

Usio, Inc.

First Quarter Fiscal 2024 Earnings
Conference Call

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CORPORATE PARTICIPANTS

Louis Hoch - *Chairman, Chief Executive Officer*

Greg Carter - *Executive Vice President of Payment and Acceptance*

Houston Frost - *Chief Product Officer*

Michael White - *Senior Vice President and Chief Accounting Officer*

Paul Manley - *Senior Vice President, Investor Relations*

PRESENTATION

Operator

Hello and welcome to the Usio First Quarter Fiscal 2024 Earnings Conference Call. All participants will be in a listen-only-mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on a touchtone phone, to withdraw your question, please press "*" then "2." Please note today's event is being recorded.

Now, I would like to turn the conference over to your host, Paul Manley. Please go ahead, sir.

Paul Manley

Thank you, operator, and thank you, everyone, for joining our call today. Welcome to Usio's first quarter fiscal 2024 conference call. The earnings release, which we issued after the market closed today, is available on our website at usio.com under the investor relations tab.

On this call today are Louis Hoch, our Chairman and CEO, Greg Carter, Executive Vice President of Payment and Acceptance, and Houston Frost, Chief Product Officer. Michael White, Senior Vice President and Chief Accounting Officer, will also be available for the Q&A.

Let me remind our listeners that certain statements made today during the call constitute forward-looking statements made pursuant to the safe harbor provisions of the Private Securities and Litigation Act of 1995 as amended. Such forward-looking statements are subject to both known and unknown risks and uncertainties that could cause actual results to differ materially from such statements. These risks and uncertainties are described in our earnings press release and in our filings with the SEC. The forward-looking statements made today are as of the date of this call, and we do not undertake any obligation to update these forward-looking statements.

During the call today, we will refer to non-GAAP financial measures, such as adjusted EBITDA, and our earnings release includes a reconciliation of adjusted EBITDA to GAAP operating income. Management will provide prepared remarks, and then we will open the call to your questions.

Let me start off with some highlights from this afternoon's release. It's been a good start to the New Year with volumes up in almost all of our businesses and first quarter financial performance is helping us to be on track to meet our full year top and bottom line 2024 guidance. We remain in excellent financial condition with positive cash flow and over \$7 million in cash at quarter end, once again aided by strong interest income.

Our ability to deliver innovative solutions has been gaining increased market attention, which has and continues to create a robust pipeline. These efforts are now being rewarded as our card business today announced that they have signed what could potentially be the largest single contract in our history. Greg and Louis will go into these exciting details, but this program offers the opportunity for card processing to double its annual volume very quickly, as little as a couple of years.

Just a few additional comments on our financial results. Margins were down in the quarter, largely attributed to the wind down of our New York City COVID incentive program. The revenues from breakage and spoilage had added considerably to our card gross margins last

year. Margins were also impacted by a large plastic card order with low margins, which Houston will discuss. However, this was offset by growth in our highly profitable ACH business, which this year will no longer be fighting the tough comps of a large crypto-currency ACH customer.

SG&A was up slightly, but by the end of the year, we expect to once again achieve our goal to keep overhead spending growth below that of revenue growth. This, together with scaling our business, will be helpful in meeting our objectives of improving operating leverage and generating a significant increase in adjusted EBITDA and positive GAAP earnings this year.

In summary, a solid start to the year with strong momentum, a solid pipeline, and incredible growth opportunities in all of our businesses that we are confident will enable us to achieve our financial objectives this year.

Now, I'd like to turn the call over to Greg Carter.

Greg Carter

Thank you, Paul, and good afternoon, everyone. Card set an all-time quarterly record for both transactions and dollars processed, once again led by PayFac, where processing volumes were up 12%, transaction volumes were up 12%, and revenues were up 14%. So, PayFac continues its strong growth.

For the card operation as a whole, dollars processed and transactions were all-time records. Keep in mind that our 100% of our efforts are focused on PayFac. As a result, we expect our legacy singular ISO portfolio to gradually attrite. With all of our growth coming from PayFac, inevitably, results for the entire business should be more reflective of the better performance we are seeing in PayFac. And we expect PayFac performance to only improve.

Today, we announced that we believe we are on the verge of a major inflection point that will significantly alter our growth trajectory. We have just signed an agreement with a leading web-based ERP ISV to provide our integrated payment platform. The ISV has over \$1 billion in annual credit card processing volume, so this program has the potential to double our credit card processing volume and generate over \$20 million of annual recurring revenue. This program is live right now and moving along with the implementation integration process.

Later this month, we anticipate boarding a small set of merchants so we can run some test transactions. At that point, the ISV will start sending out enrollment links the merchants can use to convert from their existing processor to our payments processing platform.

As merchants board, we believe the implementations and associated revenue streams will become more meaningful during the latter quarters of this year and into 2025. I think we'll get the lion's share of the merchants because of the ease of integration we are offering and the overall positive commitment of the ISV. Over time, with similar but smaller ISVs such as PracticeSuite, we have been seeing about a 60% conversion rate, but we are targeting better penetration here.

I am proud of the team that successfully competed for this business. This is a large ISV. In total, the merchants have aggregate revenues of approximately \$6 billion. So, this is only a fraction of the dollars that pass-through the hands of these merchants every year.

We were able to demonstrate to them that our technology allows ISVs to easily integrate flexible payment capabilities into their applications, enabling their merchants to process all manner of electronic payments. We won this business because our PayFac is easy to use, has a strong payment network, offers the industry's best white glove customer service, and the platform is extremely flexible.

This opportunity would never have arisen if it's not for the numerous successful implementations that are leading to additional awareness and building confidence in the Usio PayFac solution throughout the industry.

Quickly reviewing some other first quarter accomplishments, we had an educational ISV go-live and we are now processing for three universities with a fourth expected to be added soon. And there are still a number of ISVs in various stages of implementation, as well as a still robust pipeline. It was also a quarter of heavy industry and market vertical trade show association meetings. This has recently been the primary source of our pipeline.

Our performance and marketing strategy are producing results, improving our recognition, helping establish more relationships, and help us move upmarket to larger opportunities such as the large ISV welcome this quarter. It's a plan that's working, we've stuck to it, and we're going to continue to stick to it.

Now, I'd like to turn the call over to Houston Frost, Chief Product Officer, to talk about our card issuing business.

Houston Frost

Thank you, Greg, and thank you to everyone participating in our call this afternoon. Card issuing had a great start to the New Year. Card loads more than doubled and exceeded \$100 million for the third consecutive quarter, setting an all-time quarterly record. The momentum in our card load growth continues. We also saw growth in total transaction volume, including cash withdrawals, which were up 26%. Total card purchase volume was up 42%. If you remove the oft [ph] mentioned New York City program wind down, revenue in the quarter would have been up 21%.

I'll mention again that card loads are an important forward-looking metric. They are a precursor to interchange, transaction fee and breakage revenue. And the trend in these operating metrics has been very positive. I expect an acceleration in load volumes beginning this quarter, but even more so in the third and fourth quarters. We're going to have more dollars running through our cards.

As I've mentioned before, our strategy is to build a portfolio of corporate expense and other long-term programs that offer recurring revenue. We will retain a relentless focus on our gross margins.

Recently, we announced the expansion of our relationship with Mobile Money, they are launching a new instant-issue general-purpose reloadable card program, providing their clients and customers with new features and increased flexibility. They recently signed a contract with an operator of dozens of amusement parks, water parks, and resorts, all of which will be loaded with this new GPR Card.

Our relationships continue with numerous government and related entities, including International Rescue Committee that has issued 47,000 cards and loaded \$75 million since program launch.

Our external authorization tool continues to attract new commercial accounts. In healthcare, we are growing with a new account that enables employers to make tax-advantage contributions to employees that have their own individual health benefit plan. We continue to consider healthcare a growth vertical.

We're also working on new functionality and features such as in-app provisioning on Android, integrating to FedNow, and adding debit network consumer loading capabilities on our Akimbo cards. We are signing new agreements, our pipeline is robust, and on the operational side, we are working on strategies to increase recurring revenue and improve margins. I continue to remain positive and excited about the future of the card issuing division at Usio.

And with that, I'd like to turn the call over to our Chairman and Chief Executive Officer, Louis Hoch.

Louis Hoch

Thank you, Houston, and welcome everyone. I'm proud of our team and the achievements that they have accomplished. And in the first quarter, they kept us on track to meet both our top and bottom line guidance for the year.

Let me quickly go through a couple of our business lines. Output solutions had a solid start to the year with strong volume, both in mailings and electronic document delivery and increased profits in the quarter. Pieces mailed in the quarter were 8 million and electronic documents delivered exceeded 19 million. However, a lot of the volume was on lower price per unit jobs. So, revenues were understandably lower than the same quarter last year where revenues were unusually strong due to a lot of one-time jobs.

As we noted on our last call, our capabilities have been greatly enhanced by the investment in new printing and sorting machines and associated processes. This new equipment is one reason we once again delivered more electronic than paper documents for the second consecutive time in the first quarter, helping increase the volume while decreasing the cost of goods sold.

[Indiscernible] and his team have been breaking in the new machine while refining our processes to capitalize on the speed of the new machine and optimize overall efficiency and productivity. This will further position output to capitalize on its increased capacity and processing speed. I expect output to resume its growth in the second quarter while also continuing to reduce costs.

Turning to ACH, we saw a third consecutive quarter of recovery with electronic check transaction volume up 4%, return check transaction process up 9%, and electronic check dollars process up 22%, all compared to the first quarter of 2023. Payments debit also continues to exhibit strong growth.

In 2024, our year-over-year comparisons will be normalized since there is no longer any voyage or crypto-currency noise in the comparable 2023 numbers. This will provide a clearer view into the ongoing success of ACH where we have historically outperformed the industry growth rate. But the real acceleration of ACH will come when we get our FedNow and the clearinghouse

products in the market. We're not quite live yet, but it's something that we're very close to. And just like every other part of our business, the sales pipeline in ACH is rich and there are abundant opportunities.

And finally, I want to congratulate Greg and his team for landing what could turn in...out to be the largest single program in the company's history. This is a large, exceptionally well-run ISV that has proprietary ERP system installed in hundreds of small, medium-sized and enterprise level businesses. While these businesses collectively generate over \$6 billion a year in revenue, we believe that only accounts for about 23% debit and credit card payments. They also offer ACH payments. So that's another opportunity for Usio.

The processing has a potential to double our annual card processing volume while adding 20 million or more in annual reoccurring revenue. Initial conversions are already underway as Greg has discussed. We should start seeing the program contribute to our results soon, with a significant ramp beginning later this year. We won this business by demonstrating our ability to develop a program custom-tailored to specifically meet their needs.

As a result, the ISV will be notifying their merchants of this superior capability and providing them with easy, convenient means to convert their payment processing from their existing provider, which in many cases is stripe to Usio.

I also note that our strong financial position, with over \$7 million in cash at the end of the quarter, we are able to maintain our cash position over 3 months while significantly reducing payables and accruals. This provides us with the resources we need to make necessary investments to support our growth.

So overall, we had a very good start to the year. The first quarter came in essentially where we had internally projected it, with prepaid down as previously communicated, but strong volumes across the board, and a new program added that could potentially be the largest in the company's history. And the pipeline remains rich, including a few mega-deal prospects, which all equate to \$5 million or more in annual recurring revenue potential.

Consequently, I'm pleased to reaffirm our 2024 guidance. We expect revenue to be up between 10% and 12% for 2024. With a focus on enhancing operating leverage, we expect adjusted EBITDA to be between approximately \$4 million to \$4.5 million. In addition, we believe we will generate positive GAAP, EPS in fiscal 2024.

With that, I would like to turn the call back to the operator to conduct our question and answer session.

QUESTION AND ANSWER

Operator

We will now begin the question and answer session. To ask a question you may press "*" then "1" on your touchtone phone. If you are using a speakerphone please pick up your handset before pressing the keys. If at any time, your question has been addressed and you would like to withdraw your question please press "*" then "2."

Our first question comes from Scott Buck with HC Wainwright. Please go ahead.

Scott Buck

Hi, good afternoon, everybody. Thanks for taking my questions. First was probably for Greg. On this morning's announcement, it sounds like 60% conversion is kind of the standard. What's the timeframe for that been historically?

Greg Carter

Just to give you some context, back in 2020, the conversion rate was around 30%...27% to 30% through our back office and client support services, we've gotten that to 60%. But with this particular ISV, I think we're going to target the conversion at a much higher rate, as I said, because of the commitment of the ISV and the unique nature of their ERP software. So, it's really just going to be a matter of phasing those customers in and that will start that specific...one of their specifically large customers will be in the third quarter, but we'll start boarding some of their other merchants from different companies later this month.

Scott Buck

And how does the cadence of onboarding historically go? I mean, is it, you get 20% or 30% right away and then it's kind of pulling teeth to max it out or is it more of a slow climb and 6 months, 12 months, 18 months later, that's where you get the majority of conversions?

Greg Carter

That's a great question. There's really no set answer. And we've had some ISVs that convert in mass and we've had others that convert and there's an initial surge of 20% to 30% and then the others follow. So unfortunately, there's not a standard or a uniform answer to that. But again, given the support that we've provided in the various marketing and outreach campaigns that we provide, we're doing substantially better at getting those merchants converted sooner rather than later. But I can't give you a specific answer because it's always ISV dependent.

Scott Buck

That's understandable and congrats on the deal. Houston, on the prepaid load volumes, is there a single program or a couple programs that are responsible for the expected acceleration through the end of the year or is it more widespread?

Houston Frost

There's a handful. I would say these numbers are a little bit off my head, but I'd say three to five of them will be responsible for a large portion of the growth. And we've mentioned these names in the past, Class Wallet, Mobile Money, and then we do have a handful of recurring loading government programs. We mentioned International Rescue Committee on the call today. So, it's not a single program. It's not two programs, but it's not 30 programs.

Scott Buck

Yes. No, that's fair. And does the pace at which consumers utilize the cards once they've been loaded, is that different across programs or is it fairly universal?

Houston Frost

No, I mean, it actually varies based on a few different factors. So recurring loading programs, especially those with higher dollar amounts, you see very substantial spend rates, 90% to 95% plus of the dollars will be spent on those cards. If I go to the other extreme, let's call it a \$20 single load promotional card, you may only see 30% to 40% of those dollars spent. But so...one thing that's kind of interesting about that is that while if you think about a recurring loading program and you only have, call it a small percentage that is unspent, it's \$1,000 and 3% unspent. Well, that's \$30 remaining on the card, and that's a certain percent of dollars, but

it's a dollar amount that might even be higher than a single load \$20 program where less than 50% is spent and we're only making \$10 a card. So, in some ways, the dollar amount evens out and is a little bit more constant, but when you're talking about card [ph] percent of funds left on cards or left unspent, that varies dramatically depending on the type of the program.

Scott Buck

No, that makes sense. And then last one for me, guys, on ACH. I'm just curious, what exactly it is that's driving the incremental growth and is whatever that is sustainable?

Houston Frost

The incremental volume associated revenue with ACH is not only ACH is complimentary service, which includes PINLess Debit, but...and in the future it will include the Clearing House and the FedNow. And we're closing more deals. And so, there's not many providers that do PINLess Debit. It's very complicated. And so, we're closing more deals with PINLess Debit. And our ACH volumes are starting to go up in new sales as well.

Louis Hoch

I will just to add to that, as we add more ISVs, that also contributes to ACH volume. And that's becoming a meaningful number now.

Scott Buck

Great. I appreciate that. And thanks again for the time, guys.

Louis Hoch

Thank you.

Houston Frost

Thanks, Scott.

CONCLUSION

Operator

Again, if you have a question, please press "*" and then "1." There are no further questions. This concludes our question and answer session. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.