

CoreCard Corporation NYSE:CCRD FQ2 2023 Earnings Call Transcripts

Wednesday, August 02, 2023 11:00 AM ET

Call Participants

EXECUTIVES

James Leland Strange
Chairman, CEO & President

Matthew A. White
CFO & Corporate Secretary

ANALYSTS

Harold Lee Goetsch
*B. Riley Securities, Inc., Research
Division*

Presentation

Operator

Greetings. Welcome to CoreCard's Second Quarter 2023 Earnings Conference Call. [Operator Instructions] Please note, this conference is being recorded. I will now turn the conference over to Matt White, CFO. Thank you. You may begin.

Matthew A. White
CFO & Corporate Secretary

Thank you, and 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 will be making certain forward-looking statements to help you understand CoreCard and its business environment. These statements involve a number of risk factors, uncertainties and other factors that could cause actual results to differ materially from our expectations. Factors that may affect future operations are included in filings with the SEC, including our 2022 Form 10-K and subsequent filings.

As we noted in our press release, our second quarter results were in line with our expectations. Our professional services revenue remained strong. We saw sequential and year-over-year growth in processing and maintenance. And as expected, we had license revenue for the quarter of \$1.8 million.

Total revenue for the second quarter of 2023 was \$15.7 million, a 3% increase compared to the second quarter of 2022. The components of our revenue for the second quarter consisted of license revenue of \$1.8 million; professional services revenue of \$7.4 million; processing and maintenance revenue of \$5.7 million, an increase of 26%; and third-party revenue of \$0.9 million.

We did experience a decline in third-party revenues as our customers utilized fewer ancillary services on a year-over-year basis. Customers can perform these services themselves, contracts through third parties or we can provide these services through our direct contracts with third parties. Services include items such as customer service, statement printing, card production, network fees and compliance costs. We would like to reiterate that third-party revenues are lower margin compared to our other revenue streams, and so there is less of an impact to the bottom line.

As noted in our 8-K filing last week, we signed an amendment with Goldman Sachs that, among other things, converts managed services revenue, which is a portion of our professional services revenue, from a time and materials basis to a fixed monthly fee of \$1 million. We recognized a slightly higher monthly amount from this revenue stream for the first 6 months of 2023. While the partial conversion to a recurring revenue structure is beneficial from a visibility perspective, it will result in lower services revenue for the remainder of the year.

As a result and combined with lower-than-expected third-party revenue, we have adjusted our guidance for the year to approximately 5% for services revenue growth. Revenue growth, excluding our largest customer, was 7% in the second quarter on a year-over-year basis. The slowdown from the first quarter is primarily due to lower third-party revenues as discussed previously.

We continue to onboard new customers, both directly and through various partnerships we have with program managers, including programs with American Express as the network. As in previous quarters, we currently have multiple implementations and progress with new customers we expect to go live in the coming months.

Processing and maintenance revenues grew 26% in the second quarter of 2023 compared to the second quarter of 2022 from the recently added customers mentioned above who are now live and continued growth from existing customers.

And now turning to license revenue. We recognized another license tier in the second quarter of 2023 as expected, resulting in \$1.8 million of license revenue for the second quarter. We expect a new license tier in the third quarter of 2023.

Professional services revenue remained strong in the second quarter. We anticipate professional services revenue in the third quarter in the range of \$6.7 million to \$7 million.

And now turning to some additional highlights on our income statement for the second quarter of 2023. Income from operations was \$2.7 million for the second quarter of 2023 compared to income from operations of \$3.5 million for the same time last year.

Our operating margin for the second quarter of 2023 was 17% compared to an operating margin of 23% for the same time last year. The decrease is primarily driven by hiring in India and in our Colombia office that we opened in October 2021, in addition to continued infrastructure investments in our processing environment.

Our second quarter tax rate was 24.8% compared to 23.9% in the second quarter of 2022. Earnings per diluted share for the quarter was \$0.22 compared to \$0.33 for Q2 2022.

As noted in our press release this morning, for the full year, we expect growth in services revenue of approximately 5% and license revenue to be between \$3 million and \$7 million. We expect growth from customers, excluding our largest customer which is all services revenue, to be approximately 11%.

We expect license revenue in the third quarter. However, it's difficult for us to predict the timing of license revenue for the fourth quarter and beyond for reasons we've discussed previously.

Within services, we continue to expect strong growth in processing and maintenance as our customers continue to grow and as we continue to onboard new customers. Professional services revenue continued to be strong in the first and second quarters. And we anticipate professional services revenue in the third quarter of 2023 to be likely in the range of \$6.7 million to \$7 million. The lower professional services revenue reflects the change to our Goldman contract converting a portion of the revenue to a fixed monthly fee.

With that, I'll turn it over to Leland.

James Leland Strange
Chairman, CEO & President

Okay. Thanks, Matt. I think you covered all the essential financial things, and I'm going to talk about a few things in -- unprepared remarks but just things that people have been asking.

So let me just first comment on the fact that you talked about India being part of the reason for the difference between last year and this year. I can say at this point, we have pretty much flattened the growth in the India operation based on slower growth here.

We have slightly under 1,100 employees as of the end of this quarter, and that comes -- the contractors that we also use full time. I would say our full-time staff is probably about 1,000 employees. We probably have 80 contractors, most of which are full time for us, not all. And then we have maybe 20, 25 interns at the present time.

So -- and in reaction to a little bit slower growth, we have taken a step of slowing things down there now. So we are continuing to spend money in 2 areas. One, the [Tesla] project that we call a potential project, which is the new CoreCard software. That's still perhaps 2 years out. Hopefully, it will be less time than that. And we're certainly going to be using some modules that we're developing in less time. In fact, we'll be doing one of those in this year. But we're

going to continue to spend in that way.

But the big question that I'm always asked is, what about Goldman and Apple? And where do you stand based on what they've been saying?

There is some press recently that talked about Goldman is talking to American Express about taking the Apple account. I think the President of Goldman said it right when he said the GM and Apple relationship is not unilateral. I interpret that to mean that Goldman can't do whatever they want to do with those relationships without getting complete buy-in from those 2 parties.

I must say in the beginning, I know nothing. As you would expect, Goldman is very quiet in terms of how they deal with these things. And the people we deal with, not only will they not tell us, but the fact is they know nothing because it's really just -- it's really handled at the very top. So everything I say now is just speculation based on my relationship and the amount of time we spent with them and also knowing about what we do and about our software.

So here's what I would speculate. Well, let me back up. There's one place that I won't have to speculate. You note we filed an 8-K, I guess, a week or so ago that said that Goldman and CoreCard had an amendment to their agreement. So we extended all of our contracts for 2 years. So that will give you some indication of the relationship we have.

Now part of that moved some of our revenue that was on time and materials to fixed price. And as Matt said, that's probably going to result in a little less income to us over time, but we felt like that was the right thing to do to have a 2-year contract and have recurring revenue.

And in terms of a 2-year contract, it's by my opinion and I think anybody's opinion that would take more than 2 years from the time you said, "Okay, we're going to move those contracts somewhere else to another party off of CoreCard." So we're -- I am very, very, very comfortable that we'll be processing the Apple Card 2 years from now.

Of course, it can be moved. And of course, you need to do what you need to do to keep the business, but we're doing it very well. We just had a very successful end-of-month, end-of-quarter processing of the Apple Card faster than it's ever been processed before. So we're very happy with performance.

And likewise, with the contract renewal for 2 more years, we also feel very comfortable with that. Now one thing to think about on that contract has nothing to do with really licensing in the software. It's perpetual license. And as long as they add new cards, they're going to have to pay us. So it's kind of unlimited in that sense.

But in terms of just the normal things we do for them is now a 2-year agreement. So what does that mean? Will they move it? It's possible. It's highly unlikely, but it's possible. And if they do move it, what happens then? Well, it's possible that a new provider will still want CoreCard to process the card.

Now there are a lot of things you do outside of processing like this is the area -- these are the areas they're going to have problems with. And that's your customer service, that's disputes, basically dealing with the customer and dealing with some regulatory issues. It was not a problem with the processing that we were taking care for them.

So a new -- Goldman's never done that before, by the way. So if you go to someone new such as American Express, they do that all the time. They would know how to do that as well as a lot of other people discovering a lot of folks. In fact, there are some rumors that Apple might choose a bank that -- basically a no-name bank and not put their name in big letters on the card, and then Apple would take on some of that third-party stuff.

Again, I believe we will be the processor for that. Other people certainly could do the customer service and the dispute, and that's a job they do better. So that's where we stand on that. We don't believe there's a risk of that as long as we do what we're supposed to do. And as long as we do a good job for it, we don't believe there's a risk.

We believe we've priced it right. We believe that we provide very, very good service. So we don't share a problem with that. That's usually what it's all about. Everybody is worried about what the press says.

And I would say the next thing, obviously, growth has slowed. We're seeing big, medium-sized banks -- we don't deal with the big banks right now. But the medium-sized banks are really saying, "We don't want anything that would get our name in the headlines. We don't want to announce a change of processors. We don't want to do anything that simply would be a -- that would cause people to take a hard look at us."

So on that [indiscernible] really just been put on hold. We still have a good number of customers that are teed up. They can go buy the new point, but [indiscernible] some of them are just kind of put it on hold as the current financial, economic situation picks up.

One thing we are doing [next year] is that we're developing a commercial card for a mid-sized bank. So I want to say things are pretty much on hold, but there's just one situation where we're developing to their -- well, I won't say to their specification. But with their help, we're developing a new commercial card product that will go live for what we call friends and family in the fourth quarter. That simply means it will be in test. It will be used lightly. It would be rolled out in first quarter of next year.

I don't expect huge revenue from that initially. We think it's a very important product for us, particularly the fact that it's being developed hand in hand with the bank as opposed to just someone come out with product specifications. And we believe it does have really good possibility, both for that good mid-sized bank as well as others in the future.

So that's -- we're doing a lot of new stuff. We've got -- still have new clients coming in. They're just not getting to market as fast as we would hope they get to market.

Matt, any other comments that you hear from folks? Those are the main ones that I hear that I wanted to respond to.

Matthew A. White
CFO & Corporate Secretary

Yes. No, I think that covers it. I think the only thing I would add is that the -- there were 3 contracts that were extended with Goldman. One -- 2 of those were for statements of work that we have with them, and that was a 2-year extension. And then for the maintenance work that we do, that was a 3-year extension. That's the only thing I would add.

James Leland Strange
Chairman, CEO & President

Okay. So let's take it to questions now if we have any questions. As we always say, if you don't want to ask the questions here on the call, we're always open to explain whatever maybe we haven't explained that well. So operator, let's see if there are any questions for us.

Question and Answer

Operator

[Operator Instructions] Our first question is from Hal Goetsch with B. Riley Securities.

Harold Lee Goetsch

B. Riley Securities, Inc., Research Division

My question is, expense growth, you've had a good overview of the employee count and also like point out you had a lot of employee growth in the last 2 years or so. Do you think your expense growth here is going to be leveling out in the next year to 2 years?

James Leland Strange

Chairman, CEO & President

Yes, I do. I think there's going to be some inflation impact, obviously, to payroll and expenses. But in terms of overall growth, we're not going to need to grow that a lot to take on a good bit more business. We're going to need actually fewer people working on the Goldman, Apple thing because that's running pretty smoothly. So we think we're in pretty good shape to take on more business without adding a lot. Matt, do you want to add anything to that?

Matthew A. White

CFO & Corporate Secretary

No, that's right. There'll be some smaller increases. But overall, we're trying to keep the headcount pretty steady, and that's what we've been doing in India and kind of only adding where we need to. But we added enough people last year to where our focus is on getting those folks trained so they can contribute.

Harold Lee Goetsch

B. Riley Securities, Inc., Research Division

Okay. Great. If I could ask one follow-up. Leland, you mentioned the banks don't want to do anything that gets their names in the papers. And basically, it seems to me they want to keep their risk profiles low.

And what would -- should we be looking for as analysts and investors to know when that little -- that modest overhang is lifting? What will we see in the economy, what will we see in the regulatory picture based on your experience? What should we be looking for?

James Leland Strange

Chairman, CEO & President

Well, that's a good question. I need to think about that one a little bit. It's -- from an overall economic standpoint, I just think you need to -- we need the overhang that we're getting, with Fitch hitting the credit of the U.S. yesterday and with all -- I guess the market's down, S&P, and they're also down almost 2%, S&P down close to 1.5% today, I think you just need to be -- you don't need to see growth. You need to see some stability.

It's both political and economic, just some stability so people can just say, "Let's just get back to business as usual." Nobody feels like it's business as usual right now.

Harold Lee Goetsch

B. Riley Securities, Inc., Research Division

Yes. I would agree with that. I mean, there's many, many small banks that are selling consumer credit portfolios to nonbank financials to improve their ratios. And so what you're saying makes perfect sense to me. I'll get back in the queue.

Operator

[Operator Instructions] There are no more questions at this time. I would like to turn it back over to management for any closing remarks.

James Leland Strange

Chairman, CEO & President

All right. Well, we just thank you for your continued interest and support. We're going to continue to push forward. We feel pretty comfortable about where we are. We think we're moving fast at this point, but we think we're on the right path, and we'll continue. So thank you. And for any other questions along the way, please give us a call. Thank you very much. Have a great day. Bye.

Operator: Thank you. This will conclude today's conference. You may disconnect your lines at this time, and thank you for your participation.