I get as big as FIS; mine would be 82% also. We're too small for those percentages to be used as any kind of an indicator this point in time. We're just too small and the revenue components are different from

FIS. So, I could come up with those kind of numbers and play games with it, but I just have resisted doing that because it really is not relevant.

Ishfaque Faruk Yep, got it. Okay. And Leland and Matt, we talked about this before. Can you give me a sense for your new...you mentioned in your prepared remarks that you're seeing more interest from processing clients than licensing customers. Can you tell me in Q3 – we're already in Q4 - what has been the recent conversations with clients on the processing and the licensing side, and how many? That would be great, too.

Leland Strange I really can't answer that with that kind of specificity. I really can't. We constantly have conversations and I'm not going to name numbers or talk about conversations. Sorry about that; can't do that.

Ishfaque Faruk Okay. Can you give me some sort of color in terms of other than most of your customers being processing clients?

Leland Strange Well, not really. You have to look at...you're talking about the size of the client, or you're talking about the size of the revenue - I mean there's so many ways to look at that. I don't think I can say anything meaningful. Sorry, I just don't think I can answer that.

Ishfaque Faruk Okay, okay. And in terms of other large, major financial institutions, do you have like any inbound in terms of similar big sized clients?

Leland Strange Again, I'm not going to comment on that. And let me just say - I appreciate your questions, but let's give some other people a chance to ask some questions too. And if you like to call us afterwards, we can answer whatever we can. I appreciate your questions, they're good questions. They're just certain things you know that we can't answer. But thanks.

Operator Your next question comes from the line of Kelvin Seetoh from 10X Capital; your line is open.

Kelvin Seetoh Hi, good morning Leland. Yeah, I hope that you can extend the call because some of us couldn't even get our questions across. I really like the example, whereby, you demonstrated the Base Pro Shops example. So I'm just thinking about this right, given the level of flexibility of the software and having a real possibility of being adopted by a larger customer, can

you share may be some general feedback from existing customers or stories that highlight the power of your platform or how has CoreCard been able to help them in their businesses?

Leland Strange I think you may have e-mailed that question. It's just not an easy question to answer. It's -- in order to get a licensed customer, it takes months of talking about the platform and looking at bunch of things. So there's not any elevator pitch or elevator answer that I can give you just like they don't accept an elevator pitch. It's the whole bundle that makes it work. It's not a single, 1 2 3 here's the top three and here's why people choose it. This is very complex and it's a whole bundle of things that cause people to choose it. So again I can't give you highlights, I can't give you a headline that makes it work.

Kelvin Seetoh All right thank you.

Operator Your next question comes from the line of Sam Rebotsky from SER Asset Management. Your line is open.

Sam Rebotsky Yes, good morning, Leland and Matt. Keep having fun, and it was nice to meet you in person after all these years. And as far as the licensing revenue, do we need more people to take on more clients? And the licensing revenue that we have, is there - will that produce processing? Is it producing processing yet? And is it, sort of - will it make the processing significantly a greater amount?

Leland Strange Yeah, couple things. Licensing does not produce processing. I mean, licensing is strictly some other - our customer doing their own processing. So it doesn't produce any processing license for us. It does produce maintenance and support, so is there a recurring revenue from the license.

As to your question about do we need many people to take new clients? The answer is yes. I think most companies that grow had to have add new employees in order to grow. We have to add new employees to grow and we are adding new employees. It of course did take some time for training to make that happen, but we're doing that. So yes we are adding new employees in order to be able to grow.

Sam Rebotsky And then are investment the \$3,300 million investment that we have 40%; could you talk a little bit more about that? Where they're going? Are they

growing? I think it's an Indian company I think you had mentioned. Any color on that and how they are doing? And are you pleased with their growth at this point?

Leland Strange It's not an Indian company. It's a domestic company. And it's a different kind of company. So it's hard to answer that. We'll probably talk more about that next year as they kind of get more visibility. It's a company that does conferencing and has expertise in identity that applies to the card world. And it's not something that has to do with our processing, but we think it's a nice company and we hope to get a good return from the investment. But it is not as closely aligned to what we do as we thought it might be when we made the first connection. I will just say that upfront, but we think it's a good situation. It's not something we spend any time with whatsoever, but we expect to get a decent return from it. Not some 10x like we got with a couple others, but we hope to make money on it.

Sam Rebotsky Everything seems great, Leland. Keep up the good work and have fun.

Operator There are no further questions at this time. Leland, I turn the call back over to you.

Leland Strange All right. Well, we thank everyone for joining the call today. As usual I end it by saying that if you have other questions that we will be able to answer - knowing that we can never answer everything you want us to answer - please give us a call. We are available. We look forward to connecting again on our next call. Thanks everybody for joining us.

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