

Company Name: CoreCard Corporation (CCRD)
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<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

We have CoreCard here with us today for a 25 minute fireside chat. Matt White, CFO, and Leland Strange, CEO. Thank you guys for being here today. Appreciate it.

<<Leland Strange, President and Chief Executive Officer>>

Good to be here.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

We'll do maybe 20 minutes or so of Q&A and then open it up to the audience for any questions. Why don't we start with just kind of an introduction, Leland to CoreCard. Just give us the 30 second, one minute snapshot of the business.

<<Leland Strange, President and Chief Executive Officer>>

That's what we do.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Yes.

<<Leland Strange, President and Chief Executive Officer>>

Well, the easiest way to talk about it is talk about our biggest customer and that we license software to Goldman Sachs that process the Apple Card. So effectively our software keeps up with a ledger for an issuer who issues credit cards. And that's the key to what we do. Now we do a lot of those things, but that's represents in fact that one license represents 70% of our business. But we do all the things any of the processors do. We do debit card, we do prepaid card, we do spend cards. But credit is our – is really our key.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

And why don't we – just to start kind of get the macro questions out of the way. I think everyone wants to know, how various businesses are being impacted. Give us a look into CoreCard and kind of how you've been affected by the current environment and what your expectations are as you look out to the end of the year?

<<Leland Strange, President and Chief Executive Officer>>

Well, I mean, to this point, we haven't been impacted by the current environment, but looking ahead a little bit, I foresee a slowness that I didn't expect, let's say six months ago. I start seeing some of that. And we're not talking about just CoreCard because when I talk about – when I talk with some of our competitors, they're seeing the same thing. And the reason for that is that banks, which would be our primary customer, simply don't want their name in any story about anything, even if it's a good thing. They just don't want attention brought to them because of what's happening in banking. So we're seeing no change in conversations about product and future, but we're seeing changes in the idea that we can really talk about doing something anytime soon, like can't do much anytime soon.

Now FinTechs are still doing stuff, obviously we're doing that and we're still working with some banks, so it's not like things have stopped, but it's like the volume, volume may have been seven or eight at one point. Now it's down to three or four, is the way I would say it. Sometimes I say it's muted. That overstates the case. It's not on mute, but it's come down simply because of the credit crunch and also visibility of banking.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

That's helpful context. And maybe just kind of steering towards the competitive landscape or the industry landscape. Would love to get your perspective on kind of how the issuing space is laid out. I think there are some names that folks are familiar with or some that are kind of buried in larger businesses. Help us understand how you look at the landscape?

<<Leland Strange, President and Chief Executive Officer>>

Well, I mean, you cover some of those bigger ones. So your Fiservs, your Global Pay, they're obviously very good processors. Now I still think of the issuing side, some of the old names, the TSYSs and the First Datas that the big guys have purchased. They're the inside group that's still doing the issuer processing and they're still very strong. They're very good. They run on Cobalt software. It just runs, it's compliant so there's nothing wrong with it. Well, I guess if I say there's nothing wrong with it, I would say, well, what's the future for CoreCard if nothing's wrong with it. What's wrong with it is the fact that it is Cobalt. It is big, it is cumbersome, so it's hard to do anything innovative. It's hard to do anything quickly because of that. It's also – they're burdened by success a little bit.

If you have a lot of customers on the same platform, making changes is very risky in terms of what it might do for some of those customers. So they're slow for a reason. They can't just all of a sudden speed up. But they're very good at doing what everybody wants to do except for those that want to do innovation. And I fall back to Apple could not have run their card on any of the big guys. And well, it's software. You could've done it, but it would've taken three years as opposed, taken a year for it to run on ours. So they're strong. So that's the big guys. Nothing wrong with them. They're not going to lose business. It's a sticky business. They're going to continue to do what they do. And furthermore, I would say from a pricing standpoint, they will give any price they need to give in order to keep business.

So it is hard to move the big guys. You've got the smaller ones, now you've got the Marketos, SoFi that uses, that's Galileo, you've got private ones i2c. These guys can move faster. Marketo is a very good company. They've got a very good platform. It was built for prepaid, it was not built for credit. And that's a huge difference because there's a huge difference between prepaid and credit. I tend to say it's credit is 20 times as hard as prepaid. So there's issues, they're trying to do. I think credit with some of the newer guys.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

So if I can kind of read between the lines and how you align yourself with some of your peers, the ability to move quickly and credit are the two things that stand out to me. Would you push back on any of that or?

<<Leland Strange, President and Chief Executive Officer>>

No, I wouldn't push back on that. I would say credit is the thing that stands out. We were built for credit and then we did prepaid and spend cards and all the other kinds of things. The other guys were built for prepaid, and then they are trying to do credit. Let me talk a little bit about credit. Why credit so much harder though? Because if you're not in the business, you don't understand that. If you think about one of the issues of credit is simply testing new things. So if you will be innovative, you're wanting to do something new. Well, how do you test that? If it's prepaid, it's real simple. Prepaids got currency, money, it's in the bank somewhere. We just keep up with it. With credit, we're issuing new money, basically we're issuing money that doesn't exist.

So it's not really keeping up with a checking account. And then I'm putting not fees. I may put fees, but I'm putting interest on it, which is also kind of fake money, made up money. So then I've got all kinds of compliance issues, and then I have what we call in the business time travel for testing. I have to test that not just for one month, but you do a bunch of stuff. You test it for the second month, and you sort of time travel it to see what happens with interest over time. If people make the payments, they make the wrong payments, they don't make a payment. How does that interest and how does that accrue over 12 months? You have to test a whole bunch of types of things that may happen over 12 months, not just an instantaneous point in time.

So for prepaid, it's instantaneous point of time testing, really easy. For credit, it becomes much difficult. So I think it's a big difference between a ledger that's built for credit that you then use for prepaid than a ledger's built for prepaid that you then try to use for credit with the caveat that if it's real simple credit and many people are calling it spend card credit, for example. Well, gosh, you pay it off at the end – you don't charge interest. You pay it off at the end of the month or the end of the week or whatever. That's not really credit. I mean, it's credit, but not credit in this instance of any interest that attaches to it. So that you can say you do credit if you do those simple things. But not in the type of thing that we're talking about of real credit.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Moving on to kind of describing the customer base, you mentioned some banks, some fintechs, Goldman, obviously. Can you just kind of paint us a picture of the customer base today and kind of where you're winning in particular?

<<Leland Strange, President and Chief Executive Officer>>

Well, Matt, why don't you mention American Express?

<<Matt White, Chief Financial Officer>>

Yeah, that's the – those are the, I guess the industry areas that we usually mention deserve as a program manager, that's a customer. And then they have their various customers sort of that use their front end and then they deserve uses us for the back end. Cardless is another example of a program manager. They're a little newer than deserve. They do similar things but with just a different customer base. So they're out there, selling on our behalf and then adding cards to their portfolio. That then adds to the backend number of customers that we have.

So those are two good examples. American Express, they bought Kabbage a couple years ago, two, three years ago. Kabbage was an existing customer and we did their small business lending, processing. And the way that we won that business was because we were able to do something a little bit unique where they wanted to have sometimes hundreds of loans on one account for one customer. And we could consolidate that into one statement, one payment, even though you'd have different maturity dates, different interest rates. So that was a differentiator. And then when American Express bought Kabbage and launched their own, what, I guess they call it the Amex Kabbage product, it's a new product that they launched. They decided to use us as the processor for that. So we've been doing that for ever since they bought that business because they didn't actually buy the legacy portfolios that Kabbage had.

So we continue to process those legacy portfolios. So those are running off and we're doing the new program with Amex. So those are some good examples. And we're working on a commercial card program for a regional bank. And so we'll start to target more things like that that are more direct with banks versus the fintechs. But we're continuing to sign up a lot of fintechs, usually ones that have an existing customer base that's kind of our target. It's typically a new program, like a new credit program. We've done some conversions, smaller ones. But what we're looking at a lot right now is the fintechs with an existing customer base that they can market their credit product to.

<<Leland Strange, President and Chief Executive Officer>>

We tend not to throw out logos or names of customers because a lot of our customers, they pretend to be the processor. Like if you got deserves, deserves as they process credit cards, they do credit cards. So we're behind the scenes and we just assume, not worry about that. We don't think that's really material. So there's a couple of other known names that have licensed our software. They're smaller, but they are processors using our software. And again, we just don't kind of throw those out.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Sure. And taking that a step further and discussing the kind of go-to-market strategy that you all have in place. A lot of it is inbound, as I understand it. Maybe unpack that for me a little bit's.

<<Leland Strange, President and Chief Executive Officer>>

It's all inbound. We have no sales people, we have no marketing, so it's all inbound, meaning we get a call or we get a referral and we proceed from there. And up to this point, we've had all the business that we could execute on the way we like to execute, which is do it very well. I would say at this point, we're going to consider doing a little more in terms of call it business development in the sense that looking out for business two, three, four years from now, not business right now, we're pretty busy at this point.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Yeah. That's interesting. And so you think about that piece of it, the go-to-market element. And then, more recently, I think you've spoken to some product enhancements around CoreCard software. Talk about some of the initiatives to upgrade the software behind CoreCard?

<<Leland Strange, President and Chief Executive Officer>>

Well, we've kind of noted that we are actually rewriting our software one more time. The software we use now, we wrote – we took a company called PaySys, which is one we own, by the way. So Cobalt code rewrote it into what would be a modern system at that point. And that's what we use with a lot of things changed, but we're starting from scratch with a blank sheet of paper, started a couple years ago, rewriting it one more time. It'll still be a couple more years before we get that done. And one of the keys to that, again, rewrite is thinking what have you learned from the last time you wrote it?

Well, you learn this time travel testing is really a issue in terms of being able to do things fast. If other folks who've never experienced that rewrote it, they don't – they probably don't think about that. So that's one of the things that we're trying to, I don't want to say fix, but trying to make sure we get right so that we can still be – we want to be the people that can do the – bring the product, bring an innovator product to the market the fastest. We can do that now, but people catch up with you in software. So we're rewriting things again in order to do that. So, we're spending money doing that. It's we're thinking long, long, long-term, because this is a long-term business. We sold the previous business. We had the First Data in the early 2000s.

And they're still using that software, by the way, in some places, it's still very valuable to them. They got really to buy, even though it paid several \$100 million. So this is credit software has a long life and that's the good thing. I guess, the other thing I didn't mention that that's a real key on the credit software, is the fact that you're really dealing with compliance regulatory issues much more than you are with prepaid. But prepaid, you're dealing with fees a little bit. Okay, are you charging right fee and you're getting good customer service with credit, you're dealing with annual percentage rate, got to be just right. So if you have three or four plans, how do you merge

those? You have payment application. So there's just a whole lot of both OCC, which is the banking folks that you've got to deal with if you have a bank customer and all the other regulatory things. So reconciliation is a huge issue in credit.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

And when you speak to customers today, is there an ask for additional functionality? Are there things that they want to do that, that you're looking to include in the roadmap or is most of the innovation from the...

<<Leland Strange, President and Chief Executive Officer>>

I don't know of anybody who's asking for something that we can't do. But again, you don't want to sit still. You got to think of the future. If you have another Apple type customer that walks in and says, can you do this? Nobody can say they can do it, but I don't know what this going to be. You want to be in a position to say, no, I don't, but I can do it in three months or six months. And if they go to someone else you want them to say, yeah, I can do it, but it'll take me 18 months or two years. You want to be the fastest, whatever it is.

We don't have any illusions that a lot of the big, the big issuing customers are going to move to CoreCard in the next five years. They're not, because they're not innovative. We just need a few that are innovative, that want stuff they can't get from the big processors. But there's nothing today, we're not trying to fix a problem that we have today. We're trying to forestall a problem that could be out there two years from now, because it'll take us another two years at least to fully utilize what we're writing, even though we're going to – we're taking parts of it, putting in our current system, but generally it's a total system.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

And just to jump back to some of the challenges associated with credit for a minute. I mean, I hear what you were saying. I guess, maybe just want to kind of understand, is it just an experience and it takes time to build the chops to serve credit. And what is the true, I mean, the software is different. It's much harder to do to, if you're starting from prepaid and debit. I guess, maybe how did CoreCard get the entrance into credit and how was that?

<<Leland Strange, President and Chief Executive Officer>>

Our processor company owned a company called PaySys. And it had the world leading credit software. A lot of banks around the world used it with Cobalt. And at a point in time, we said, well, ultimately, frankly, made a wrong decision. My background is PCs, microcomputers, not mainframes. This was all mainframe. And we ended up buying control of that company that was all mainframe. And I said, those mainframes are going to go away. You're not going to need those things in 10 years. You need to put all this on PCs. Well, mainframes didn't go away, okay, but they said they're still there, but they still have the problem they had.

So that's what drove the decision to simply take a good credit program, which by the way, it was started by three guys with a company called Credit Card Software, and their early customer is Neiman Marcus in private label, then they got into the basically using the rails, MasterCard and everyone. So that's kind of how the decision was made. It was all credit. We didn't think prepaid till, I don't know, five, six, seven, eight years ago. We said, hey, there's a wave here that looks pretty easy, let's just go do that.

Right now, for example, okay, you do debit and there are people that fight for debit, debit pays for just pennies because debit's nothing but an expense for a bank. Nothing but an expense for a user, a bank can't make money on debit. They just have to have the debit card. Where do they make money? They make money with credit cards. That's the only place you can make money really with cards. You can do a little bit with fees, but interchange gets eaten up pretty fast and interchange is a risk that someone else has control over. You don't, so you make your money on credit.

So it was just logical. That's what you do. So you use the other things as because you have customers that use – that need all of those. So we'll do a debit card if it's – we'll do it first. If it's a customer that might, that we believe for sure will want a credit card, eventually. If we have a credit card customer, we'll obviously do debit card for them. And likewise, we prepaid, so I mean, credits where the bank will make money, credits where the process or automate their money ultimately.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

And Matt, maybe jumping over to the model, I think if I have understood some of the past comments correctly around processing services growing very nicely, and I think the general expectation is for continued growth at a very similar rate. As you look out a couple of years, talk about how you kind of build up to that and what underlies that?

<<Matt White, Chief Financial Officer>>

Well, it's growth from existing customers as they continue to add accounts. And I talked about some of the ways that happens with Reserve and other customers like that. And then we're continuing to sign up new customers. We're signing new contracts every quarter. We've got new customers going live every quarter. And so it's that combination that gets us there on the processing and maintenance growth. And for processing and maintenance, both it's driven by active account fees. So it's a per account per month fee that we charge. So we can be pretty confident that that continues to grow. Even if there's a decline in transaction volume or the number of transactions that's we're really agnostic on that. It's just as long as there's an account and someone continues to use it. Our customers continue to pay us. So that helps us out a little bit if there's – if some of those other things go down.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Sure.

<<Leland Strange, President and Chief Executive Officer>>

And that's an important point in terms of looking at comps. We do it based on accounts, not on transaction volume, either dollar or number of transactions. Whereas most of the other, many of the other particularly, the newer fintechs, they try to jump into their customer's business and program management or share interchange, do things like that. That's a big difference.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Yeah. Matt, when you look at the investment priorities, I think we've addressed some of them in the product roadmap and such, but lay those out for us for the balance of the year and how you're thinking about that?

<<Matt White, Chief Financial Officer>>

Well, we've got plenty of cash and generated a significant amount of cash so far this year. A lot of that was based on a reduction in AR, we've got some payments that came in at the end of June. So we've got \$31 million plus another \$5 million investments, so it's just maximizing the yield on that is a high priority right now, looking for ways to reinvest in the business. So if there's an opportunity internationally to invest, we'll look at that. We've done that over the last two to three years with a new office in Dubai, new office in Columbia. But right now, we're trying to stay pretty steady with our hiring. And so, kind of keep our costs pretty level we think we have the right amount of resources to continue our revenue growth at this point.

We're always looking for potential acquisitions. It's typically been hard to find a good fit for CoreCard. That's the right price. And so, we'll try to say disciplined on price and we continue to buy back shares this year. Did a lot less this year than last year, but still did over 400,000 in the second quarter.

Q&A

<Q>: You talk about the option of American Express. Is that – would that be as big as one for Apple?

<A – Leland Strange>: Yeah. I'm glad you asked that because I want to – that's another topic, we don't know. Okay. The idea is that I can sit here and tell you what American Express tells me. I can tell you what I think, but the truth is we don't know. So from a business planning standpoint, we plan like, we don't know and it is not as big as Apple, by the way, that's for sure. But it could be very big. But see, it's only if they decide to promote their program, of which we don't know. And sometimes, we've had situations where you'd have hire a person in some, let's just say like American Express at this point, who's ready to go spend a lot of money to do it, then somebody says, let's put emphasis over here within the companies.

So all of a sudden something that could have been 500,000 cards becomes 25,000 cards because of a decision made outside of that group. And that's why I just don't want to plan on any one of those, being successful. I plan on having enough companies that whichever one surprises me on

the upside is great because somebody's going to surprise me on the downside. It's not as big as Goldman, though, I can tell you that. There's probably nobody out there that's not true. I said to you, there's nobody out there in the next two years that we're likely to get that would be as big as Goldman in the next two years. We've talked to folks that could be bigger, but it's would be several years out.

<A – Matt White>: Just for some context, Kabbage at one point was \$3.5 million annual run rate. There are two components though, to the Amex relationship. We do have now the network connection. We are getting some traction there. You don't know how much of that's incremental where they weren't going to go with CoreCard unless they could use Amex versus Visa or MasterCard, which we also have connections with. But again, it's just very hard to predict what that's going to...

<A – Leland Strange>: That Amex thing is complicated. There's the Kabbage component that they were sold to, we're still doing that. That's going to run off at some point. That's been a surprise that hadn't run off as much, we're happy it was better. There's the part that they're trying to grow, it's grown probably not as fast out wide, but it's grown fine. There's the side where we're the network for Amex where people want to issue a card with the Amex brand on it, whether MasterCard or Visa. So all of that, we've got really good relationships with Amex and frankly, we're developing the same thing right now with Discover. People don't understand. Discover's got about as much coverage as they got more than Amex, by the way. About as much as some of the other bigger guys so we're working a whole lot of angles there.

<Q – Alex Markgraff>: Any other questions from the audience? Well, Matt, maybe one last one for you to wrap it up. The balance of growth and profitability is kind of top of mind for everyone. Would love to just get the CoreCard take on what is that, that right balance to strike between growth and profitability having been nicely profitable for some time?

<A – Matt White>: I think for us it's just, we expect to stay profitable. And at this point, we're not focused – laser-focused on what the margin is, whether it's 25, 20, whatever it is right now. We do think that long-term though, if you look at some of our larger competitors, if they do break out their issuer businesses, their EBITDA margins are high 30s, low 40s, and that's where we think we end up. But it's we're too small for us to really focus yet on that, so we'll just focus on being profitable.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Sure. Great. Thank you, Matt. Leland, thank you for joining us.

<<Leland Strange, President and Chief Executive Officer>>

Thanks.

<<Matt White, Chief Financial Officer>>

Thank you.

<<Alex Markgraff, Analyst, KeyBanc Capital Markets Inc.>>

Thanks everyone.