

INTELLIGENT SYSTEMS CORPORATION

Moderator: Leland Strange
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OPERATOR: This is Conference #1292276

Operator: Good morning. My name is (Christine), and I'll be your conference operator today. At this time, I would like to welcome everyone to the earnings release and investors conference call.

All lines have been placed on mute to prevent any background noise. After the speakers' remarks there will be a question and answer session.

If you would like to ask a question during this time, simply press "star" and the number "1" on your telephone keypad. If you would like to withdraw your question, press the "pound" key. Thank you. Leland Strange, CEO, you may begin your conference.

Leland Strange: OK. Good morning, everyone and welcome to the Intelligent Systems Investor Conference Call. My remarks today will actually be shorter than usual, but I'm going to try to answer the question that I, as an investor, would want to know after picking up the press release that was released this morning and taking a quick look at the 10-Q that we also filed this morning.

Our typical conference calls -- or I guess, I should say on typical conference calls, the CEO or the CFO often says we assume you have read the 10-Q and won't repeat everything. And then of course they go on to repeat everything.

So I'm going to tell you today my remarks are not scripted. Yes, the legal counsel is probably getting worried when they hear me say that, but we are

not going to go through the press release or the 10-Q except for a brief explanation.

And that means that you really should determine, as I discuss the business, if there are any questions that should be answered and maybe things I left out in the brief remarks that you need to know and that we have the ability to tell you.

I do have our CFO Karen Reynolds with me, if you have any questions for myself or her at the end of the call.

As usual, I would encourage you to read the business section, the MD&A and the risk section of the 10-K for a more complete understanding of our business and its risks and opportunities.

We do spend a fair amount of time trying to get that as accurate and with as much explanation as we can give, so it's appropriate for you to use that and to read it and ask questions from that if you are either an investor or a potential investor.

I'm going to actually start by explaining my usual -- my unusual comment or quote that was in the press release this morning. Well actually, I'd better say and remind you first that the remarks and answers to questions today will contain forward-looking statements that do relate to the company and its operations.

And my statements, of course, are likely to be considered forward-looking statements when I talk about I anticipate or I believe or I plan or I estimate or I expect or this is what I think.

So if you are an investor or thinking about investing, you've got to know that these are forward-looking statements, they're not guarantees of future performance. They do involve risks and uncertainties.

But I am going to give you my best judgment, and that judgment could be wrong. I'm just going to convey what I believe and know at this point in time.

So with that, I will go back to say that I'll start by explaining my unusual comment or quote in the press release. And as I look at it, when I said having too much business at a point in time is not something you often hear from a CEO, and I would probably say it's nothing -- it's not something that I've said probably more than two or three times in the past 30 years.

But it is true, and we can take on new customer engagements for the rest of the year and even early part of next year with some exceptions, which I'll talk about. I did make the point also -- and those of you that have been holders of the stock for a period of time know that we have no sales or marketing people.

Now, in trying to help you understand why I said that and how that plays with the idea of no sales or marketing people, I think an investor can get a good understanding about the DNA of the company because it is a little different.

If you have no sales or marketing people, how do you get business? Well, I take the approach with this business -- and that's the CoreCard business since that is the primary and the only operating business of Intelligent Systems -- that any company that we, as CoreCard, would want to do business with, is surely smart enough to source CoreCard as a possible partner and ask to talk to us.

Companies that can't find us are probably clueless, and we want to work with other smart, innovative, resourceful partners that want the best, which is all we want to deliver. So if you can't find us, you're probably not a good prospect and we don't need to be knocking on your doors.

Now, I may change my mind three years from now, but at this point, that's our approach. We'll leave that kind of business and that potential business of those who want primarily low-price and low-quality and slow service -- and frankly, those typically go together -- to our competitors.

And we'll choose to go with the companies that want to be innovative and have really good stuff and quick stuff. So effectively, we do limit how many customers we can take on at any one time, and that allows us to effectively choose our customers as our customers, of course, choose us. And we do

choose those that want high-quality contacts and service with that innovative and unlimited functionality, again, leaving the others to our competitors.

Could we take on more? And do we have more opportunities to accept? The answer is yes to both questions. We could give names for those that we have declined, sometimes making them pretty unhappy.

But we think we're doing it the right way and until we get more trained resources, we're simply not going to take on business that we do not think that we can very successfully end up with from the customer perspective.

Now there are other factors involved with this. We promise our -- and I'm going to use this interchangeably. We'll call them partners, clients, customers. And frankly, the reason we don't have one name for them is because each of them like to think of themselves different.

Some of them will come to us and say, we want to be partners of yours, and some say we want to be clients. Some say, we want to be customers. So I'll just use that interchangeably.

But I'll say that we'll take on no more business than we feel that we can handle successfully. That means that they will feel the engagement is successful. And we're serious when we say that. As I said, I can point you to potential customers that we've declined to take on.

But sometimes, despite our honest attempts to abide by that principle, we get into an inadvertent situation that can create real stress and conflict. And that's really the genesis of my statement when I say we have too much business.

It means that we have crossed the line and are fighting our way out of that in order to continue with our reputation, which provides really, really good quality really, really fast.

And by explaining the current situation, I hope to, again, help you understand more the DNA of the company and how we operate so you can make an intelligent decision about whether it's the kind of company you want to be involved with or not.

What happened in the current situation is that we were negotiating a contract with a substantial player, and I'm going to define, I think, substantial simply saying valuations in the billions. Sometimes maybe it's \$10 billion.

Sometimes it could be \$100 billion. But we were in a time for negotiation with this potential player in the loan or card space that actually began last April. Now as often happens -- and I say often happens, but then I have to say sometimes not, these negotiations take a long period of time.

We, of course, never know if they will end successfully because the client -- they'd be talking to someone else, and usually that's not the case, or because for strategic reasons unknown to us, they need to delay.

After all, often when they're talking to us, they're entering a new business or are adding a new product to what they have, and they have their own ongoing strategic business plan. And sometimes there are simply delays.

We have had situations where we have worked with someone and then it ended and then three years later, they come back, and we ended up in a relationship.

In terms of taking a long time, it's almost never about price as we remain consistent in pricing all of our customers the same for similar volumes and similar terms and conditions.

They don't have to understand that, but I believe ultimately, they end up respecting our ethical position of trying to be fair to everyone, being fair to everyone equally rather than willy-nilly based on how convincing they are in terms of why and how they should get a lower price than their neighbor. So we're pretty rigid in that, in trying to keep it consistent. And I think as I said, ultimately, they respect us for it.

So in this situation, we completed the contract in either late December or January, I'm not sure exactly when, but remember I said it started in April, and we needed to move quickly.

And quickly is a reality in our business, and it's actually a real competitive advantage for CoreCard. And when we told them in April that we were going to move quickly, we meant it.

And we told them in April we would take on no more business than we could successfully complete, meaning that we wouldn't threaten their business by taking on other business. We meant it. But the contract had not closed. We didn't know when or if it would close.

And then, another opportunity knocked last November. So we looked at that opportunity. We knew it would be incredibly challenging. We internally reviewed it and determined that we could make it fit our model, which is a model of successful engagement, not just a lot of revenue, and we immediately went to work with literally all hands on deck by the first of the year.

And then, of course, the other customer that started in April came back and wanted to close that contract again, end of December or January.

So there we were and are with two customers that we had promised with good reason and with an appropriate time frame that we wouldn't take on anything that would jeopardize letting them go as fast as possible.

When we said it, we meant it. And frankly, it was impossible to do with two customers. So we've had to make a choice, and that we're moving one customer as fast as they can move internally and as fast as we can move them.

And we've had to slow down the other customer slightly, still giving them good quality and still, I think, making them reasonably happy -- hopefully, they're very happy, but I'm going to say reasonably happy at least, while we have all our resources engaged really fully, even to the extent of pulling some of our people that would be strictly R&D or having to pull them out of what we call strictly R&D and do customer-specific work in order to accomplish what we're trying to accomplish.

So that's a long way of saying that we have too much business. But I think in going through that, it explains a lot about our business of what we do.

Now does it really mean that we can't take on any more business? Well, it means we can't take on any more business that's going to utilize the kind of resources that these two customers are utilizing now. No, we cannot take any more this year.

Having said that, we have another multibillion-dollar customer that wants to get live pretty quickly, so we've had to delay them until next year, although we will be doing a pilot this year to try to keep things on track.

The other way we can take on more business is in the processing area because it's more easily scalable. And if somebody comes in and wants to run programs very similar to the programs that we're already running in our processing environment, then yes, we can take on more of that business.

But in the license business, we'll have to be delayed to next year, and we would just have to politely decline any more license business and, frankly, any more large -- really large processing customers that want to get live this year.

Now that's probably an unusual, mouthful or paragraph-full, remark-full statement of how the company actually operates in the situation that we find us in right now. But of course, there's some good things to -- there's some good outcome to that, and that's our revenue and our operating profits.

Without saying that I'm making projections, which I'm not, I think you can take from what I've said to feel that it's pretty safe that we'll continue at least on this path for the next few quarters.

And then hopefully, we'll have a better sideline to next year by the first quarter. But at this point, there will still be fluctuations, but we hope the fluctuations are all to the good side. And that means you really can't expect straight-line increasing revenue because I will remind you again, that we have processing revenue and licensing revenue.

If we execute a licensing contract, there will be licensing revenue coming in, and it's recognized immediately in the quarter in which it is -- for the quarter in which the licensed -- material you've licensed is effective.

And I'm trying to be a little firm on how they find out. For example, you could have a license customer that licensed the software to use for 1 million cards.

And when they do, we'll have to take that licensing revenue all in that one quarter. But you also could have that same customer who, six months later, who need 2 million cards, and they would pay additional licensing revenue for that extra 1 million cards.

So you could see what would happen. Let's just assume the first 1 million cards, and I'm making up numbers, so I'm just trying to give an explanation.

Let's say the first 1 million cards, the license is for \$1 million, and it was the first quarter, you'd have a big pop of \$1 million for licensing revenue. And that would be -- a good chunk of that would fall to the bottom line.

And then in the second quarter, you had -- you couldn't repeat that. And then let's say, the third or fourth quarter, they need another 1 million cards and you get another \$1 million pop.

So that's to try to give an explanation for why our revenue and income are still likely to fluctuate, but I consider the fluctuations to be all on the hindsight.

But don't try to hold us accountable for the straight-line earnings and straight-line revenues because that's not the way the business works when your revenues are \$15 million, \$20 million, \$25 million. Now with \$100 million, those fluctuations do not matter as much, and you can have kind of a steady-state income and revenue.

The good point I would make is that a lot of our revenue right now is for professional services, and that is really using our highly talented team, both in the U.S. and India, and that is more highly used when you first engage a customer -- a license customer or a processing customer, as you attempt to customize what you do specific for that customer.

And then, that can fall off until you have another customer who needs the same kind of customization. So I just kind of want to make that point.

So you'll see our revenues are, in many cases, are for professional services. They'll be for support and maintenance, and they will be for license. Now I don't believe we had -- do we have any licensing income, Karen, in this quarter?

Karen Reynolds: Yes, tier upgrades.

Leland Strange: OK, we had a little bit of licensing income, and that is kind of the example I gave you before. And remember, I just threw out random numbers. You may have someone that has a license for about 100,000 cards, and they want to go to 200,000 cards and maybe all they have to pay is \$100,000.

But that is license revenue. So you'll see the license revenue bounce all over the place, but it's nice income because it really is reimbursement for the substantial money that Intelligent Systems and CoreCard invested in giving the software to the point to be licensed.

And for shareholders that have been around for a long time, you'll recall, however you want to account the number, we spent \$35 million to \$50 million developing this highly complex, complicated, functional, feature-rich software that we believe should have a very long life.

I said my remarks should be brief, and I've already stood up for 20 minutes, so I am going to wind down without discussing the things that are in the Q. Again, I'm expecting you to read that.

I'm going to open it for questions in a second. So think about things you might want to ask. But that's as good an explanation as you'll probably ever hear from us of how the business actually works.

We are still looking for more processing customers, and if they come in the door and don't require a lot of customization, we will take them. We are not looking for -- we will not accept, and I'll make that very blunt.

We will not accept any more license customers this year or any more licensing customers that require us to do any work in the first quarter of next year because we are absolutely going to put all focus in making successful the large, license customer or to-be license customer that we're working with right now and trying to get their program the way they want it.

With that, I'm going to just open it up for questions. Again, I'm reminding you that Ms. Reynolds is here, who has to handle all the financials if you want to ask specific questions.

Or if you have any more questions about the business, I'll be happy to answer them. So moderator, we're going to take it -- see if there are any questions at this point.

Operator: Thank you. At this time I would like to remind everyone in order to ask a question, please press "star" and the number "1" on your telephone keypad. We'll pause for just a moment to compile the Q&A roster. Your first question comes from the line of Sam Rebotsky. Your line is open.

Sam Rebotsky: Good morning, Leland. You've made all shareholders, and I presume yourself, of your accomplishments, having sold the ChemFree and developed CoreCard. Congratulations.

You're entitled to many kudos. Now let's go on to the -- yes, go ahead. Yes. Let's go on to the number of employees. I think you had 400 employees. Do you have a higher amount? Or do you think that you'll get more employees? So what's the status of that?

Leland Strange: It's about 400 employees. We are still hiring at this point. It's a little over 350 in India in total. So just in total, let's just say about 400. You can't keep over the exact number because they're going to change day-to-day.

Remember, with the India operation, you are getting some turnover. We probably have less -- well, I know, not probably. We have far less turnover than the average Indian company.

But we do get some turnover. So we're adding and losing some on a regular basis, but the real key is we have a lot of long-term, really highly-talented employees. And I'll be spending next week over at India and Dubai at our offices and with customers.

Sam Rebotsky: That sounds good. Now the investment, you took a write-down of \$250,000. What is the total investment that you have with the write-down? What did you start? And what is it currently?

Leland Strange: OK. It requires a different explanation. I'm going to ahead and give it. It really was a \$1 million investment. But it was really an investment in a potential customer, and that potential customer has or will pay us \$0.5 million.

So although the investment is going to stay at \$1 million, we did get or will get, I think there's still some remaining, we'll get \$0.5 million back on the revenue side.

And we got them as a customer because of that investment. Now they're having problems raising money, and we're simply -- and it's a good customer. They've got good programs. They've got good people.

And we hope that they're going to be able to raise the money to make it substantial. But frankly, we believe that we should be prudent, and we wrote \$0.25 million of the \$1 million down, so it was not really a cash issue.

And it may need further write-offs. From my view, if you write it down to \$500,000, it's still a breakeven for us even though the books are different.

And Sam, being a long-term shareholder, you know my view, and I'll just state it for everybody, is that we're going to run the business the right way to run the business. And we're going to let the accounting drop out the way the accounting does.

So if it wants to -- if it kindly wants to say, which it will, if I write it all along that had \$1 million loss, that's fine. But if I know I've got \$1 million in revenue from them or \$1.5 million for that \$1 million loss, I did the right thing business-wise.

Sam Rebotsky: I agree with you, Leland. Now the other thing, the other note, the \$1.5 million, this is some potential company that might go public. What's the status of that? And I know that -- I don't want any names, none of that.

And do we see any -- is the horizon getting any shorter or longer? Do we see any changes? And I know it's difficult on the quarter-to-quarter basis, but if there's any color, that would be helpful.

Leland Strange: There really is nothing I can add now. They're not like bursting at the seams, where we can say, oh, gosh, it's going to be a big win. They're also not having huge problems, so it's not like it's going to be a big loss.

So we're still just kind of riding in the middle now. And that's the kind of thing we really review more annually because it was an earlier-stage company unlike the other ones.

Sam Rebotsky: OK. I'm going to step out, Leland and hopefully some other people come in and ask some questions and I'll come back. But you've done a wonderful job and everybody has to be happy.

Leland Strange: (Inaudible).

Operator: Again, if you would like to as a question, please pres "star" and the number "1" on your telephone keypad.

Leland Strange: Well, if there are no more questions...

Operator: Your next question -- we do have another question.

Leland: Strange: Oh, I did have on. Are there any?

Operator: Yes. It comes from (Bobby) (inaudible).

(Bobby): Hi, Leland. I wanted to also congratulate you. It's kind of a historic conference call. In fact, it might be historic, not only just for Intelligent Systems, just in general. I've listened to a lot of them.

I don't think I'm going to be the only shareholder at your future stockholder meetings, either. But anyway, just can you speak about the cash level to -- for a business growing as quickly as you are, how you feel about the ability to finance the growth?

Leland Strange: Well, there's kind of -- I'll let Karen say something about it. But first, let me just say, we don't really need cash to finance growth.

Meaning that, yes, we're doing some investment with new employees, and yes, we do some investment with equipment, but it's very small in relation to the growth of the business. And again, that's also the kind of customers we have.

And because of treating everybody the same, customers pay us timely. We provide services. They pay us. It's an expectation we have. We don't deal with collections, and we tell them right upfront that's not our game.

If you want our price, you pay timely. If you want to take too long, then we're just going to raise the price. So we just don't have -- I don't anticipate any cash issues in terms of needing cash.

I'm going to probably have to think about cash issues than the other side of that, what's the best use of cash for our shareholders? Karen, why don't you speak to the cash right now just as a...

Karen Reynolds: Leland, for the most part, addressed it very well. We do feel we have adequate cash in the near term to support CoreCard's operation.

We actually feel we have some additional cash available to see any potential investments that complement CoreCard's business in the fintech industry. But we're adequately positioned right now from a cash standpoint.

Leland Strange: And I think everybody -- that anybody can read from the Q. Of course, we have no debt and have had no debt for a very long period of time.

(Bobby): All right. Well, I appreciate it.

Leland Strange: Thank you, (Bobby).

Operator: Your next question comes from the line of (Newman Cohn).

(Newman Cohn): Hi. Thank you for this call. This is really good news. My question relates to the client, the customer -- the one customer that you're serving. How long is the contract for with them?

Leland Strange: Well, I mean, there's more than one client. If you're talking about the bigger one -- contracts in this business are very misleading, meaning that, they can forever, forever add additional license tiers, meaning, increase the number of licenses that they want. They're buying a perpetual license.

So there is no end date to that, but there's also no recurring revenue from licensing unless they do add tiers. In terms of maintenance and support, typically those contracts are for five years.

That's the maintenance and support. During that time, there's also typically a large amount of professional services as they want to change their programs. No one just puts a program out there and sits on it and make no changes.

This business, the Fintech business, it's changing quickly. And you've got to respond to what customers want. And since each of these licenses are essentially unique, meaning, they've got a base that may be 80 percent the same, but they've got 20 percent that's unique on top of it, they always need to make changes.

And generally, they -- well, almost always no change -- always, up to this point, they have found it more efficient to ask CoreCard to make those changes and to use our professional services than they have to try to develop their own.

And I would easily guess, and I'll put this under our forward-looking statements, but anyone that tried to develop their own would maybe do that for a year, and then they would come back to CoreCard because it's very expensive to develop and keep those kind of resources that can really do what you need quickly.

So I know I didn't give you a crisp answer, but there is no crisp answer to licenses -- to how long contracts are in this case. Another, just an addendum to that, my view is, I don't really care and I don't want to make the contract length the key to the business.

If you're not serving the customer, no matter how long the contract is, it pretty much doesn't matter because something will cost them to get out of it, and it certainly cost me too if I were on that side.

On the other hand, if you're serving the customer well and they need you, then it doesn't matter whether it's a 1-year or a 10-year contract. You're going stay -- you're going to keep doing business with them for as long as you're in that business.

Operator: Your next question comes from the line of Sam Rebotsky. Your line is open.

Sam Rebotsky: Leland, the service revenue of \$4.5 million and the six months, \$8.4 million, is there any license revenue in those numbers?

Leland Strange: No, there is not.

Sam Rebotsky: Do we expect any license revenue for the balance of the six months or the next year? Because you spoke of license that we don't -- and I know what it sounded like.

It's not clear when these things happen, so I don't know if you could talk about it. Is there any imminent license that might occur with any of these two main customers you're working with?

Leland Strange: Well, again, my expectations, and my expectations are forward-looking statement, my expectations, there will be some license in the next six months. I'm going to give some color to that. My expectation also is not going to be \$2 million. OK? So it's not like there's going to be a big, big, huge, number.

But my expectation is that there will be some license revenue this year and some license revenue next year. Now one of the large customers is a

processor -- I mean, it's a processing customer, so it will not be licensing revenue.

Sam Rebotsky: OK. Now the other thing. The fact that you are working at capacity, and although, it's difficult to find an acquisition where the people can help you do what you're doing and learn your approach and sort of to help you, but is there any possibility of an acquisition that would be beneficial that wouldn't hinder you going forward that you may look at from time to time?

Leland Strange: Not that we're aware of at the present time.

Sam Rebotsky: OK. Well that's all I have, Leland. And just keep up the good work. That's all. Thank you.

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

Leland Strange: OK. Thank you, everyone. I thank you for taking the time to hear the remarks today. And I guess, I usually end these by saying if there's anything that Karen Reynolds or I can add under the guidelines that we're able to add, we're certainly happy to try to do so.

I think going forward, we're probably going to have a conference call every quarter given the change in status. We used to do it every six month, but we'll probably do it every quarter going forward. And I think that's all I have.

We appreciate those of you who have stuck with us over a long period of time. Hopefully, you're happy. Although, I guess I will add this, for long-term shareholders, probably, none of us are happy until we're able to realize the actual return on what we have.

And I've said before, the company is always open to do the right thing for our shareholders, whether that means staying the course as we are now, whether it means a merger, whether it means a sale.

We're simply going to do what makes sense for the shareholders going forward. There's nothing imminent in any of those areas, so I don't want to mislead in that sense.

But we know that what is really the key here is to how shareholders realize on their investment over the long-term. So we thank you for that. We look forward to reengaging you in another three months. Thank you, everyone.

Operator: This concludes today's conference call. You may now disconnect.

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