Intelligent Systems Corporation

Q4 2020 Earnings Call Transcripts

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Call Participants

EXECUTIVES

Leland Strange
Chairman, CEO & President

Matt White
CFO & Corporate Secretary

ANALYSTS

Anja Marie Theresa Soderstrom
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Presentation

Operator

Greetings, and welcome to the Intelligent Systems Corporation Fourth Quarter 2020 Earnings Conference Call. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Leland Strange, President and CEO of Intelligent Systems Corporation. Thank you, Leland. You may begin.

Leland Strange

Good morning, everyone. Welcome to our call. I need to remind you in the beginning that whatever Matt and I say during this call is a forward-looking statement within the meaning of the federal securities laws, unless, of course, we're stating a historical fact. We will be offering opinions, comments, and analysis that we believe at this time, given what we know or believe today, so that's the -- I'm trying to make the thing that's normally just red tape interesting, as I scratch my head with that. So know that whatever we say, they're subject to a certain number of risk, and we include many of those, but not all of them in our SEC filings. If you have any questions, review the followings, and I hope the lawyer is okay with what I just said.

Now to get to the business of what everyone is signed on for, I'm going to turn the call over to Matt White, our CFO, for a discussion on last year as well as some current expectations. Matt?

Matt White

Thanks, Leland, and good morning, everyone. As we noted in our press releases, our fourth quarter results were in line with our expectations. While we anticipated 2020 to be a building period relative to a very strong 2019, we did not anticipate the impact that COVID '19 would have on our planned workforce expansion and development efforts. We are very pleased with what we accomplished in 2020 and despite unforeseen headwinds, we completed crucial investments in our infrastructure that laid the foundation for 2021 and beyond.

Revenue for the fourth quarter of 2020 was $9,623,000, a 7% decrease relative to the fourth quarter of 2019. However, revenue for the fiscal year 2020 came in at $35,873,000, an increase of 5% relative to fiscal 2019. The components of our revenue for the fourth quarter consisted of license revenue of $2 million; professional services revenue of $4,783,000; processing and maintenance revenue of $2,412,000; and third-party revenues of $428,000.

As we previously disclosed, we recognized $2 million of license revenue in the fourth quarter, which was sooner than we initially expected. However, as a reminder, because we recognized license revenue in the fourth quarter, we do not expect to recognize license revenue in the first quarter of 2021. And I'll talk a little bit more about the license revenue later.

As we indicated during our call last quarter, we saw the impact of revenue declines from Wirecard and the government stimulus program that did not occur in the fourth quarter. We do not expect any additional revenues from Wirecard going forward and have only recognized to date amounts that have been paid or are probable of being paid.

While we do expect additional revenue in the first quarter of 2021 from new government stimulus programs, it is too early to quantify the impact that these programs will have on subsequent quarters of the upcoming year. Similarly, we have started processing loans for American Express, but it is still too early for us to determine the degree that this customer will impact 2021 revenues.

We do expect continued growth in our processing and maintenance revenues from a combination of new recently signed customers and continued growth from existing customers.

And now turning to license revenue, as previously mentioned, and also disclosed in our January press release, while we do not expect license revenue in the first quarter of 2021, we currently expect a new license tier in the second quarter, and we continue to expect significant license revenue in the second half of 2021.

Professional services revenue did see a dip in the fourth quarter primarily due to recognition -- to the recognition timing of various projects we're working on. In the first quarter of 2021, we expect similar or slightly higher professional services revenue as compared to the first quarter of 2020 when professional services revenues were $5.3 million.

Turning to some additional highlights on our income statement for the fourth quarter of 2020. Income from operations was $2,732,000 from the fourth quarter of 2020 compared to income from operations of $3,979,000 for the same time last year.

Our operating margin for the fourth quarter of 2020 was 28% compared to an operating margin of 39% for the same time last year. The year-over-year change in operating margin was primarily driven by lower revenue and previously announced infrastructure investments in our processing environment as part of our long-term growth strategy. The investments we've made will enable us to take on additional processing customers in 2021 and future years.

Our fiscal 2020 tax rate was 23.2% compared to 18.8% in fiscal 2019. The 2019 tax rate benefited from tax deductions on stock option exercises, which depend on the timing of the option exercise and the difference between the grant date and exercise date fair value. We expect our ongoing tax rate to be between 22% and 24%.

Earnings per diluted share for the quarter was $0.24 compared to $0.41 for Q4 2019, and full year 2020 diluted EPS was $0.91 compared to $1.22 for the full year 2019.

I'd now like to provide a quick update on our liquidity position. Our cash balance at December 31, 2020 was $37,956,000, a significant increase compared to $26,415,000 as of December 31, 2019. As we noted in our press release, we repurchase $1.6 million of our shares, while maintaining significant reserves to weather the current crises and invest in our future.

We also invested $6.9 million in our processing infrastructure in 2020 and opened the recently announced offices in Dubai and Chennai. We believe these newly added employees and locations will allow us to enter new markets, grow our processing capabilities and further expand our offerings on the core product platform. We are still in the early stages with these new offices. However, we expect to start generating some revenue in the second quarter.

Before I turn the call back over to Leland, I would like to give a brief update on the effects we're seeing during the continuing pandemic. Overall, we experienced a relatively muted impact on our business, stemming from COVID-19-related economic slowdown in 2020. And the most significant impact has been on our employees in India that have been working remotely for almost a year now. We're encouraged that we've been able to maintain key functions and business continuity in addition to delivering excellent service for 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 our 2021 professional services revenue.

We remain incredibly optimistic about our long-term prospects and believe the investments we've made 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 15% to 25% for 2021 as compared to 2020.

And with that, I'll turn it back to Leland.

Leland Strange

Okay. Thanks, Matt. I'm going to make some short comments and then open it up for questions, which you can do on the phone. But another way you can do it is to send us an e-mail at questions@intelsys.com. I have my computer open, and I see them as they come in. We're not going to be able to answer all of them, but we'll go until about 11:30.

I always take a look at what I've said in the past before having these annual calls for 2 reasons. I don't want to be repetitive, and I want to check myself for accuracy after the fact.

It appears that the last 3 years, I said something to the effect that we did not believe the year would be as strong as it turned out to be. I think I've said that at the end of '18, '19 and '20. We felt that each year would be good but had no information in January of each year that would justify a forecasted range different than what we had articulated. As I've said before, our budget forecasts were not meant to be either conservative or a stretch, just our best guess based on contracted and business under discussion.

We recognized and commented that license revenue is virtually impossible to predict on a quarterly basis, although we can come pretty close in predicting annual amounts. I emphasize the word close since, again, I've said we don't know how well our current or new customers will grow their portfolios. In many cases, they also lacked good insight on how they'll grow.

This past year is no real exception. As Matt discussed, we received license revenue in the fourth quarter earlier than expected even as late as the third quarter. We thought that would not come until the first quarter of this year. That was good for last year, but it eliminates a couple of million that we expected to come in for this first quarter. As to the year, we certainly did not expect or project the insolvency of Wirecard. That one event put a hole in our projections of almost $3 million.

We also did not expect pandemic-related events that also cost us another approximately $1 million in revenue as one of our customers does mobile parking. And one of their big areas of income is New York. And of course, business loans dried up so the Kabbage revenue went down as far as business loans. Now some of that was made up in other ways, as Matt talked about.

You've heard me repeat too many times that resources are a constraint on growth. With the lower demand on resources by Wirecard, we were able to move some resources to other billable work. And in total, made up the big holes left by that insolvency and the pandemic to still end the year up 5%. I'm very happy with that result. So to come full circle with my comments in past years, we certainly ended up about where we thought we would be, but we got there in a very different way than we expected. Certainly, the fourth quarter license revenue made it possible.

In calls throughout last year, I probably unintentionally underplayed the effect of COVID on our operation as our numbers continue to come in strong. As Matt said, they were -- the effect of COVID muted in terms of our numbers. But also, as he said, it certainly impacted our ability to grow 2021 as much as we had previously thought. A lot of business went into slow motion and making strategic moves to change processors became more risky for potential customers, plus we did not get a substantial number of new team members sufficiently trained to handle big new opportunities.

Remember, a year ago before the pandemic, I said we would use 2020 as a catch our breath year and gear up for a big 2021. Well, maybe 2020 turned out to be more of a hold your breath than a catch your breath. One hold your breath example is our growth in India. We set out a plan in early 2020 to buy a land and build a campus for 1,000 employees in our India headquarters office of Bhopal. But due to COVID, those types of activities ground to a halt, and we're just now moving back down that path to either buy land and build or buy buildings.

The opportunities have somewhat shifted due to COVID. Also, just reiterating what Matt said, we do expect our processing revenues to continue to grow in 2021 as we add new processing customers. Our current expectations are to grow total revenues in the 15% to 25% range.

Question and Answer

Leland Strange

With that, I am actually going to go now to questions. And I've got some already and several of them, I'm just going to try to combine into one. People are asking about -- I got 3 questions about the cloud and about technology and our new effort to rewrite some software.

Answering that, trying to put all those together, I would say, we expect to spend in the neighborhood of $25 million in the next few years with the team taking a fresh look at how to do issuing with all the newest tools available, including the cloud. While we believe we have the latest and most flexible and agile architecture in the marketplace today, we're not going to rest on our laurels.

Cloud is mandatory in addition to being a buzzword, and we currently run on the cloud. As a matter of fact, our new operation in the Middle East, headquartered in Dubai, is moving from Wirecard Germany computers to the Azure cloud, that is the Microsoft Cloud. By the way, we also have an instance running on the AWS cloud. So, we run on the cloud.

But while everyone is chasing after putting everything on the cloud, in my opinion, that may not be the best final solution for everyone. So, our new architecture will be cloud independent, including running on private clouds. And that's what our own U.S. processes system is doing today. It's a private cloud. We believe we'll have a cost advantage with this solution that will play out over the long term, but we do check the mark that we run on the cloud. And I think that was the essence of one of the questions, do you run in the cloud.

And that's clearly something that all prospects, 1 of the questions they asked, are you run on the cloud? And then we say, well, does it matter? And they really don't have a good way to answer that other than we just need to know.

I've got 2 more questions that just came in. Let me -- those up, here we go. One is about America Express growth. Can you elaborate on the loan processing you're doing for American Express?

The fact is we are processing for American Express based on their purchase of Kabbage. They have taken over the Kabbage contract. We now have an agreement with American Express, and we are running -- we're going to be running a completely separate environment for that product. I can't say much more about the product. I will tell you, factually, we do not know how fast it will grow, we do not know what their plans are. This is the case with many of our customers. They get started. They kind of measure the progress and see what's happening, then they decide what they want to do. In many cases, they want to put things on pause while they change their program. They've learned some things.

So the fact is we are processing for American Express. We just don't know how fast or how that program will grow. We do think it's significant though that they made the decision to stay with us. We also continue to process what's called the old Kabbage as they run off their loans. We're also continuing to process the old Kabbage for the new PPP loans. Again, have no idea how many loans will come on that. Last year, it was significant for us. We're hoping it will be similarly significant, but it's very hard for us to try to project that. And it's very hard for an analyst to try to factor that into their numbers.

So we just want to let you know. We tell you what we know, but we can't tell you what we don't know. And your guess is as good as ours on how fast either of those programs will work.

Another question that came in is -- oh, there is another one on American Express. So, it looks like everybody likes American Express here. One is about how do you think about the timing of share repurchases in relation to your underlying business or in relation to the volatility of the stock.

I generally try to make sure that I don't comment on stock price because I really have no idea of where it would be. And after saying that, I'm going to comment on stock price. One comment I will make is that given the relative valuations of other fintech companies in the business, we're probably in the low end of valuation.

Now on the other side of that, given the norms, it's how you evaluate a company based on their growth rate and their profits, we're probably about right. So I have no idea.

In terms of additional share repurchases, we have that open. We've never felt like we should manipulate the price by stepping into the market. So we're simply there if there's a clear -- buy signal for us, meaning without any question, it's a value, we're likely to step in and do it. Where that number is? I can't tell you right now because it probably does move as the market moves.

The other question was impact on COVID in terms of trends and underlying end customer sign-ups for new cards. I don't think we see a trend there. I think there's -- the new card sign-ups for our current customers is going very well. Even to the extent when we say, well, we think now we may have another license here in the second quarter. I think most of you realize how those tiers work. We made a -- barely made it for fourth quarter of last year instead of first quarter, but we made it and went into fourth quarter.

We think based on current rates that we'll probably have another tier in the second quarter for 1 of our customers. And we are pretty certain again, based on the information we have now, that probably in the third quarter, we're going to have a very, very big increase in license revenue. Could some of that move into the fourth quarter? Of course. And it's not really something that we can control. It has to do with customers or potential customers either deciding to slow down what they're doing, maybe make some changes to move it into another quarter or to accelerate a little bit. We're there, so we could go either way, but it's not within our control.

On the other hand, we don't see any particular COVID impact from the business side other than things I mentioned earlier, things like if you're in the parking business, it obviously affects you. If you're making loans to small business, it definitely impacts you.

Let's see. Could you expect more -- could you say more about what you expect for the Dubai office next year? Honestly, we think we're going to grow that. We're not -- it's not a significant number this year. We hope it will be significant 2 years out. We're just not -- but we do expect to get new business. We'll definitely have new clients, and it's full processing.

Matt White

Do you want to take a question from the phone, Leland?

Leland Strange

Sure.

Matt White

Operator, is there anyone waiting to ask a question?

Operator

Yes. We have 2 participants, one moment. Our first question comes from Mark Palmer with BTIG.

Mark Palmer

Just wanted to get your perspective on the guidance for 2021. The range you provided is fairly wide, 15% to 25%. And if you can just give us a little bit of color on what would cause the result to be to the higher end of that range or the lower end?

Leland Strange

Matt, do you want to take a shot at that one?

Matt White

Sure. Yes. So it's the -- some of the unknowns that we talked about, if those come in more positive than maybe we were planning for, that's some of the upside. We've talked about the new offices in Dubai and some of the revenues that we could get there. If that comes in quicker than expected, we'll be at the higher end, similar for American Express.

Leland Strange

Yes. We're trying to kind of take a middle range there. If we don't know what the American Express program will bring. We don't know what the PPP program will bring. We don't know how much additional revenue we'll get in the Middle East, although we expect to have some. And I would say those are the -- well, there's actually some other unknowns, and I'll add some other color here.

People want to know about customers. We're signing new customers, but they're typically small ones. There's a test project that we just signed yesterday for a -- one of the neo-banks that has a pretty big name that would know kind of around the world, Europe and U.S., but it's a test project. Now if -- and they're paying us for it.

If they were to work out well, they could end up doing a lot of business this year. They could decide after 6 to 8 weeks of test, that they want to make some changes. So it defers for 3 or 4 months as they make changes, and they look again. So it could go into next year.

So it's just those unknowns, Mark, is why we have to try to be careful. We believe 25% is the upside cap. We are pretty sure 15% is the lower side cap. So we're kind of picking that wide range because that's all we know now.

Do we have any other questions on the phone before I hit some...

Operator

Our next question comes from Anja Soderstrom from Sidoti.

Anja Soderstrom

So I just wanted to get a little bit better understanding of the headwinds in terms of the growth. You mentioned some difficulties hiring in India and that might hamper your growth. How would that -- would you be able to achieve the 25% upside even if you're not able to hire anymore in India? Or how do you see that affecting your growth targets?

Leland Strange

Yes. Thanks for the question. No, we believe that we will have the resources to achieve the 25% if these programs grow to that degree. So we have different kinds of customers. Some require resources to the level of, I'm going to say, 50% of revenue we need resources for that. Some -- there's a lot of scale to it. We need 20% in costs for 100% revenue.

So the kinds of things that we're talking about, they hits the upside, that's for the scale side. So we believe that we're -- we believe we certainly have coverage to be able to go to the 25% if these customers achieve anywhere close to their goals.

But we have to look a lot further out in terms of training. And I'm going to give you another example here. So we have -- I'm not going to even call them a potential customer. We have someone a major bank that we've been working with in terms of showing them what we do. And I'm going to guess that they've got 200 man hours into just looking in demos. And that means they may have 25 people on an hour or 1.5 hours demo several times.

But yet, just in the last couple of days, I got something more specific from them, and they said something about, "Ah, it's great to learn about your great architecture” by the way, which is from one of the top executives. Then he said our -- I'm reading, “our credit aspirations are really big, but our road map is not fast. We are approximately 3 years away from actioning any change if we were to make a change. But we look forward to continuing to learn more about your capabilities.”

So hopefully -- again, you hear me talk about the long term and the long cycle here. Hopefully, that will help you. That's a very specific example that's happened this week. Now it's not our first contact with them this week. We've been having it. But we're having at the high level, along with 25 or more people at other levels.

So these are huge strategic decision for these people. And they -- before they would go with us, they would expect that we have a really good, trained group to go with them because the reason they go with us are things like our people. That's one of the main reasons. Second is our architecture. And third is our ability to move fast. So we're training -- we're hoping to be training this year for 2023 in terms of the way we look at it. This is our long-term vision to compete with the biggest people out there.

And -- so hopefully, that will give you a little more perspective because that's a real-life example. I've got the e-mail up right now that I just read out to you. And we'll stay in dialogue, and they expect, as I said, I look forward to learning more. They are going to continue over the next couple of years to still work with us to see what we have compared to other people. And then they do an RFP at some point. Do we have any more phone questions?

Operator

No. There are no further questions at this time. I would like to turn the floor back over to management for any closing comments.

Leland Strange

All right. Well, thank you. We appreciate everyone's interest in the company, and we know there's been a lot of volatility lately. Have no idea where that's coming from, but hopefully, you're satisfied with some of the pricing.

And again, we're building for the long term. So we're not concerned with where it is now, but we believe that what we have in place, and we believe the conversations that we have, and we believe that where we're headed, we're at a good place. Again, thank you all for your time, and we look forward to the next call.

Operator This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation. Have a wonderful day.