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CoreCard Corp. (CCRD)

Q3 2024 Earnings Call

CORPORATE PARTICIPANTS

Matt White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

J. Leland Strange
Chairman & Chief Executive Officer, CoreCard Corp.

MANAGEMENT DISCUSSION SECTION

Operator: Ladies and gentlemen, greetings and welcome to the CoreCard Third Quarter 2020 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. Please go ahead, sir.

Matt White
Chief Financial Officer & Corporate Secretary, CoreCard Corp.

Thank you and good morning, everyone. With me on the call today is Leland Strange, Chairman and CEO of CoreCard Corporation. He'll add some additional comments, probably more than you're typically used to, and answer questions at the conclusions 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 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 2023 Form 10-K and subsequent filings. We'll also discuss certain non-GAAP financial measures, including adjusted diluted EPS and adjusted EBITDA, 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.

Before I get to the financial highlights for the quarter, I'll comment on the filing this morning regarding the decision brought by our auditor not to stand for re-appointment following the completion of our fiscal 2024 audit. This is a business decision that our auditor made, given the expense involved in auditing public companies and the fact that we are currently their only public company client. They may take on public companies in the future, but for now it didn't make sense for them to have only one public company client, so we will be looking for a new auditor as a result.

And now on to the results for Q3. As we noted in our press release, our third quarter results were better than expected with earlier than expected license revenue. Total revenue for the third quarter of 2024 was $15.7 million, a 17% increase year-over-year driven by higher license revenue, higher professional services revenue and higher processing and maintenance revenue. The components of our revenue for the third quarter consisted of license revenue of $1.4 million, professional services revenue of $7 million, which came in ahead of our previously guided range, processing and maintenance revenue of $6.1 million, and third-party revenue of $1.2 million. Revenue growth excluding our largest customer, was 7% in the third quarter on a year-over-year basis. Revenue growth excluding our largest customer, in addition to the impact from ParkMobile and the legacy Kabbage business as detailed in prior quarters, was 30% in the third quarter on a year-over-year basis and is expected to be 25% to

30% for the full year, which is above our previously guided range of 15% to 20%.

We continue to onboard new customers both directly and through various partnerships we have with program managers. As in previous quarters, we currently have multiple implementations in progress and new customers that we expect to go live in the coming months. Processing and maintenance revenues increased 4% in the third quarter of 2024, compared to the third quarter of 2023, primarily due to higher revenues from existing customers and the addition of new customers, partially offset by the revenue decline from the legacy Kabbage business I mentioned above.

Now turning to some additional highlights on our income statement for the third quarter of 2024. Income from operations was $2.8 million for the third quarter of 2024, compared to income from operations of $0.4 million for the same time last year. Our operating margin for the third quarter of 2024 was 18% compared to an operating margin of 3% for the same time last year. The increase is primarily driven by higher license revenue, higher professional services revenue, partially offset by continued investments in our new platform. The income statement impact of our new platform build was $0.7 million in the third quarter of 2024, compared to $0.5 million for the prior-year period. Our third quarter 2024 tax rate was 25% compared to 24.5% in the third quarter of 2024.

Earnings per diluted share for the quarter was $0.27, compared to a loss per share of $0.03 for Q3 2023. Adjusted deluded EPS for the quarter, excluding stock compensation expense was $0.30 compared to $0.09 for Q3 2023, which excluded an impairment loss on a cost method investment. Adjusted EBITDA was $3.9 million compared to $1.9 million for the third quarter of 2023. We have over $28 million in cash and marketable securities on our balance sheet as of September 30, 2024, and we expect to continue generating operating cash flow for the full year 2024. We plan to use this excess cash and cash generated from operations to continue investing in our new platform and to continue buying back shares. We repurchased 134,650 shares in the first quarter of 2024 for$1.6 million, 147,040 shares in the second quarter for $2.1 million and 123,370 shares in the third quarter for $1.7 million. For the full year 2024, we expect total revenue to be approximately flat. As mentioned earlier, we expect growth from customers excluding our largest customer, in addition to the impact of ParkMobile and the legacy Kabbage business, and the $0.5 million of accelerated revenue that we recognized in the first quarter, to be between 25% and 30% for the full year above our previously guided range of 15% to 20%. Within services, we continue to expect strong growth in processing and maintenance, as our customers continue to grow, as we continue to onboard new customers.

As mentioned in our press release, this morning, for the fourth quarter of 2024, we expect total revenues to be between $13.3 million and $13.7 million and earnings per share between seven and $0.09. We recently renewed our agreements with Goldman as outlined in our 8-K filing with the SEC last week, extending the agreements through December 31, 2030, with early termination rights starting in January 2027. This extension gives us increased managed services fees starting in January 2025, resulting in higher fixed revenue from Goldman and increased visibility on revenues from them for at least the next two-plus years. With this increased visibility, we provided guidance for 2025 of total revenue between $60 million and $64 million and earnings per share between $0.88 and $0.94 and revenue growth excluding Goldman of 30% to 40%.

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

J. Leland Strange
Chairman & Chief Executive Officer, CoreCard Corp.

Okay. Thanks, Matt. I know that on a day like this when both the Russell and S&P are down 2%, I'm going to ask Matt not to schedule our conference calls on days when the market crashes, but nevertheless, it is Halloween.

So as Matt said, the quarter results did exceed our expectations from our call even a quarter ago. We do frequently have lumpy revenues that are hard to project. We've talked about that many times before. It consists of license revenue, or the lack thereof, and that revenue often distorts period-to-period comparisons. We don't know in advance; it's based on active cards of licensed clients at the end of the quarter. We don't know the answer until reports are run several days following the quarter end. Best we could do is give you our predictions, given what we know at the time. I'll admit we try to be conservative but also accurate, it's what I call the line-of-sight view and not a hopeful view.

With Matt's comments today and I think we're providing a little more of a forward view of how we see things while noting areas of risk. My comments today will follow a four-point outline incorporating the four most frequently asked questions we get in conversation with investors. We certainly don't selectively disclose info, so for those of you who have asked these questions in the past and didn't get a satisfactory answer, hopefully you will today. Now, they'll include a lot of opinions, beliefs and just thoughts as of right now, so they clearly fall under forward-looking statements for safe harbor purposes, so you should consider them with that caveat in mind. The outline for my comments or questions is first, Goldman Sachs relationship and all that entails, after all, it is a highly concentrated position at CoreCard. Second, succession or my situation. Third, acquisition or what we do with cash and then I'll give a brief summary and talk about growth outside of Goldman.

So for topic number one, the Goldman Sachs relationship, I'll elaborate a little more on the newly amended agreement, but I need to warn the press or others that are listening to this call that you cannot read anything to what I say to predict anything about Goldman Sachs or Apple. What I say simply is my belief what CoreCard will be doing and expecting. Goldman Sachs may have a totally different view. The new amended agreement is very good for CoreCard and that we have more certain locked in revenue through the end of 2026, the next two-plus years. I've said in each of the earnings calls this year I think that we're likely to be processing the Apple Card with Goldman through 2026. This new agreement doesn't say that, although I believe it to be true. It says that Goldman will pay us the contracted amount through 2026, whether we're processing or not, because they can't cancel the contract before then. It also says they'll pay us a termination fee if they cancel before December 2030. Now, I believe that will happen, in fact, it's almost certain it will happen. You can generally assume that termination fees usually are higher if canceled earlier and smaller if canceled closer to the terminal date.

What I think will happen is, based on what Goldman has said publicly, what has been said in the press. I'll offer you really nothing new other than my interpretation and opinion. But first, let's talk about the GM program. It is definitely going to Barclays Bank. That has been announced by Barclays and Goldman. Barclays has a current relationship with a legacy processor and is more than likely going to move processing to their current provider. It's a standard credit card with limited innovation. The reward portion is handled directly by General Motors even today, so it should be easy to transition. The press says that it will happen in the third quarter in 2025. That in itself should give you an idea of how long it takes to transition and that the name Barclays was first reported in the press in April earlier this year. So, April, the third quarter next year, would be about 18 months. Actual conversion time, however, for a program like this would typically be about 12 months. Note there is very little revenue impact for this conversion off of CoreCard due to the fact it's coming off of license software and not a processing agreement. While licensing has some disadvantages, it also has some advantages. The conversion off does, however minimize future license fees we might have collected in future years, so I'm not going to minimize the loss.

Second, about the Apple program. I think the program will be moved to another bank. A year ago, the press said that they were talking to AMEX. Wall Street Journal and Bloomberg have recently reported conversations were going on with JPMorgan. I could neither confirm nor deny that, and it would be out of line for me to comment on that speculation. What I would speculate is that the Apple program will be processed with the CoreCard platform for a longer period than what is guaranteed to be paid under the amended contract. I believe that the card will be on the platform until at least mid-2027. And note, I said believe, while I have no information that would confirm that belief, and I really don't think anyone knows today. It could be longer; it could be much longer. The program might not find a willing buyer, but I think they will, but the buyer could choose to still use the platform for a short or even longer period. We're certainly open to working with the potential buyer to make it happen. We will not be making any specific comments about this or any negotiations unless there is a more than likely than not something happening that would materially impact our future financial results that actually differs from what we've said. In future calls, I expect to have very little to say about this subject, which is why I'm trying to be as open and comprehensive as possible today.

This is all very positive for CoreCard. We intend to continue servicing Goldman as a significant and very reliable partner for the highest level of service possible. Goldman rightly expects that and is paying for that kind of attention. Both Goldman and his partner Apple are first class companies that demand and expect first class service for their customers, and we're happy to be that kind of company and definitely don't want to disappoint.

The last comment about this program concerns questions we received about the recent fines imposed by the CFPB on Goldman and Apple. CoreCard was not part of the issue and was not part of any investigations. In my opinion, the issue resulted from the success of the program. Fast growth of financial services often leads to issues. Yes, there were mistakes, as pointed out by the CFPB, but they were not intentional. They were not the result of poor management decisions. They were the result of being overwhelmed by the phenomenal success of the program and having insufficient resources and systems to cope. I believe fines should be imposed on managements who fail to respond to problems, or those who are insensitive to customer complaints, or those who just don't care, not to those who are working feverishly and are highly sensitive to customer success as are Apple and Goldman, and we know from our relationship how much they want to do right for their customers as they push us for perfection, but that's just my two cents.

Few more topics I'll cover because I often get questions around them. They are about succession and the possibility of being acquired or CoreCard acquiring another company. First, let's talk about succession. I don't shy away from talking about the fact that I've been doing this a long time and the fact the good Lord has blessed me at the age of 83 with good health and energy, and drive to keep pushing. It is in my opinion the time to consider someone else for president who could do what is needed to keep the company on its present good trajectory. I guess I should caveat the health comment in that I do need a new knee as my bum one kept me off the ski slopes with my grandchildren for the first time this year breaking my 15-year consecutive string.

The CoreCard board has, for the last several years, discussed succession planning at almost every board meeting, so this is nothing new. There are no specific plans in place. I do expect it to move from the discussion and consideration phase to action early next year. Who knows, a new president might even decide to establish a sales team. And for those who might not know, CoreCard has no salespeople and does very little marketing. But that last statement was made with a little squint in the eye. Current non-Goldman revenue growth, which we think will come in at a 30% compound annual growth rate over a three-year period comes from growth of existing programs, web inbound and referrals. It may be that a new sales team can speed up that, it may be that our capabilities would limit as to the 30% growth rate anyway for the next couple of years.

The last topic is about use of cash and acquisition potential. We have previously been buying back stock when not in a blackout period under a plan that was previously approved by the board. It is our intent to keep doing so. We believe the current stock price significantly undervalues the company, when viewed as a stand-alone enterprise given the future we see, as well as the value it might bring as part of a larger organization with established sales force. I can admit we do lose some deals now due to our small size.

As far as using cash to fund an acquisition in the fintech space, we're regularly approached by possibilities but almost every case is for companies losing money with a cash burn and hockey stick projections. That is really not appealing to us as a company that has grown while staying consistently profitable. Matt and I also field regular inquiries and reach-outs from private equity groups and investment bankers with thoughts of companies that might be or are interested in acquiring us and even we get them directly to the companies themselves. CoreCard to shareholder own, so of course we want to see shareholders rewarded. We've had large private equity groups, names you would all recognize, visit our offices both to gain more information and also to pitch us. While we work for shareholders, we also have a responsibility to employees and customers, and we strive to balance the short-term and long-term consequences for each of these constituencies. We have concluded that the likelihood of a private equity transaction is very limited. We're not interested in any type of squeeze for loyal share shareholders and that's usually a component of a private equity proposal.

We've had several management teams from interested acquiring companies, both domestic and international, come to Norcross over the past several years and even as recently as this month. We have also reached out to some in the normal course of business looking for partnerships and have had some serious conversations. Typically, the conclusion is that our team and technology are first class but with the unknown surrounding the Goldman relationship and the noise surrounding the future of the Apple program, plus our low stock price and the optics related to paying a high premium. What we believe would be the right balance for shareholders is a hurdle. Notice I said optics as the real substantive value is usually confirmed. It may be that some interest has been rekindled with the recent amended agreement with Goldman providing a little bit more certainty.

I'll digress a second and talk about the newer cloud agnostic native successor platform we're building that's called CoreFinity or CoreFi for short. We're almost four years into it and have another year to go before it will be ready for production. Ready by the end of 2025, but probably not fully utilized until 2026. Now the current platform is very good as CoreFi is taking advantage of all the newest tools with the goal of being the most flexible, feature rich, cloud native, active-active, real time credit platform in the world with the lowest maintenance operating cost. It's truly superior to anything we're aware of being considered today and it's well-positioned to compete with other legacy processors. But that's a digression but it has something to do with value, so I suspect some of you are going to ask, what do I think the value is? I'm not going to put a specific number on it, but we have invested more than $130 million building the current and CoreFinity platforms. And just as important as the dollars invested or even more, is the fact it would take someone four or more years if they started now to get where we are. We have thousands of test cases for revolving credit, no other modern processor processes that. We have the proven scale that no other processor has. All of modern processors combined, we believe, have less than a million revolving cards and we have around 15 million. You learn a lot to scale up to where we are. And our people make up the real value with a thousand team members with heavy and detailed knowledge of the credit card domain in offices in Atlanta, Romania, India, Colombia and Dubai. Over 350 of them have been with CoreCard for more than 5 years; many more than 10 years.

Just this year, we began issuing restricted shares that have three-year vesting to long-tenured employees, those with more than five years, as incentive comp to keep them focused on building value and strong customer support. While we've got customers such as Goldman, American Express for small business loans, Gemini, Qatar Airways through a great partnership with Cardless, Deserve, Aven, Juice for Business, Amarillo National Bank, Al Ansari and Al Fardan, Stride Bank and on and on.

So back to value. Last summer, we were traded in the 20s. The markets up a lot, the company looks better and has more visibility on future revenues than a year ago in all respects. So as a personal observation and speaking as probably the largest shareholder. I don't expect to vote or support any acquisition offer that would value the company for less than something north of
$200 million, and I fully support the company buying back its shares with excess cash given the current stock price. The buyback limits the shareholder dilution that comes with providing the restricted stock grants that I mentioned earlier.

You can do your own math around stock price. I emphasize with this comment, I am speaking personally of the way I currently feel. I think our results speak for themselves. We're comfortable continuing on our current trajectory. The company is well positioned to continue to grow its non-Goldman business at a 30% compounded annualized rate with decreasing earnings the next few years, as a lot of that revenue drops straight to the bottom line. Our expenses are increasing slowly, we're not as scaled as a processor, but margins will start going up. All internal planning is focused on making that happen while we're still trying to balance the interests of our shareholders, employees and customers by being open to a transaction.

With that, I'm happy to take any questions and while you're taking your questions, I guess I should include that we don't update progress numbers, activities or disclosure between quarters unless mandated and don't comment until there's something substantive to talk about. So, let's open for questions and we'll conclude with that.

QUESTION AND ANSWER SECTION

Operator: Thank you. Ladies and gentlemen, we will now be conducting a question-and-answer session. [Operator Instructions] Ladies and gentlemen, we will wait for a moment while we poll for question. The question comes from the line of Hal Goetsch from B. Riley Securities. Please go ahead.

Q

Hey. Thanks, guys, and thanks, Leland, for your commentary and the story about your family. That's terrific, about your knee. I wanted to ask if you could help us bridge the change in non-Goldman revenue growth from the prior guidance, what's kind of going on in the last quarter-and-a-half that has allowed you to take that guidance up and just give us as much detail as you can? Thanks.

A

Yeah. I'm going to let Matt to talk to that a little bit.

A

You're talking about just from taking it from 15% to 20% to 25% to 30%, you know, a lot of that is some of the new programs that have come on, some of that's reflected in the third-party revenues being higher than expected. And really that's hopefully an anticipation of future processing revenue. So, I think that speaks to the numbers for next year as well but that was a big, I would say, of, you know, why the number came up from Q2 to Q3 for the full year to 25% to 30% excluding Goldman.

Q

Okay. And on next year's guidance, can you give us any feel for how much of it of that is the license revenue or is that too soon to guide with that?

A

Matt White: It's really too soon, given that the license revenue came in a little sooner than we expected here in Q3. And then the timing of the de-conversion of the GM program will have a big impact on license revenue. So, we're really not counting on license revenue in 2025 given those dynamics.

Leland Strange: Yeah. I think the story is that it's a good growth to the non-Goldman stuff. So, license revenue, if we get it somewhere along the way, that's fine but it's not something we're counting on. We're counting on just continuing to grow the company for the non-Goldman side.

A

Okay. And if you, last question from me, then I'll get back in the queue, if JPMorgan is, I know you can't comment, but I would think JPMorgan would take this program in-house, you know, given their vast processing businesses and payments businesses, you know, what – how long you think it'll be before a decision for a sale? Because as you mentioned, Leland, there's been multiple parties interested in the Apple card. Any thoughts on your timing there?

A

Yeah. I think, as I said, I don't think anybody, and I really mean that anybody knows timing. There may be some people guessing right now, but I don't think it's at a point where anybody could know the timing. And the difference there, you rightly surmised that it would make sense for JPMorgan to take it inside. On the other hand, it might not, you know, it actually could be disrupted. The Apple program has some unique things to it and it's a decision that we're not going to be party to, so I'm just sort of speculating here. I mean, that would be happening outside of any conversation we might have as to where it goes. I would say, yeah, common sense that they might take it all but also you could also make a good argument by the cheaper and less disruptive to work with someone like ourselves, to continue it going if it is going to JPMorgan to which we're not privy to or would ever comment about.

Okay. Thank you.

Thanks, Hal.

Operator: Thank you. Ladies and gentlemen, this concludes our question-and-answer session. I would now hand the conference over to Mr. Leland Strange for his closing comments.

J. Leland Strange
Chairman & Chief Executive Officer, CoreCard Corp.

Okay. Well, that does conclude our call today. We appreciate interest in the company and as I usually say, if you have any further questions, please let Matt or I know, and we thank you for your interest in the company. Have a good day. Thanks.

Operator: Thank you. The Conference of CoreCard has now concluded. Thank you for your participation. You may now disconnect your lines.