16-Feb-2023

CoreCard Corp. (CCRD)

Q4 2022 Earnings Call

CORPORATE PARTICIPANTS

Matthew A. White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

Leland Strange
Chief Executive Officer, CoreCard Corp

OTHER PARTICIPANTS

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Hal Goetsch
Loop Capital Markets

MANAGEMENT DISCUSSION SECTION

Operator: Greetings, and welcome to the CoreCard Fourth Quarter 2022 Earnings Conference Call. At this time, all participants are in a listen-only mode. A brief question-and-answer session will follow the formal presentation. [Operator Instructions] As a reminder, this conference is being recorded.

It is now my pleasure to introduce your host, Matt White, Chief Financial Officer. Thank you, sir. You may begin.

Matthew A. White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

Thank you. Good morning, everyone. With me on the call today is Leland Strange, Chairman and CEO of CoreCard Corporation. He will add some additional comments and answer questions at the conclusion of my prepared remarks.

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 CoreCard Corporation 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 our filings with the SEC, including our 2021 Form 10-K and subsequent filings.

We'll also discuss certain non-GAAP financial measures, including adjusted diluted EPS, which is adjusted for certain items that affect the comparability of our underlying operational performance. These non-GAAP measures are detailed in reconciliation tables included with our earnings release.

As we noted in our press release this morning, our strong performance continued in the fourth quarter of 2022, and we are pleased with our full year revenue growth of 45%. In the fourth quarter, our professional services revenue remained solid. We saw continued growth in processing and maintenance revenue and we recognized license revenue of $1.8 million. The components of our revenue for the fourth quarter consisted of professional services revenue of $7.7 million, processing and maintenance revenue of $5.1 million, third-party revenue of $1.3 million and as I already highlighted, license revenue of $1.8 million.

Total revenue for the fourth quarter was $15.8 million, a 21% increase year-over-year. Services revenue defined as total revenue less license revenue grew 25% in the quarter on a year-over-year basis with full year growth of 27%. Within services, processing and maintenance grew 33% in the fourth quarter on a year-over-year basis, with full year growth of 34%. License revenue for the quarter was flat year-over-year and saw full year growth of 174%. We expect this to be a record year for license revenue and our focus going forward will be on continued growth in services revenue, with an emphasis on growing our processing business.

Revenue growth, excluding our largest customer, was 18% in the fourth quarter on a year-over-year basis. We continue to onboard new customers both directly and through various partnerships we have with program managers, such as Deserve, Vervent and Cardless. We currently have multiple implementations in progress with new customers to get back to go live and in the coming months. We completed our connection with the American Express in the fourth quarter of 2022 and expect that to open up new paths to revenue growth in the coming years.

Turning to some additional highlights on our income statement. For the fourth quarter and full year for 2022, income from operations was $3 million for the fourth quarter of 2022 and 2021. Our operating margin for the fourth quarter of 2022 was 19% compared to an operating margin of 23% for the same period last year. The year-over-year decline in our operating margin was primarily driven by continued investments in our processing environment, our new office in Bogota and our hiring in India. Additionally, we're building a new platform that is resulting in higher development costs. These investments are a key component to future growth.

Our fiscal 2022 and 2021 tax rate was 27.1% and 23.2%, respectively. We expect our ongoing tax rate to be between 25% and 27%. Earnings per diluted share for the quarter was $0.12 compared to $0.30 for Q4 2021. Full year 2022 diluted EPS was a $1.61 compared to a $1.03 for the full year 2021. Adjusted diluted EPS for the quarter, excluding the impact of a write-down of one of our equity method investments was $0.24 compared to $0.30 for Q4 2021. And full year 2022, adjusted diluted EPS was a $1.74 compared to a $1.03 for the full year 2021.

We achieved significant growth in 2022 by onboarding a significant number of new customers, converting a large portfolio of millions of cards in the first quarter, adding over 300 people in India, Bogota and the US and continuing to build out our processing infrastructure. We expect to stabilize our workforce in 2023 and continue growth in our services revenue primarily with the people we have today. We believe we're at the point where existing customers can continue to grow and we can continue to onboard new customers without significant increases in head count or infrastructure costs.

For 2023, we expect growth in services revenue of approximately 10% and license revenue between $3 million and $7 million. We expect growth from customers excluding our largest customer, which is all services revenue to be approximately 20%. We expect license revenue in future quarters in 2023, starting in the second quarter. However, it's difficult for us to predict the timing for reasons we've discussed previously. Within services, we expect strong growth in processing and maintenance as our contest – customers continue to grow as we add new customers. Professional services revenue continued to be strong in the fourth quarter and we anticipate similar professional services revenue in the first quarter of 2023, likely in the range of $7 million to $7.2 million. We're expecting some slowdown in the growth of professional services in 2023 due to the continued strong demand in 2022. However, we expect that revenue stream to remain at a high level.

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

Unverified Participant

Okay. Thanks, Matt. Let me start by just reiterating or perhaps expanding on some of the points that Matt made in his remarks. First, yes, we had a very good year. It was punctuated by the large inflation revenue received in the first quarter of last year. I've repeated in several of these calls starting a year ago that the circumstances that resulted in net income was not repeatable and could, I guess, proactively be considered, though not for accounting purposes a onetime event. We were happy to get it as it represented a second large program being processed on corporate software with millions of new cards and also the revenue with the cash with very little cost of goods sold, but we knew it would make it comparable for this first quarter that we're in now look bad and investors who just follow the charge are going to be misled. That's yet to unfold, but 2023 first quarter revenues will be down or revenues from other than license revenues will be up. That last fact does not show up on the chart.

Also the one time large revenue bounced our 2022 revenue up to $69 million plus marking a 45% increase from the preceding year. If I continue to talk about license revenue, we currently expect approximately I'm going to say plus or minus $5 million this year compared to the $16 million we received last year. That projected plus or minus $5 million is more than likely the norm for the next few years unless we bought a very large new leasing customer and or maintain our current license pricing model.

I'll talk more about that later. But that difference in license revenue is not going to be able to be made up in 2023. The difference is approximately $11 million. I've also previously said and will reiterate here that we believe the percent of our revenues coming from our largest customer peaked in 2022 and will be smaller each year going forward. It was approximately 75% last year, which was again highly skewed by the 2022 first quarter license revenue. While we expect our current programs for our largest customer Goldman Sachs to continue growing, we're not currently projecting any increase in other income generally plus or minus other perhaps from inflation adjustments.

I think the press has reported their emphasis on controlling cost. So we would expect to help in keeping our cost of control meaning revenues to stay approximately flat. We obviously will try to make more things easier to run it just in a lot of ways try to keep our costs down in order to come under the pressure that they're having to reduce cost. There's a lot of speculation about when or if the new programs to the CoreCard platform. If I had any non-public information about future plans, I, of course, would and could not disclose it. I'm going to reiterate what I've said in the past, which I believe to still be true. They will grow their programs despite the negatives you hear in the press, any real problems or simply the result of too much success rather than management screw-ups. The programs really have been wildly successful and for a first time processor that's successful growth to pressure, whatever systems you plan for and whatever you put in place, all of that can and will be fixed.

There are a lot of super smart people there making certain that it gives face and they're putting in place systems that will support a robust business. I think the greens are getting impressed really does not align with the incredible success they've had with cards. Long performance is going to eventually normalize and the business will be a very good business in my opinion. Now it only makes sense that if they take on our program that's currently processed by someone else, they'll consider leaving it there considering all of the questions that are being peppered with. Of course, we would prefer we go to the CoreCard platform and we believe the economics would clearly support that. But we also would not be surprised if they should take the path of least resistance. Public companies sometimes have to do that.

So I guess summing up the large customer concentration topic, one the concentration is coming down' two, at this time, we know we will receive lower license revenue and believe other revenues will not vary greatly from 2022; and three, we simply don't know if any new programs will be added in 2023, but do believe it will make sense to continue growing programs in the CoreCard platform in future years.

So let's talk about the rest of business. It's always kind of funny when you're sitting where I'm sitting, that if go from being such a big part of the business, we have shareholders and say, well, let's talk about the other parts of the business, because you need to grow the other part. So they want to talk about the other parts again, but want to talk about growing the global revenue. But anyway, so you've heard about some real good when we talk about the rest of business.

Non-Goldman revenues grew a positive 28% in 2023 when we exclude wild card which is going to bankrupt us out. We expect that to continue growing at approximately that pace, although perhaps a little slower in 2023. If we look strictly at processing revenues, I expect to see growth of 20% to 30% for the year. We've said for some time that we're building for the future. Well, the future is 2023 and 2024. If we achieve our target of processing revenues this year, and I believe we will, I believe they'll be much higher in 2024, given the potential for partnering with.

Another, I guess, recurring theme that we hear at this point is pipeline. Well, we don't use that term internally. I'll say we're satisfied with the current pipeline while being honest, I'd like to see it larger. Six months ago, we thought we'd be working with a larger client in this quarter, but that has not panned out. We were working with the larger client and have spent a lot of time and there's been a lot of time. We're honestly not certain what the situation is as there have been no public announcements about what they may, what they may have or what they're doing. They've actually gone silent but it's possible they think they've found a pretty girl. Maybe I shouldn't say it that way.

But sometimes makeup people use, we don't use makeup. Maybe they just decide to do nothing. I should know better or more, I think, in the next 60 days. We're in various levels of discussions with a few other large potential opportunities. Some could be resolved by the third quarter and some will fall into next year. While big, I think, contract completed this year. We're still in the mode of under-promising and over-delivering. So we'll finally only be going to one or two this year. And I'm talking, of course, about large situations where there's an existing portfolio involved and those are the only kind you'll call large even though a lot of smaller, which could be very large.

We've got numerous smaller portfolios that all hope to grow to large numbers. They're live now and lot coming live over the next several months. I take a very conservative view on their Excel spreadsheet projections. So when I give you our process and growth expectation for 2023, I don't include what might happen with these opportunities. The competitive landscape really hasn't changed much in the last year. We still feel incredibly told by current prospective, by current and prospective customers that CoreCard is recognized as the gold standard for modern card industry. There are others that are good enough, or some programs I can remember back in the early days of Intelligent Systems, we were both in the hardware business with personal computer enhancements, as it was then called, and also the software business as we built Peachtree Software. I can remember vividly conversations and debates with engineers and project managers as to when to release our product. The debate always revolved around, does it work? Is it finished ? Is it full proof? Does it have everything we want or is it good enough? There were many times we had to say, stop. It's good enough and release the product. We never did that with the accounting software, because it simply had to be right. As far as every software, CoreCard never says it is good enough. Of course, even if those are for perfection, we sometimes don't get it perfect, but we never settle for good enough. In reality, we work and report to the regulators of the firms who are our customers and regulators don't want good enough.

I would say their competitors have sold for good enough, either consciously or because they did not know better. CoreCard sales are reconciled to the penny each.. Of course, there are some exceptions. Many others accept large expense accounts in order to balance. They can offer rock bottom pricing that typically correlates with settlement issues and poor customer service. On another note, one of our larger competitors for Canada recently purchased a company called Power for around $250 million. Power has, I understand, about 30 employees and provides frontend program management for card measuring programs. It's an interesting fact that Power is actually a customer report card and has been working on a new card program with us over the past, I guess more than a year, but I'm sure we'll not see much more later the day. So they paid as much as almost as much as the current market capitalization of CoreCard for a frontend problem management capability.

A partner of ours deserve a similar or in my opinion, better frontend functionality and we have several current and developing programs with their customers. We're going to be jointly proposing offerings with deserve for some larger accounts.

Let's – let me move to people resources. I believe we're finally reaching an equilibrium point, where I'm comfortable taking on larger programs that require significant conversions. While we'll keep hiring, the pace will slow considerably now that we have caught up and are able to stabilize the organization. I did mention conversions. We're really very good and experienced in doing those, so that relieves some risks from programs that want to switch from legacy to a gold standard modern insurance system. Our newer international locations, Dubai and Columbia, continue to be import in our future plans, I would say we're not able to really monetize them as we – to the level we expect in our original plans, but we're confident that it was a – it's good decisions and they're really adding a lot of value to the company.

Let me end my remark with one word. That's seldom heard in the fintech space today. That word is profits. CoreCard will continue in 2023 to be largely profitable, providing good return on average assets, average equity and investment. Those are key measures for long-term shareholders in building real value for an enterprise.

Operator, for that – with that, I think I'll stop and see if we have any questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now be conducting a question-and-answer session. [Operator Instructions] Our first question comes from Anja Söderstrom with the Sidoti.

Our first question comes from Anja Soderstrom with Sidoti. Please proceed with your question.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Hi, and thank you for taking my questions and congrats on the nice progress you are making. I appreciate the additional color you gave on the Goldman Sachs business. I'm just wondering if it is true that there are going to want to pass the efforts to bid for any more credit card programs. How could that affect you? I assume those customers that they're talking to would go to another player and I guess maybe some of you are talking to as well, or how do you think that might affect you?

A

Well, again, we – I have no information I can disclose about what they may or may not do. I would only speculate that it would make sense. It would make sense in one way for them to have another supplier of card services if they own a large customer that's already usually someone else. Now, the argument the other way, it would make more sense for them to get a more modern processor or rather a legacy processor and how it themselves. We don't have a part in that decision. So we're just there to support them in any way they want to be supported. And I'm fairly comfortable with I think I'm very comfortable with the projection we make and we're not projecting anything that we don't know that we don't feel is likely to come to play. So I don't see any impact on us in terms of our current 2023 projections with whatever they do.

Anja Soderstrom
Analyst, Sidoti & Co. LLC

Q

Okay. And you've previously said you expect that you could add probably two new large customers by the end of 2023. Do you still anticipate that?

A

Well, what I – what I shared that we have the capability of doing that. I'm – I'll say it this way. We have enough folks we're talking to that would allow us to have two lined up before the end of this year. How much work we do this year versus next year? I don't know at this point. We're still early February. We're still early into conversations. But again, our projections probably don't have any put – any significant large program in there. So that would all be an upside positive.

Q

Okay. And in terms of new customers, do you think they're more prone towards you said you probably want – you said you think they're going to be more prone to the processing rather than licensing, right? Or I don't know if I misunderstood that?

A

Yeah. Yeah, yeah. I think – I think the – from a market standpoint and just from a business standpoint, we – we're going to concentrate on building the process and business. We had – we had good increase last year. I expect to have a 20% to 30% increase this year in processing, and it could be higher. I would expect to have that or better in the next year. So from the license, I don't – actually I should – I would talk more about it, I think and then I did. We're still trying to decide whether it makes sense for us to license some of the folks or be competitors with us and how to do that license. So we're still reviewing that strategically to see how much we want to consider – how willing we'll be to do another license and we're not certain right now.

Q

Okay. Thank you. That was all from me.

A

Thanks.

Operator: Our next question comes from Hal Goetsch, Loop Capital Markets. Please proceed with your question.

Q

Yeah. Thanks for having this call. I just wanted to get a big picture question and you mentioned Leland going from legacy to a new gold standard modern platform. And could you share with us what your vision of, what does legacy look like, and what is – what's the modern platform look like and how difficult is it to move and where is most of the market at, is it mostly still on legacy, is it moving to a modern center need to define both of those four things?

A

Well, it is definitely legacy by a huge margin. We're not about credit cards now not just...

Q

Yeah.

A

....prepaids go everywhere. But in terms of credit cards, it's preponderance of legacy right now. And there's nothing wrong with that. If you want to have a cookie cutter plain programs, they're solid, they work well, they can give you low pricing and there's no reason to move. But there's a certain percentage. And I'm just would have to guess the percentage, the percentage of banks that want to have more control, they want to have the ability to make moves, to make changes, to dream up new ways of doing things. And they can't do that on a legacy processor. They have to have one of the modern platforms to do it. But it has to be a modern platform that also has a ledger, a system, a record that can withstand the regulators. When they look at – when they look and see these unique things that people want to do. So I can't give you numbers. I'll typically say there is probably going to be 10% to 20% of the card issuers that're going to want to really be on a modern platform meaning they want to be innovative. Now, I would say just quickly, they're probably 50% of the card issuers who say they want to be innovative, but they really don't. I mean, they want to be able to say it, but they don't want to spend the money or take the time or really be there. So, well, whether it's 10%, 20% or even 5%, there's a huge market for folks that need more flexible than they can get on legacy.

Q

That makes sense. Thank you. Would you say that a new issue as opposed to a established bank or credit issuer would more than likely if they were to know of a or want to go with a modern platform? If it was a startup, it was a start – a new – a new endeavor. Would that be accurate, do you think?

A

Yeah. I'll – I'll say it the way Strange says it that I'm going to crazy to go a legacy if you're a new issuer. But let me back up. If you still said, gosh, I want to do is exactly what CitiBank does maybe it will be fine. Maybe they'd give you 20% lower price, you do it. But yeah, yeah, I mean, your point is correct. Practically anybody that comes to the market now is going to want to go onto a modern platform.

Q

All right. Thank you so much.

A

Thank you.

Operator: [Operator Instructions] It appears that there are no further questions at this time. I would now like to turn the floor back over to Leland Strange for closing comments.

Leland Strange

All right. Thank you, everyone, for taking the time to listen the call. I hope I'm answering most of your questions. We – we are pretty pleased with what we're doing. And as I said, when I close, we certainly understand the need to make a profit. We understand the need to get a good return on assets, equity, and investment, and we continue to manage the company with those goals in mind. So thank you very much.

continue to manage the company with those goals in mind. So thank you very much.

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