Investor Update Call June 5, 2019 (no Q&A)

Thank you for joining our call. For those that pick this call up through a transcript, thanks for taking the time to read. We will have the edited transcript of the call up on our website in a few hours. I suggest you check it on our corporate website, intelsys.com, rather than Seeking Alpha or other sites because the speech-to-text automatic transcription often fails to convert some industry terms correctly. Of course, maybe my southern drawl is the problem but the transcript on our website cleans it up – along with my grammar I might add.

As often on my calls, I have both script and bullet points but I won't hesitate to go extemporaneous when I think, as I talk, I may have not fully covered the point. I'll take questions at the end but plan to cut off after 30 minutes total call time. I can tell you I have received a ton of advice on what to say and not say from shareholders, employees, investment bankers, and lawyers. I'm taking it all into consideration… but I certainly won't please everyone. I can summarize the response from the few customers who have messaged as …"Who cares?".

I'm, of course, taking this part of the advice I get from counsel that I need to preface the remarks by noting the protection provided to company and company executives with forward-looking statements within the meaning of the federal security laws. Everything I say that's not a historical fact should be treated and read as speculation. It is what I think or believe as of this moment and believe I have a good basis for it but it may be proven incorrect in the future.

I may expect, project, believe, plan, intend or use any number of other similar words in this call and these are all forward looking statements.

Note also, the New York stock exchange has decided to halt trading in the stock until after the call or after the transcript is posted to our website. I'm actually not sure when it will open. I personally don't think there will be information here that should cause volatility but that was there call.

The call is precipitated by two recent commentaries that we believe to be "short and distort" hit pieces. Regardless of the quality of the reports, they achieved their objective of driving the stock price down. If they closed their short positions earlier, they have been handsomely rewarded.

When the reports came out, I received many calls and emails from folks who were angry at the flimsy and even laughable attempts to discredit the company. They expected me to immediately jump up and down and scream – and maybe were not happy with me as I was pretty sanguine about it knowing that ultimately the truth and company performance would trump distortions and false inuendo.

You see, I believe there is a place for shorting in our market system. It is as fair to bet on a stock price going down as it is to bet on a stock price going up. I've certainly done that in my personal portfolio. Sometimes the short players actually discover and root out dodgy or dishonest accounting or managements. I feel differently, however, when they take easily googled public facts and stream them together in a misleading narrative. I think that pushes over the boundary of legitimate and ethical market activity. But that's for others to decide. My purpose here is to provide enough information about some of the claims so you can get on with determining the value of the company based on its merits. The market then decides the appropriate stock price – achieving or maintaining a certain price is NOT my objective. My personal opinion of where the stock should trade is unimportant and irrelevant.

A quick note that should give current and potential investors pause about the Grizzly report specifically … INS is the only thing on their recently setup website. A few days ago the Grizzly website disclaimer that is identical to one for Gotham City Research, still had an accidental reference to Gotham City. Gotham City is another anonymous short website that appears to have published one report last year and none this year. Also the Grizzly INS report shows the logo for INS to be the one used by a Japan gaming company called Intelligent Systems. Neither is important on their own but as I tell my grandkids – consider the source.

In trying to decide how to approach this call my first thought was -–– let's go to the most damaging facts. In musing about that approach, I found it difficult because there was absolutely no damaging factual information disseminated in either report– it all came from our filings or openly available with any Google search.

I then considered opening with a discussion of how they got to Intelligent Systems in the first place. The answer to that question is pretty obvious – one of our directors with an 18-year tenure on the board – has been accused of various revenue manipulation practices as CEO of his former company. The company was the object of a highly publicized short attack. He denies the accusation. The company's investigation claims it true along with other charges. The short players following that company found he is a director of Intelligent Systems and determined to target our company based on his association. They have come up with some innocuous claims about us to make it appear we were up to some worrying practices. His being on or off the board does not change the accusations and innuendo. If he stays on the board for now, they will say we have a problem by association. Leaving the board at this point in time they will say that we are trying to sweep the problem under the table and make it go away by him leaving. This is NOT the subject of today's call. But I will address more on the Board later in the call.

Usually a predicate for the ability to successfully originate a short attack is an over-valued stock that has been pumped by the CEO or proxies. Even the commentaries from the shorts admit I have not in any way tried to hype the stock. A careful reading would even conclude I have, as some say, talked the stock down. It is kind of original where they blame the investors and speculators for pushing the price up and not management!

Let's go to the root of the problem and talk about the opinions that affect Valuation. The stock has declined substantially since the reports last week - we have to assume the narratives around the facts along with the opinions expressed HAVE affected the market valuation as they put a $5 to $12 tag on stock price.

Probably the best argument they have is … and I will quote and read an edited paragraph from the commentary …

"We view INS as largely a niche Indian outsourcing business ... In our opinion, shares have been propelled to highs by speculators chasing recent headlines in pursuit of quick profits. … we believe it's only a matter of time until the stock reverts to a valuation more reflective of the underlying economics.

… INS trades at premium valuation of 15x trailing revenues and 40x trailing EBITDA. If INS were to revert to a valuation of around 2-5x trailing sales, a multiple typical of Indian outsourcing businesses such as Wipro as well as larger processing companies such as First Data, the stock would be worth roughly $5 to $12 per share."

That is their statement and their opinion. They view comps for INS as Wipro and First Data. They and everyone else are entitled to their opinion. We respectively disagree on the outsourcing characterization and don't operate, manage, or think of ourselves as an Indian outsourcing company.

We have spent, over the years, over $50 million developing what we believe to be unique transaction processing software. We own it, license it, and use it ourselves. Some very high-quality large enterprises with deep technical resources have chosen to use CoreCard software for their transaction processing requirements. We will not confirm or deny that the enterprises in the Short commentaries are accurate but the companies mentioned do represent the kind and quality of customers who have chosen to use our software.

If you completely disregard that we are a software company – just an outsourcing company (and we are not) and look at the WiPro argument, their valuation conclusions still fail. My numbers may not be exact but I believe Wipro expects to grow revenue 5% in 2019 compared to INS target of 25%. If you believe our company growing revenues 5x as fast as Wipro should be trading at the same earnings multiple than you can buy their argument and we are worth maybe $12.

We do agree with their opinion that we are in the same business as First Data. We are similar to First Data's Global Financial Solutions segment –(GFS) - that is their issuing business. First Data reported 4th quarter segment revenue was down 9% from prior year but up 7% on an organic constant currency basis – so just stick with the middle point and say they were flat. INS 4th quarter revenue was up 138% - compared to their no growth. Our Operating income went from a loss of $704k to earnings of $2.3M from prior year – compare that to First Data's 2% EBITDA growth.

Even if you accept ALL of the Short commentaries' key valuation comparable arguments, they fall apart when looking at the great disparity in growth rates. This is the key quantitative argument they made for saying the stock was worth $5-$12 and it fails miserably when you shed light on all the numbers

Moving on from the valuation observations, I think the most serious allegation that was made with the goal of impugning the company's accounting is that the company is recycling, round-tripping, or siphoning off revenue. You read on the press release announcing this call a little about our response to this topic.

We referenced an example of a very successful first round (maybe even their first outside dollars) investment of $100,000 that required them to use CoreCard as their processor. We could have negotiated the arrangement with a loan, a convertible note, a preferred or common equity instrument – or we could have just said we will handle the setup of your program for free and waive the first six months of potential revenue or minimums which would equate to maybe $100,000 in services. The larger processors have many ways to offer customers' incentives – or in some cases they compensate sales persons big bucks (and we are not paying any of those) or spend a lot of marketing dollars (which we don't spend) to attain a customer and its attendant revenue. As I have said before, we don't 'buy' customers. We don't give away much of anything. But we will do what we believe will get us the optimum total return from customer engagement. And we will take some risks like we have over our 35-year history looking at opportunities from a venture capital perspective. I would hope shareholders would expect nothing less. We don't design a program to maximize how we present and look on a quarterly basis or where things end up on the income statement or balance sheet. We make decisions as if we were a private company with a long-term horizon as we craft terms. We will win on some and lose on some. I certainly don't expect many – if any - to turn out as successful as this successful instance where we get a 15x return on the investment and again 50 times the investment in profitable processing revenue over 5 or so years.

The investment of $235,000 that was referenced in the report yielded approximately $41,000 revenue in 2018 representing .2% of our revenue. That is NOT 2% but 2 tenths of a percent and so far in 2019 it represents .03% - 3 - 100ths percent of our revenue. If I were trying to round-trip revenue, I certainly think I could do it in a lot more competent fashion! I am tempted to say this is just noise but actually it is so small you would need a hearing aid or amplifier to even hear a squeak!

Imagine what they could have said and what I would have to be saying different right now if the company that we had invested in had paid CoreCard last year $200,000 in processing fees. I could not have said it is just at noise level like I just said. I would then be talking here about how much we expect to get in the future rather than how little we got. And I would be much happier. Simple conclusion – we are going to do what makes business sense and then leave it to the accountants to handle the accounting.

The rest of the claims in the Grizzly piece are just as baseless. CoreCard does use some independent contractors for specialty work in India and sometimes they represent on their resumes or Linked-in pages that they work for CoreCard when in fact they did work for CoreCard as a contractor or employee of another company. We don't go around the world and police what people say on their resumes – and most people who have done work for CoreCard in India like to brag about it because we are a very well-respected company.

Actually, our subsidiary in India is named ISC Pvt not CoreCard. Employees just say CoreCard. That may be the next scandal some short reports when they report they have searched the corporate records in India and find CoreCard does not exist and has no employees. Technically, that is correct. But there are 400+ employees in India of a wholly owned subsidiary of Intelligent Systems as reported in all of our filings.

We also have licensed software from an India testing company in which one of our India managers has an interest. But instead of this being a case of 'siphoning off revenue' as accused, CoreCard got a very special and favorable deal because of the relationship. It was fully vetted by me and our CFO at the time of contract execution. Some point to relationships as bad – keep in mind that can go just as easily the other way. We have good policies in place to monitor and manage potential conflicts. Now I am not going to claim there will never be one, but I can tell you the company will never knowingly allow one to happen that is disadvantageous to shareholders – remember I am a pretty large shareholder myself.

What else – the first report pointed out there is a relationship among the directors. That is true – three of us are alumni of Georgia Tech and are financial supporters of the school. Russ Chandler is a director of Intelligent Systems. I watch Georgia Tech baseball play at Russ Chandler Stadium on the Tech campus. Russ may go to a conference or symposium in the Jane & Leland Strange Entrepreneurial wing located in the College of Management building. Or I might go to a Georgia Tech Research Institute meeting held in the Petit Bioengineering Building.

We have that in common. We did not graduate the same year nor know each other while at Tech. We were not fraternity brothers and don't hang out socially together. I don't think we have all been in the same room or area together in the last 20 years except for Intelligent Systems Board meetings, Georgia Tech Foundation Trustee meetings and in the same stadium for Georgia Tech football games.

The fourth director, Phil Moise, is retired general counsel for a public company that was taken private. Prior to that position as general counsel of that company, he served as Intelligent Systems outside counsel. He has a long history that brings valuable insight to board meetings.

However, having said that, criticism about the board is somewhat valid and we take note of that. With the Intelligent Systems' now much higher valuation and our decision to concentrate on Fintech with the CoreCard business, we are highly likely to both increase the board size and restructure board personnel to focus on directors who can bring that type of expertise and relationships to the company.

Moving on … The first short report discussed licensing and quoted some experts about how it works. They also named customers which I cannot comment on as a result of contract terms, I will not confirm or deny the accuracy. But it is fair to assume the logic around their premise about how many cards any new program is going to issue. None of us have a good feel for the number of cards. You don't know. I don't know. But you do know they were writing the report in an effort to lower our stock price so it would be logical that they would use worse case.

I will also state that their consultant was wrong in trying to project likely terms of our license agreements. Our terms are typically much better than he opined as to what is normal but I am not going to breakdown the economics of a specific license agreement for competitive reasons. It is generally true that the license price for an active account goes down as the quantity of active cards goes up. It is also true that sometimes there is a negotiated maximum price for a very large number of cards. But we are talking really big numbers to get to that point and maintenance and support is triggered indefinitely for that big number.

Another question was about scale – we think we have scaled about as well as any company the last year or two and will continue. If we were growing as slowly as First Data, we would not have to add more employees to take on more business. But our growth is substantially higher so it requires a commensurate number of additional trained employees.

Let me be crystal clear on this point: We are going to support the large license customer to the nth degree and throttle growth as necessary in order to do that. If as a shareholder, you value quarterly growth at any cost, you are investing in the wrong management. This has nothing to do with scale but everything to do with priorities. And choosing this priority, in the opinion of management and this large shareholder, is best for the company over the long haul.

I am going to wrap up by talking a little about future performance because this is what should be the driver of enterprise valuation.

I have consistently said as of the middle of 2018 (and was quoted accurately throughout one of the reports) that I expected the company to grow revenue at an average 25% per year for the next few years. That is still the case.

We don't normally and don't plan on giving more guidance. However, I will add a little finer tuning to what we think about this year and next:

We believe that 2019 revenues will exceed those of 2018 by at least 25%. If 2019 is up by 25%, we believe 2020 revenues will be up another approximately 25%. Listen carefully to the wording as I don't want any misunderstanding. I am saying our <u>average</u> increase the next two years is anticipated to be 25% per year. If 2019 increases by 40%, I can tell you right now it is highly unlikely that the next year will be 25%. Likewise, if the increase in 2019 should only be 20%, it is highly likely that the increase in 2020 will be more than 25%. I have explained in previous earnings calls the effect of license revenue 'pops'.

Why do I not have a clearer picture in June of 2019 of what our revenues will be for the second half of the year? It is because I do not know with a certainty when the large licensed program will go live (which means more revenue for us) and have no idea how many cards will be issued this year. But I am comfortable with guessing a middle ground estimate of revenue over two years combined – I just don't know the distribution by year. That is why I continue to say that the 2019 and 2020 years should have an approximate 25% average revenue growth rate. Operating income growth is likely to be slightly higher over the two years unless we make a strategic decision to substantially increase expenses to prepare for a bigger 2021 and thereafter.

I don't really have a lot more to add. You can make your own decisions and we will just keep doing what we have been doing.

We have a few more minutes left for questioning but will do what I said in the beginning and close the call at about 30 minutes. You can save the other questions for our next earnings call.

No Q&A on this transcript – to be added later.