

## CORPORATE PARTICIPANTS

**James Leland Strange** Intelligent Systems Corporation - Chairman, CEO & President

**Matthew A. White** Intelligent Systems Corporation - CFO & Corporate Secretary

## CONFERENCE CALL PARTICIPANTS

**Anja Marie Theresa Soderstrom** Sidoti & Company, LLC - Senior Equity Research Analyst

**Mark Anthony Palmer** BTIG, LLC, Research Division - MD & Financials Analyst

## PRESENTATION

### Operator

Greetings, and welcome to the Intelligent Systems Corporation First Quarter 2021 Earnings Conference Call. (Operator Instructions) Please note, this conference is being recorded.

I will now turn the conference over to our host, Leland Strange, Chairman and CEO. Please go ahead, sir.

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Thank you. Good morning, and thank you, everyone, for joining us today. As you probably know, this morning, we announced earnings for our first quarter 2021 and filed our 10-Q. I'm going to turn the call over to Matt White, Intelligent Systems' Chief Financial Officer, in just a minute, who will discuss the quarterly results as well as expectations and some things that are currently impacting our operations.

I will say upfront, not much has changed and not a lot to add, except for the COVID impact compared to the last call. So it may be a short call. Also though, I want to remind you that we will take questions upon the conclusion of our remarks. Probably one of the best ways to do that, though, is to e-mail us during the conversation any questions you have to questions@intelsys.com. Matt and I are both in the conference room, and we are monitoring that. That's probably the best way. We may not answer them all specifically, as I do try to weave the information you may be asking in the context of other comments.

With that, I'll turn the call over to Matt to discuss the first quarter.

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**Matthew A. White** - Intelligent Systems Corporation - CFO & Corporate Secretary

Thanks, Leland, and good morning, everyone. Before I start, I'd like to remind everyone that during the call, we'll be making certain forward-looking statements to help you understand Intelligent Systems and its business environment. These statements involve a number of risk factors, uncertainties and other factors that could cause actual results to differ materially from our expectations. Factors that may affect future operations are included in filings with the SEC, including our 2020 Form 10-K and subsequent filings.

As we noted in our press releases, our first quarter results were in line with our expectations. Our professional services revenue remained strong, and we saw quarter-over-quarter and year-over-year growth in processing and maintenance. Revenue for the first quarter of 2021 was \$8.9 million, a 13% increase compared to the first quarter of 2020. The components of our revenue for the first quarter consisted of professional services revenue of \$5.7 million, processing and maintenance revenue of \$2.6 million and third-party revenue of \$558,000. As we expected, we did not receive any license revenue in the first quarter. However, as a reminder, we do expect to recognize license revenue in both the second quarter and second half of 2021. While we recognized some revenue in the first quarter of 2021 from new government stimulus programs, the impact was minimal and will not likely have a material impact on our annual results. Similarly, we have started processing loans for American Express, but minimal revenue was recognized in the first quarter and it's still too early for us to determine the degree that this new customer will impact 2021 revenues.

We do expect continued growth in our processing and maintenance revenues from a combination of recently added customers who are now live and continued growth from existing customers. We went live with the Al Ansari Exchange in the second quarter of 2021, an exciting beginning for our Dubai office and our global prepaid processing platform that will drive future growth in our processing revenues starting in the second quarter. Our platform provides complex functionality of a multicurrency wallet with 17 different currencies in one wallet.

Turning to license revenue. We did not receive any license revenue, as I mentioned, in the first quarter, and that was in line with expectations. However, we do expect to achieve a new license tier in the second quarter, and we continue to expect significant license revenue in the second half. Professional services revenue was strong in the first quarter as expected, and we anticipate similar professional services revenue in the second quarter, likely in the range of \$5.5 million to \$5.7 million. However, we could be impacted by the recent increase in severity of the COVID-19 pandemic in India, which we will discuss more later.

Turning to some additional highlights on our income statement for the first quarter of 2021. Income from operations was \$1.465 million for the first quarter of 2021 compared to income from operations of \$2.379 million for the same time last year.

Our operating margin for the first quarter of 2021 was 16% compared to an operating margin of 30% for the same time last year. The year-over-year decline in operating margin was primarily driven by previously announced infrastructure investments in our processing environment, our new office openings in Dubai and Chennai, both of which are a critical part of our long-term growth strategy. Additionally, we are building a new platform that is resulting in higher research and development costs. That development is currently in the early stages, and therefore, that's classified as expense. Future stages will result in capital expenditures and depreciation once the platform is live and in production. The investments we've made will enable us to take on additional processing customers in 2021 and future years.

Our Q1 2021 tax rate was 26.1% compared to 28.5% in Q1 2020. The 2020 tax rate was higher due to a valuation allowance on tax benefits from Q1 2020 investment losses. We expect our ongoing tax rate to be between 23% and 25%.

Earnings per diluted share for the quarter was \$0.12 compared to \$0.12 for Q1 2020. As we noted in our press release, we repurchased \$2.7 million of our shares while maintaining significant cash reserves to continue to invest in our future. In April 2021, as announced this morning, the Board approved an additional \$10 million authorization for future share repurchases.

Before I turn the call back to Leland, I'd like to give a brief update on the effects we are seeing during COVID-19. Overall, we experienced a relatively muted impact on our business stemming from the COVID-19-related economic slowdown in the fiscal year 2020 and so far in 2021. The most significant impact has been on our employees in India that have been working remotely for more than a year now. Our employees have gone above and beyond to be able to maintain key functions and business continuity in addition to delivering excellent service to our customers as reflected in our strong professional services revenue. However, we haven't been able to hire and train at the pace we expected before the pandemic, which could impact growth in 2021 professional services revenue. Additionally, the recent increase in severity of the pandemic in India could impact future operations and professional services revenue. We appreciate everything our employees there have done and continue to do throughout such a difficult period.

We remain incredibly optimistic about our long-term prospects and believe the investments we made last year and into this year will yield new customer wins and revenue growth in the future. As mentioned in this morning's press release, we expect top line growth of 20% to 25% for 2021 as compared to 2020, a tighter and slightly more positive range from our previous estimate of 15% to 25%.

And with that, I will turn it back to Leland.

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Okay. Thanks, Matt. It's kind of ironic that many companies now are sort of on the tail end of the COVID experience that are talking about coming back and looking to a full reopening, and Matt talked about our issues with COVID. We're -- we kind of went through the last year without any great impact on it in terms of our operations, and now we're seeing some impact. I would say that COVID in our India operation today is our main concern. We're concerned about the employees and their families and the daily impact either directly or emotionally even as they wonder if they're next.

We're doing everything we can, but so are all the other companies. So competition for private doctors and vaccines is a difficult one at this point. I think the latest report we have from our offices in India is that about 10% of our employees are affected, and there have been some who've had it and who have already recovered.

How does that impact our business? Well, first, we obviously have to align our resources to maintain current revenues. That simply means we're going to first focus on continuing to support our largest customers. And by that, I mean, largest in revenue. And when resources are tight, then those customers get the priority. When we spread fewer resources across all our needs, future business and smaller customers have to divide those resources that are left after we maintain support for the largest customers. We do believe that we can handle that and don't see any deterioration in any of the support and the revenues that come from them -- from our largest customers.

Think you heard Matt say that we expect additional license revenue this quarter and also substantial additional license revenue in the second half of the year. That's highly likely to happen because of what I just said. We'll maintain constant support for our key customers who will provide your company the revenues. But again, emphasizing what Matt said, we can't dismiss the impact of COVID on our earlier plans for getting a workforce

up and trained to accelerate our growth. I wish I could quantify the impact, but since I cannot project the time line for getting COVID under control, I simply cannot, at this point, do any better in terms of projections.

We do continue to add to our team in the U.S., but most of that increase and expense is going to what we call the Tesla project, and that's the complete reengineering of our processing software using the latest technologies. It's a costly and multiyear project, but we believe it has a big future payoff. And we'll talk about more about that later as it develops, but just wanted to make you where we are adding a good number of resources there and expense.

As far as new business, you probably read about the opening of our Dubai offices, and Matt commented on that. We're going to be adding new customers there later this year. We are running a complete separate instance of our software on Azure, which is the Microsoft Cloud, to support the multicurrency offering there. Also in the U.S., we have several new customers coming on with innovative credit programs, including one with crypto rewards. These are not big banks. They are new programs that will take time to develop.

So that's pretty much the highlights of the business before we get to some of the questions. I do want to mention, however, the lawsuit that was filed -- the Class Action Lawsuit that was filed has been dismissed by the judge. We are waiting on the rest of the opinion, but it has dismissed.

As we've talked about a couple of years ago when filed, it had no substance. We had hoped they would simply dismiss it, but there's always a question when you get in the court system what will happen, but we're happy to report it was dismissed. Let me go to some of the questions. I think one of them that I like is, you said that one of CoreCard's significant selling points is its flexibility and credit processing capability. So it's a bit surprising that Al Ansari Exchange decided to use CoreCard for prepaid. Can you help me understand that dynamic? What differentiates CoreCard on the prepaid side?

Well, I've talked often about the complexity of credit, and I do that because that is really one of the things that we do that very few other folks do, other than the big processors. There are a lot of prepaid processors out there. I don't know how to quantify that, but 50, maybe 100. The number is not important. It's not thousands, but there are a lot more prepaid processors than credit processors. So we tend to emphasize the credit. But we have a very strong prepaid offering. We have a good number of customers on our prepaid platform, and we have a particularly strong multicurrency offering. So that's what would attract folks who are particularly issuing travel prepaid cards, where folks are going to different countries and need a different currency.

So again, I know that I often talk about just credit, complex credit. But truth is we have a very strong prepaid program, along with some good prepaid customers. I think one of our customers is providing -- maybe I shouldn't say all the names, but they're providing a prepaid card for one of the large pharmacy benefit providers. So we are very active in that.

We did get a question through our questions@intelsys.com that's a technical question. And since we're in the office today, Matt and myself, I also have Eswaraprasad Dontu, he is our CTO, with us. I'm going to ask that question, and I'm going to ask Dontu to explain it for those of you that like the technical side have fun. So Dontu, the question is, could you explain the importance of tokenization for your clients? And is it offered by other providers?

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#### **Eswaraprasad Dontu** - CoreCard Software - CTO

Yes, Leland, thank you. I'll try maybe a minute. So why tokenization? As you all know, cards are getting digitized every day. So cards are being provisioned and added to the digital wallets. As that market segment increases, the usage of the digital side of the cards will increase. So that's why the -- our clients want to add these cards to their wallet, mobile wallets and ultimately, to the Apple Pay, Google Pay and Samsung Pay and other pays. So that's what we call tokenization. So as you can see, the market share has increased. And that's a strong offering we have. There are 2 ways of doing tokenization. One is manual, like you present your card to the wallet and then you let it scan. And that's the manual side. A lot of people do it. We do it. Everybody does it. Meaning any card that's allowed to tokenize can be done that way.

But what we do now on top of that is the automation part of it, which is a sequence of APIs that can be originated from our clients' mobile app, where the consumer, as a cardholder, all they have to do is, yes, I want to tokenize my card. They push a button they don't need to have the card number. They don't need to have the actual card with them. But this button initiates -- the sequence of automations goes through the mobile app to the clients -- the gateway and then the client will actually call us through an API. We do all the cryptography for the card information that's necessary to be tokenized. And then from there, we send the cryptography back to the client, the client mobile app, mobile app to the wallet like Apple Pay wallet and then Apple Pay talks to Mastercard, other providers and blah, blah, blah. So there's that whole sequence, I don't want to take up so much time, but this is all automated using the provision we were talking about earlier. That is definitely whether the other people are doing it, yes, some competitors are doing it, but we are proud of our solution, and we believe we are the first to the market to do that automation. Other people came to the market, too, but we were first.

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

So it has to do with cryptography and security for digital cards. And obviously, the future is in digitalization. You will find that more and more cards will come out even without a number on the card and more will be in the wallets. So it's part of our wallet offer. So thank you, Dontu.

Operator, I think I'll open it now to see if we have any callers that want to ask a question. We have a few others in writing, but there -- I think we've covered most of it.

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## QUESTIONS AND ANSWERS

### Operator

(Operator Instructions) Our first question comes from Mark Palmer with BTIG.

**Mark Anthony Palmer** - BTIG, LLC, Research Division - MD & Financials Analyst

Yes. I guess first question is, you've bumped up the lower end of your revenue growth guidance for 2021. Just wanted to get some color on what gave you confidence to do that in terms of your outlook?

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Well, typically, as we get closer to each quarter, we see how new cards are coming along, what the growth rate is for our customers. So we're able to project that a little tighter. We also have a little bit of history in terms of -- and history, I mean, the previous quarter, history in terms of professional services. So between those 2 things, that gives us a little better insight for the next quarter or 2.

Matt, do you have anything to add to that?

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**Matthew A. White** - Intelligent Systems Corporation - CFO & Corporate Secretary

No, I think it's just the strength of the first quarter enabled us to bring up the bottom end of the range and to tighten that a little bit.

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**Mark Anthony Palmer** - BTIG, LLC, Research Division - MD & Financials Analyst

Okay. And if you could give some color on what you're seeing right now in the processing pipeline, in particular, especially as we are seeing the uncertainty associated with COVID relieved at least in the United States? Are you seeing a pickup in pipeline as a result? If you could just give some color on that in general.

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Well, in terms of new prospects, we're seeing it pretty much medium. I think you still see the larger folks are hesitant to think about making moves and making changes. So that's still very early. There's no real pipeline to consider there. In terms of newer entrants, it's fairly strong. They're coming out with something new, so they don't have to worry about messing up something that they already have. As far as growth, yes, with -- as COVID is coming to -- as it's slowing down in the U.S. at least, we're seeing the card growth increase. So it's a mixed bag right now, and it's still early. I'm going to say it's in between everything to come up with any real good projections on what we see.

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### Operator

(Operator Instructions) Our next question comes from Anja Soderstrom with Sidoti.

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**Anja Marie Theresa Soderstrom** - Sidoti & Company, LLC - Senior Equity Research Analyst

I wanted to have a better understanding of this partnership, I'm sorry, in Dubai with the former Wirecard customer. Is that unique? Is that -- is there more opportunities for partnerships there? Or is that wide-spread already those kinds of partnerships?

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**Matthew A. White** - Intelligent Systems Corporation - CFO & Corporate Secretary

We think it's -- we think there's more opportunities. A lot of it depends on the pace of travel globally. So as that picks up, more customers will be interested in a similar offering. We had some discussions this morning with a potential customer that wanted a multicurrency offering unrelated

to travel. So we're getting some traction there, but it will probably take some more time before travel picks up and people are more -- customers are more interested in that type of offering.

**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

But I would say that we wouldn't have made the investment there if we had not thought there was substantial opportunity there. It just will not happen this year. It will be in future years, but we think there's substantial opportunity in that market.

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**Anja Marie Theresa Soderstrom** - Sidoti & Company, LLC - Senior Equity Research Analyst

And that would be driven by the (inaudible) opening up again or?

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Right. Opening up the Dubai office, taking on a couple of the -- first, Al Ansari was a former Wirecard customer. And there are other former Wirecard customers that we're talking to at this point. Again, because travel is muted, there's no real hurry on their part to immediately do something. But as travel continues to open up, we think we'll get more customers, and we'll get more general purpose prepaid customers there, and we'll be looking for credit customers over time in the Middle East. So we think it will be a strong offering over time.

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**Anja Marie Theresa Soderstrom** - Sidoti & Company, LLC - Senior Equity Research Analyst

Okay. And then in terms of the professional services, you said that what's going on in India that might get muted in coming quarters. Can you just expand a little bit on that?

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**Matthew A. White** - Intelligent Systems Corporation - CFO & Corporate Secretary

Yes, we can expand a little bit. It's hard to quantify at this point. It's a very fluid situation. As Leland mentioned, about 10% of our employees are impacted or have been impacted. As he said, some have recovered. So it's just hard to tell what that impact would be, given the fluidity of the situation there. There's some optimism that things are improving, but I don't -- we're not there yet to be able to say with certainty what the impact will be in the future quarters.

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Yes. We find it's not helpful for us even inside to try to project that. What we want to do is to mitigate any issues to make sure we take care of the customers. And then once we see it, kind of the trend line moving the other way, then we'll be able to project where we're going with it.

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**Anja Marie Theresa Soderstrom** - Sidoti & Company, LLC - Senior Equity Research Analyst

Okay. But do you think it might be more impactful in 2022 since you are maintaining your guidance for this year?

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Absolutely. Yes, yes. We believe that we'll be able to get through 2021 with our plan. But it will -- well, stay with our plan. That's with the current customers we have. It will impact potential new business because, because as I've said before, new business, they ask you, what kind of support do you have? What can we expect? And in some cases, they want not only numbers but names, very specifically who's going to support us. So at this point, we are not in a good position to offer that. So that does have some impact in 2022. We hope it's minimal. I'm just not going to talk about until we see daylight with that.

We have another question that came in on our questions@intelsys.com, and I'm going to let Matt read it and try to answer that one.

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**Matthew A. White** - Intelligent Systems Corporation - CFO & Corporate Secretary

Sure. We got a question about the increase in R&D, and I talked about that being due to the technology platform that we're building in addition to the new people we've hired in India year-over-year. And as far as the move from expense to capitalization on the new platform, the timing of that is just dependent on when we hit the develop phase. So we're still in the early stages of working on that platform, and we'll follow the accounting rules that we're very specific about when you can capitalize and when you expense. So it will be later this year that we start to see more CapEx.

We expect to continue to increase our R&D spending in anticipation of future growth. The hiring in India will impact that. The hiring for our platform development will impact that. So, we don't know exactly what the run rate will be, but we think it will continue to increase and be impacted in the short term by the capitalization of some of those costs, but that will eventually come through as depreciation in future quarters -- in future years, I should say.

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**James Leland Strange** - Intelligent Systems Corporation - Chairman, CEO & President

Okay. Thanks, Matt. The only other question we have outstanding, and I'll answer it quickly, is about our cloud offerings. I think I've said before, our software is currently running in production in both the AWS, which is the Amazon Cloud, as well as the Azure Cloud, which is Microsoft Cloud. And we also run on our -- what we will call our private cloud in data center. So we're very flexible in terms of our ability to run software in the cloud.

That's the last question we have. I think I just want to thank everybody for being on the call. If you have any other questions as we usually say, you can contact Matt or I directly. I want to thank Dontu for answering the technical question today. And with that, we'll end the call and thank everyone for joining us.

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