

**INTELLIGENT SYSTEMS CORPORATION**

**Moderator: Leland Strange  
November 8, 2018  
11:00 a.m. ET**

**OPERATOR:** This is Conference # 7655509.

**Operator:** Ladies and gentlemen, my name is (Lance), and I will be your operator for today's conference. At this time, I would like to welcome everyone to the earnings release and investor's conference call.

All lines have been placed on a listen-only mode to prevent any background noise. Later, we will conduct a question-and-answer session. If you have a question during that time, simply press star followed by the number one on your telephone keypad. If you would like to withdraw your question, just press the pound key.

I would like to turn the call over to Leland Strange. You may begin your conference.

**Leland Strange:** Good morning, everyone. Thanks for joining us on the Intelligent Systems' third quarter earnings call. I'm going to assume that you've read the press release and maybe even perhaps the 10-Q that we filed this morning.

As usual for my calls, I'll only repeat a little of this information, as you can read it for yourself. What I'd say to date is actually non-scripted. Although, I do have bullet points, so hopefully, I won't leave out some important information without the proper comment or color.

With me in the conference room and on this call today is Karen Reynolds, the CFO of Intelligent Systems; and Matt White, who has recently joined us as

Vice President of Finance of CoreCard Software, which, of course, is our main business.

I'm going to call on them to assist or to help answer any of your questions after I conclude my remarks and hope they'll correct any misstatements I might make as I try to talk with you in a conversation mode as if you were here with us in the conference room.

So let's start with some financial facts that are in the press release. Our third quarter delivered an operating profit of a little over \$1.7 million. I tend to concentrate on the operating profit line, as it is really the only thing that can be managed. I'm not saying that the other items below the line are not important, because they're ultimately included in the earnings per share calculation, of course, that's important to all of us.

But things below the line mainly affect cash and treasury functions, not operations. So the operating profits came in about \$1.7 million compared to the second quarter, I'm talking about the previous quarter, not last year, of a little over \$1.3 million. So, quarter-to-quarter meaning in the same year, we were up.

I guess I could talk about a comparison of the same quarter last year and call attention to it being up whatever percent. But if I did that, you could rightly conclude I did not mean what I said later in the press release and have consistently stated in that the company is managed on a year-on-year basis and not quarterly. I want to see what's going on in successive quarters not necessarily compared to last year, and then I want to see what goes on for the full year-to-year.

If you want to focus on revenue, and I know that many make revenue growth their key metric, although, we look for balance of revenue and operating results, our revenue for the quarter was a little over \$5 million, \$5.4 million to be exact, and the nine month revenue is little over \$14 million.

You can compare that with our nine month revenue last year of \$6.6 million, so it has more than doubled. But please don't make the assumption that it will

be our run rate, because I seriously doubt our first nine months of 2019 will be doubled this year's first nine months.

Now I guess, before I offer my view of the year, again, reminding that I prefer to look year-to-year rather quarter-to-quarter, I'd better provide the usual caveats that when I say "I believe" or "expect" that our fourth quarter will have similar operating profits in the third quarter, plus or minus a few percent, and our 2018 year should have revenues of between \$19 million and \$20 million, remind you that these are forward-looking statements within the meanings of the federal security laws.

Now what does that mean? It means that everything I or the team says that is not historical fact is simply speculation. We're going to speculate on what we truly think as of the moment we say it. We might not have a good basis for what we think, but obviously, we would not say it if we did not think we did.

We may expect, project, believe, plan, intend or use any number of similar words in the call, but it may or may not be so, or it may or may not come to pass. So everything I say that is not an actual historical or current fact should be deemed a forward-looking statement.

I could learn something tomorrow or even later today that could cause me to believe or say something different, and we don't plan to continue updating those forward-looking statements, even if they come obsolete.

I guess there are couple of other caveats that always hangs over the head of a growing financial technology company. The first is about the technology. It could be working well at any moment in time, but when you use in a different way or with additional stresses, it could be found to be inadequate in certain situations and require time for solving the problem.

And I guess, the second and worse caveat would be a possible outside breach of the system. And I just mention these because we are in the fintech business. We know of no existing problems, but you only know what you know and it is a risk in the fintech world. So everything I say is qualified by these previous comments, and I hope our corporate lawyers are happy with the way I presented those.

As I said before going to the caveats, I believe our 2018 revenues will end up between \$19 million and \$20 million. I'll go further with a forward-looking statement and say that I have reasons to believe that the 2019 year can be substantially better on both the revenues and operating profits, if we get the license revenues we're anticipating. Now I'm not going you give any further guidance at this point, but this is what I know and this is what I believe at this point.

Let's go to the second component of the press release and then I'll come back to discuss the business internals that are driving the revenues and profits. We announced that the directors have approved the Company spending up to \$5 million for a stock buyback. That decision was driven primarily by the fact that the Company has cash or cash equivalents almost equal to our revenues. And our return on the cash is pretty little – pretty small given the current interest environment.

So what we do? It can be used for an acquisition, but we tend to find the type of companies that are of interest to us are generally overpriced, at least in our view. We want earnings and not just revenues, and earnings need to be priced no higher than the market's price on our earnings to not be diluted. I guess, let me backtrack on that comment a little and say that it's a current position that could change.

I'm not saying an acquisition has to be immediately accretive or strategic, but projected earnings within a few years have to justify the investment. And we've looked and have not found many candidates that meet that criteria. We're not going to be – we're going to stay the same conservative company we've been for a long time, but we're not going to be chasing things just to show that we can acquire something and boost our revenue.

We also believe we have the ability through either cash, stock or financing to absorb or engage with a larger entity. I guess, that sort of makes the question, well what would we be interested in? Well, obviously, something that does something similar to what we do, but it is primarily probably going to be program management kind of company.

That would be a consumer of our software – folks who are either smaller processors who have program managers or direct program managers that would use our software. These are the kind of companies that we'd be interested in. If we don't find someone, we could develop this ourselves, and of course, that would use some cash and that also would impact short-term earnings. So, I would say that's not our current plan, but it's not out of the question.

I've taken a long time to get to the bottom line of why the Board decided to use some cash to buy back stock and it's really simple. It's a better use of cash than the returns we're getting in money markets. And, we believe we have sufficient cushion for our operations, along with other available resources to continue down the path that we're on.

I think I'd be remiss if I did not mention some other aspects that you'll probably question or at least that you're thinking about when we talk about a stock buyback. We do understand the difficulty of purchasing stock in the open market, and, of course, we're not limited to that.

As our average volume is pretty low some days, we'll just have to see how successful we are given the restrictions surrounding a company purchasing their own stock. And for those of you who are not familiar with the safe harbor guidance, the Company can only buy in the market at the last transaction price. That's commonly called the zero plus tick – zero plus tick requirement or at the last independent bid.

There are other safe harbor restrictions, but this one is the one that would be the most limiting. But we have determined that for now that this is a good use of up to \$5 million of our cash.

How about the business? It's obviously robust as the financials disclose. And I'll provide a little more on a customer traction, but let's see – let me say in a discussion with a microcap analyst for an institution investor last week, he grew frustrated, I think, at my attempt to really describe the business.

After 30 minutes or so of discussion and questions, he said, “Look, just tell me at a high level what you do so I can write it up in one paragraph. And,

why customers choose you? Explain why it's sustainable, and give me the facts on recurring revenue? Actually, I thought that sounded good for an outline for an annual letter, but let me take a stab at some of that here.

For those of you – and I know we have some new folks that are joining us here – for those of you that are not familiar with us, CoreCard has developed a parameter-driven, real-time financial transaction processing software that's very flexible and easily customizable into a variety of products.

In simple terms, it maintains the relationships between an account. An account can be a person, a company, a vehicle or any number of things – and, with a currency. And the currency can be dollars, rewards, gallons of gasoline or any number of things. So that software is generally productized most often around what's commonly called a card management system or an account management system that provides account personalization and lifecycle management of a credit account.

It is a robust, financial transaction engine that could be used in many ways and for many purposes. And it can (have) very complex programs, which are sometimes called schemes and complex terms. Ways to handle credit that have not even been dreamed up – or some people would say dreamt up – can be parameterized on the system. We take this robust, real-time financial transaction processing software and productize it.

A majority of our revenue that was generated this quarter and also this year came from customers who have licensed our issuer processor system that we call CoreIssue. So that's a product, an issuer processor system. It's a software system that a bank or a program manager of a bank uses to issue a prepaid or credit card to a consumer or to a business.

CoreCard Software has a complete process starting from embossing, which means ordering the plastic card if it's not virtual; keeping all the rules that surround the use of the card; authorizing or declining transactions real-time; statementing of the customer accounts, which may include calculating interest or rewards.

The accounts or cards could be debit, credit, prepaid, gift, virtual. They could be revolving credit, plain charge or could be installment. The software then does the reporting and settlement with the networks for the issuing bank and the program manager. More specifically for this quarter, about 65 percent of our revenue came from the servicing our licensed customers and not from new licenses or upgrade license.

Upgrade license revenue means a customer purchased the right to use the software for more accounts. That usually means business is growing. So you can get a sense from that of how inextricably linked we are to our customers growth and success.

What do they pay us for in addition to license grants and use? Remember, I said, 65 percent of our revenue came from servicing licensing customer, but I said, we had no new licenses or even upgrade licenses during the quarter. Well, there are three things they pay us for:

First, maintenance and support. Yes, this is recurring and goes on as long as they are in business and they use our software. The second thing they pay for is professional services. We call these PSAs, which stands for professional service agreements. There are no long-term contracts in this.

This revenue is usually higher initially for a licensing customer, and a large part of our current revenue, talk about this quarter and even in the last couple of quarters, is coming from a newly licensed customer. This is likely to go down from a new customer, but the revenue is likely to be replaced by another customer. So virtually, all licensed customers end up utilizing our resources for customizing or helping them to solve their needs or their customer needs.

Remember, our customers are usually processing for their customers. And after a year or so, a pattern gets established and we can usually budget the amount as regularly or recurring revenue so we know – because we come to know what they're going to need on an ongoing basis.

So all the recurring revenue that comes from a licensed customer comes from the utilization of our personnel. It's nicely profitable, because we invested in

the workforce and have highly skilled resources that know the financial technology business as well as know our software.

We expect to actually record some revenues in the fourth quarter for the use of the software. In other words, license revenue that does not have any significant expense against it. And if our customers do what their plans project they will do, we should get another license revenue pop another – again, that pop is not a good accounting term, but we should get another license revenue pop in the first or second quarter.

Issuer software is also used managed loans, either those that are sourced through the network – and that's Visa, Mastercard, Discover, et cetera – or what is called “closed loop,” meaning private label. And we have licensed customers using it strictly for loans, I will say complex loans or with complex terms, and we also have our integrated collection package that goes along with it.

So several third-party prepaid processors have licensed our software to offer processing to third parties. It's not just credit. I guess, don't get me started because I could talk about using for debit, stock trading, insurance or a myriad of other ways. And you can see why and how I got the micro cap analyst confused when I tried to really explain what all it can do. But that's the issuer software that's used for licensing.

Now I'm going to break the business down for the next part and talk (?about how we did in it)?. The other main leg of the business is hosting processing, using the same kind of products I just described. This would be what is traditionally called “processing,” similar to what (TSYS) and (First Data) provide for their issuing business.

And don't get this confused with their acquiring business because they have acquiring business also, and that is merchant acquiring. First Data's heavy in this and pushes it all through to merchant point of sale terminals.

Remember, we work from the issuing bank side, the one who provides the credit or card or loan or check or prepaid account, not for the merchant-acquiring side that accepts the card for purchase. The merchant sends the

request for authorization to the issuing side, and our software takes care of that. As an aside, we could do the acquiring also with our software, the way it's architected, but is not really our current strength, so we're not pursuing that.

So processing is recurring revenue in the traditional sense, and processing customers made up about 33 percent of our revenue. And when I say made it up, that also included some professional service revenue, along with the actual per-transaction revenue that we get from processing.

Also, there's actually some passive, ghosts or phantom revenue in this – and by the way, those are not accounting terms either. But in revenue guidance requires us to include pass-through and interchange fees in our revenue. So I'm guessing that of our, let's say, \$19 million to \$20 million in revenue this year, maybe as much as \$1 million will be of this type that we're required to keep up in – at the top line as revenue.

So that's the two sides of the business, licensing and as I said, that represented 64 percent of the revenue for the current quarter and processing, which represented about 33 percent in the third quarter. And I guess, that still leaves two things that are unexplained from that earlier mentioned call with the microcap analyst. And that is why do customers choose us?

Well, you have got to ask your customers to say why they choose us and asking them generally, they say it's the overall power and flexibility of the software. There is no one thing or one feature. And then, secondly, our team is very, very good and impressive. And then third comes up, we can move fast. So (tends to be) what customer tells me is why they ended up choosing us.

Again, the power of the software – power and flexibility; the team that knows what they're doing, both in terms of the business as well as the software; and finally, the speed at which we can move.

And then, the last question they asked was, is it sustainable? I think I can say about that is I think so. And I believe that we can continue to grow for a very long time. Can't prove it, but the future looks bright. So I think I'm going to

stop there given that I've done the 20 minutes I usually talk and open it up for questions. Operator, if you can see if anybody has any questions?

Operator At this time, I would like to remind everyone if you have a question, please press star followed by the number one on your telephone keypad. We will pause for just a second to compile the Q&A roster.

Your first question comes from the line of (Abbie Fisher). Your line is open.

(Abbie Fisher): Hi, thank you for those details.

Leland Strange: Sure.

(Abbie Fisher): Why now? Why are you suddenly growing now?

Leland Strange: You've got – we ended up with, one, a very large customer that helped. We'd be growing without that large customer, but the significant growth took place because we ended up with a large customer. I think if you read the q, you'll find when we talk what percentage of our revenue is pretty high for the quarter.

(Abbie Fisher): You've been at this for a long time. And it's as if you are now the outsourced arm to a lending organization as their card issuer processing system.

Leland Strange: What's your question?

(Abbie Fisher): It just seems like you are now their outsourced arm in their card issuer processing system. It's quite amazing.

Leland Strange: No. We've licensed them our software to be a processor. We've licensed them our software, so they can become a processor.

(Abbie Fisher): Thank you, that's all for me.

Operator: Your next question comes from the line of (Sam Rebotsky).

(Sam Rebotsky): Good morning, Leland. The presentation was unbelievable. Your explanation if anybody didn't understand what you are doing, they clearly, having listened

to you should understand now. And the – you've indicated in the q this new customer that you got in October of 2018. Do you have more than one new launch customer, the size of your customers that you would consider now?

Leland Strange: Well, I'm going to say, one has been very large. And we have other large customers standing in the wings. In fact, we've had to postpone some work for some other folks in order to satisfy the requirements for this particular large customer. And some of them are not real happy right now.

But you'll note that I've said several times (that) I suspect the revenue will go down from the largest customers but it will be replaced by someone else, that's because we do have other people are lined up, which is what gives me a lot of confidence on our next year. And there is really no reason that shouldn't continue over time.

As with a lot of companies, you have to kind of get through certain levels to get the confidence of the next – next level sized customer. And we have been doing that and frankly, it was an intentional plan. We, normally – you've heard me say, we normally would not take on a customer that we felt it was too big, because we wanted to do this brick-by-brick, step-by-step.

And, there was presented to us an opportunity that we had to do a lot of soul searching to determine whether we'd be able to successfully implement for this customer, given their demands. And we did that and we decided that we could do it and we are doing it. We're executing well. But – so I guess, to answer to your question, yes, there is one that's been fairly dominant, but there's others too that are – they're big companies, and they can be big customers.

(Sam Rebotsky): And also it seemed positive that you – that (Matt White) has joined you with CoreCard to sort of handle this further, and expand this operation. Could you sort of indicate what his background was prior to joining CoreCard?

Leland Strange: Yes, yes. I can. I probably don't – I don't have his resume in front of me, but the key component is that he was with Deloitte (Deloitte, right?) for about six years. So, in their audit practice. And, so had a lot of experience with a variety of sized companies there.

He has worked with Humana, has most recently worked with Equifax for a good number of years, both in the SEC and in the accounting side. So we certainly need to again, given the growth, we need to continue to do things here on the accounting and financial (front).

(Sam Rebotsky): And then your stock has been strong even though it backed off. Is there any thoughts – have people come to you to tell you story more? You sort of explained it very well in your 20 minutes, but do you have any time or any thoughts of getting more exposure to the investment community?

Leland Strange: We're not going to actively seek to do that in the next two, three months. And again, you have been a shareholder for a good while, and I always say let your numbers do your talking, rather than just talk.

So we want to get our year behind us and even show a good first quarter and then maybe we'll do that. But perhaps, those that just find us should be the lucky ones, rather than the ones we go out to find. Stock prices for us, is just something that happens (eventually). We're just going to run the business and run it right, and everything else takes care of itself.

(Sam Rebotsky): It's wonderful, Leland. Thank you, and keep doing what you're doing.

Leland Strange: OK, thanks.

Operator: Again, if you have a question, simply press star followed by the number one on your telephone keypad.

There are no question at the moment. Presenter, please continue.

Leland Strange: All right. Well, I just thank you for taking the time to join the call. I'll remind you to read the (Q) that we filed this morning to learn more about risk and get more information about us. And, also that our website should include a transcript of this call by tomorrow. So again, thanks everyone and have a good day.

Operator: Thank you for joining. This concludes today's conference call. You may now disconnect.

INTELLIGENT SYSTEMS CORPORATION

Moderator: Leland Strange

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