



Intellicheck

Third Quarter 2018 Earnings Conference Call

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CORPORATE PARTICIPANTS

Gar Jackson, *Global IR Group*

Bryan Lewis, *Chief Executive Officer*

Billy White, *Chief Financial Officer*

CONFERENCE CALL PARTICIPANTS

Mike, *Northland*

Ishiq Farooq, *West Park Capital*

Roger Ladelle, *Clear Harbor Asset*

PRESENTATION

Operator:

Greetings and welcome to the Intellicheck Third Quarter 2018 Earnings Conference Call. At this time, all participants are in listen-only mode. A brief question-and-answer session will follow the formal presentation. If anyone should require Operator assistance during the conference, please press star, zero on your telephone keypad. As a reminder, this conference is being recorded.

I'd now like to turn the conference over to Gar Jackson with Global IR Group. Please go ahead.

Gar Jackson:

Good afternoon, and thank you for joining us today for the Intellicheck Third Quarter 2018 earnings call. Before we get started, I will take a few minutes to read the forward-looking statement. Certain statements in this conference call constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 as amended. When used in this conference call, words such as will, believe, expect, anticipate, encourage, and similar expressions as they relate to the Company or its Management, as well as assumptions made by and information currently available to the Company's Management, identify forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on Management's current expectations and beliefs about future events. As with any projection or forecast, they are inherently susceptible to uncertainty and changes in circumstances, and the Company undertakes no obligation to—and expressly disclaims any obligation to update or alter its forward-looking statements whether resulting from such changes, new information, subsequent events, or otherwise.

Additional information concerning forward-looking statements is contained under the headings of Safe Harbor Statement and Risk Factors, listed from time-to-time in the Company's filings with the Securities and Exchange Commission. Statements made on today's call are as of today, November 14, 2018. Management will use the financial term Adjusted EBITDA in today's call. Please refer to the Company's press release issued this afternoon for further definition, reconciliation, and context for the use of this term.

We'll begin today's call with Bryan Lewis, Intellicheck's Chief Executive Officer, and then Bill White, Intellicheck's Chief Financial Officer who will discuss the Q3 financial results. Following their prepared remarks, we will take questions from our analysts and institutional investors. Today's call will be limited to one hour. I will now turn the call over to Bryan.

Bryan Lewis:

Thank you, Gar. Good afternoon and thank you, all, for joining us today.

I continue to be excited about what we're doing here at Intellicheck on multiple fronts. Key to our success is the growing realization across our market verticals of the importance of authenticating a government ID as the critical first step in combating identity fraud, keeping age-controlled products out of the hands of the under aged, and increasing police officer effectiveness and safety.

As I've said since day one, we believe that the market is coming our way. I was brought on board earlier this year to accelerate the Company's growth, and would like to bring you up-to-date on what we have accomplished. But first, I would like to remind everyone of the magnitude of the problem we all face with identity theft and the amount of data stolen.

I will start with the consumer space, specifically retail, where we believe we have the most immediate revenue opportunity because we can show the fastest payback to both retailers and their banking partners. On any given day, you will see an article or research report detailing how identity theft and the creation of synthetic identities is costing billions of dollars a year, and it's taken countless hours for victims to clear their records. Criminals use stolen information about individuals—think the data taken in the Equifax breach—to create identities that are then used to open fraudulent accounts.

Take a moment to think about the frequency of announced data breaches and you will quickly understand the severity of the situation. Just do a quick Internet search, and you'll see how many records have been stolen. From numerous sources, you will learn that easily over 760 million records have been breached this year alone. Additionally, 15 of the top retailers in the country were hacked in 2018, this is an addition to the more than 145 million names, social security numbers, and dates of birth that were breached at Equifax last year. The amount of data stolen and available on each of us makes it far too easy for criminals to steal our identities. In fact, the math says that on average, an identity was stolen every 1.88 seconds in the U.S. in 2017, and that is a staggering figure.

Combine the availability of this information with the simplicity of obtaining a fake ID on the Internet that looks real and coordinates perfectly with the stolen information on the dark web, and you have a severe problem that costs retailers, consumers, and banks billions annually. Retail ID provides a simple and effective solution to this problem. We authenticate the ID at the beginning of the transaction. We stop fraud before it starts. Let's quantify the impact of all these breaches. Javelin Strategy and Research puts the total value of identity theft at nearly \$17 billion in 2017.

Every year, this number has grown and there is no reason to suspect it will not do so again this year, and timing is everything. As we speak, the ongoing news regarding fraud stands to take another ominous turn. Given the Accenture study that found that the time from data breach to when the data is used for fraud is

12 to 18 months, we expect this to be a very dangerous holiday shopping season as the data in hacker's hands from the Equifax breach should be hitting the market now, just as the holiday shopping season is getting started. The good news is that Intellicheck's Retail ID Solutions stops this fraud in-store at the point-of-sale, online, and on mobile devices. We do it by integrating with the retailer's existing hardware, making it a simple and low-cost solution. We offer a fast and effective solution to the problem that protects their most important asset, their customers.

With that in mind, let's talk about what we did for our clients in Q3. If you remember from previous calls, we polled our clients to ask them how much this fraud cost them per transaction before they installed Retail ID. Department stores averaged \$2,100 in loss. Tool and equipment stores averaged \$2,569. Furniture and home furnishing stores average loss was \$2,908, and jewelry stores topped the average losses at \$3,574 per transaction. We looked at a sampling of 29 of our clients across these client types for Q3 2018. Based on catching fake IDs and stopping transactions before they started, we estimated that Retail ID stopped just over 41,000 transactions that we project, using the average loss by client type, resulted in over \$88 million in fraud savings. These numbers serve us well as we speak to prospective clients looking for a solution to combat fraud in their businesses. We stop fraud before it starts. Ultimately, what is most important is that these statistics prove that Retail ID works, is fast, effective, easy to adopt and use, and affordable.

Quarter-over-quarter usage continues to show momentum. We did 42% more scans to authenticate IDs in Q3 2018 than we did in Q3 2017. With these numbers in mind, let me reiterate an important point that is key to view in the competitive marketplace. A key competitive advantage is that our SaaS products typically do not require a hardware investment as biometrics solutions would. We understand that there is excitement about the concept of biometrics. We're watching developments that may prove valuable for Intellicheck. But we will do so as we keep a watchful eye on associated issues that need to be addressed. Among the most significant ones are the lack of a universal database for comparison purposes and a method to identify people at stage one when establishing an ID credential. These are unmet challenges that undercut a number of the current biometric offerings. There are also issues related to privacy and how data will be stored and protected, as well as how access will be decided, should yet to be resolved.

Just as importantly, our marketplace realities. There are a number of issues that impact the practicality and cost-effectiveness for many retailers who typically operate on slim margins, which eliminates biometrics as a viable option. Once again, we continue to believe that this makes Intellicheck's Retail ID the simple and affordable solution that protects both customers and businesses. For those of you new to Intellicheck, the simplicity of our solution is an important competitive strength. Our Retail ID technology solutions work with two things that already exist. One, you carry with you in your wallet, and the other is the store's existing point-of-sale, online or mobile device selling channels. Retail ID is easy to implement and frictionless to the consumer. It is not unfamiliar and thus off putting because we're all used to providing our license to prove our identity. With Retail ID, we authenticate that ID to stop crime and protect the consumer, the retailer, and the credit card issuer. We effectively stop fraud before it starts.

Let's turn back now to the reason that I was brought on board, which was to accelerate growth. I am pleased to report that we're making progress on a number of fronts and I am particularly pleased with the progress we're making with major banks. I'm excited to say that we have recently signed the Master Services Agreement and a statement of work for development with one of the top five credit card issuers to provide ID authentication to both the retailers and at their bank branches. We have already begun the development needed to connect to their system. The bank expects to start activating their retail credit card clients by the end of Q2 of 2019 with their bank branches authenticating IDs by the end of Q3 2019.

One of the things I discussed on earlier calls was the importance of selling to clients directly. In many cases, we had been selling through a third party, and this bank was an example of where we had been doing that. Shortly after I came on board, we ended that practice, and I'm happy to say that in a matter of

six months, we successfully negotiated the Master Services Agreement as well as a statement of work and pricing. It was a fantastic team effort including every department of the Company, and is a great example of what we can do when we operate more efficiently. This bank provides credit cards for some of the largest box stores and retailers in the country, and we are very excited to be working with them. This client will also be charged on our new per scan pricing model which we believe extracts more value for the services we provide, while also creating an incentive for the bank to bring more stores online faster. From discussions with them, we anticipate that the first four retailers expected to be on-boarded could generate over three million scans per month. That is stopping a lot of fraud.

We've also successfully re-engaged with one of our existing clients, who happens to be one of the largest private label credit card issuers. This client had been doing very little new business with us. We are migrating this client to the new per scan model with their January renewal. We have agreed to the commercial terms, and this client has committed to bring on more of their clients. In fact, they have introduced us to seven new retailers that we expect to be bringing live in early 2019, with more retailers in discussion.

On the last call, I mentioned that we've begun to sell specific use cases to retailers and banks, based on who bears the cost of fraud. I mentioned that we had signed a 3,000-plus location North American retailer. This client wanted to enhance their customer experience by speeding up the credit application process. They wanted the data parsed, and the form filled out. They did not care to pay for authentication because they do not bear the cost of new account fraud, the card issuer does. As of this call, we have rolled out to 1,400 locations. We currently do not work with the bank issuing the credit cards for this retailer, and we will be tracking how often a fake ID was used to attempt to open a fraudulent account. This retailer's bank will be monitoring this with us, and given the fraud at comparable companies, we believe we should easily prove the ROI to the bank and sign them up for use cases here and at their other retailers, where they bear the cost of fraud.

We also spoke about a 1,000-location retailer that will be paying us for the use case of non-receded returns, a use case where they eat the loss. This is our first major player to purchase a fraud use case solution, where the retailer bears the entire cost of the fraud. Again, the retailer has the pain-point and wants to stop fraud before it starts. We've began the roll out for this client, and are currently in 950 stores.

The work we have done on search engine optimization and mass marketing, with the help of our inside sales team, has dramatically increased the number of age ID sales per quarter. When we announced that we had brought a state's alcohol beverage controlled apartment on board, we typically send a mailer to the bars and restaurants in that state which says, "The ABC is using age ID to police you, you should use age ID to protect yourself." This is a very cost-effective way to acquire clients. In Q3, we sold 113% more subscriptions than we did in Q1 and Q2, and we are currently on track to outpace that number in Q4. We've also begun to partner with insurance companies that insure bars and restaurants, who then help us promote our products. You may have seen the press release yesterday about the Hospitality Insurance Group as an example of this type of collaboration. Typically, these insurers provide discounts when the merchants have age verification tools in place. This discount can often cover the age ID subscription costs. We are actively pursuing more opportunities like this.

Moving to the law vertical, we continue to see interest for both age ID and law ID from police departments across the nation. In states where we do not have an inlet switch connection, we are actively selling age ID. We now have 46 police departments, University police, and ABC departments using age ID. As I mentioned earlier, having law enforcement using the product is a great help in selling age ID to retailers, bars, and restaurants. We are still getting great press about the New York DMV saying that they tested 1,000 fake IDs, and Intellicheck caught them all. We also received excellent press from the Hampton Virginia police department press release regarding their use of law ID. The local ABC and NBC news

channels, as well as several radio stations, did segments on the announcement, with the Hampton PD participating and reporting excellent reviews of law ID.

We have switch connections completed in six states that include New York, Massachusetts, Delaware, Virginia, Tennessee, and Mississippi. We have pilots underway who are scheduled in each of the aforementioned states. South Carolina has cleared us to proceed with the connection to their state. We're in the process of scheduling pilots with 16 other prospects, and have four others in the budgeting process. Feedbacks on the pilot test has been extremely positive. I do want to be clear that most pilots have been with smaller agencies. I would also caution that we're dealing with government agencies, and while feedback has been excellent, we must deal with the reality of their budget and approval processes, which varies with each department and continues to take longer than I would like to see. In addition, we must deal with the challenges associated with switch connections that run at the pace and priority set by the state. While we've been approved in South Carolina and have multiple large agencies requesting the connection, we still do not have a date from South Carolina as to when they will work on the connection. As I said, initial feedback is overwhelmingly positive. However, to-date, sales are small, but we continue to aggressively pursue opportunities. Several of our pilots have been delayed due to requirements by some of the states and law enforcement agencies. While sales are taking longer to come to fruition, based on customer feedback, I remain optimistic about the product, and the states' (inaudible) that it provides law enforcement officers and the communities they serve.

You've no doubt notice at one of my recurring themes on all our calls is that the market is coming our way. I believe our recent successes prove this to be the case. The easiest way to combat identity theft and to protect banks, retailers, and consumers is to authenticate a government issued ID. Identification authentication is intrinsic to on-boarding good customers, and is the necessary first step in issuing credit and assuring the veracity of a transaction before it occurs. Our successes are demonstrating that more banks and retailers are seeing this. The fact is, there is no reason to believe that the problem of identity theft is going to get any better. The breaches we continue to see and the enormous amount of personal information already available on the dark web would suggest is only going to get worse. Important to our success over the past six months are the changes we have made to our sales team, process and products, that are all showing results as demonstrated by the speed that we're bringing clients live. I'm excited by the new sales we have made, rejuvenated relationships we've achieved with our financial institution clients, and the doubling of our age ID revenues under the new sales model. I am proud of what the team has accomplished in the nine months since I've been here.

Unfortunately, I must conclude my prepared remarks today on a sad note, which is to announce the departure of our Chairman, Vice Admiral Mike Malone, due to personal health issues. I'm going to miss his counsel, and I pray for his speedy recovery. The Board has announced the appointment of Guy Smith as Chairman. Guy is the longest serving Director, and most recently served on the compensation committee. I look forward to working closely with him. Before I turn the call over to Bill, I just want to say that I'm even more excited by the prospects the future holds, and remain energized by the opportunities ahead, and what I believe is a bright future for this innovative company.

I will now turn the call over to our CFO, Bill White, to discuss our third quarter financial results.

Bill White:

Thank you, Bryan, and good day to our shareholders, guests, and listeners. I'd like to discuss some of the financial information that was contained in our press release for the third quarter, ending September 30, 2018, that we released a short while ago. We anticipate that our Form 10-Q, will be filed with the SEC later today.

I'll begin with our third quarter results. Revenue for the third quarter ending September 30, 2018 grew 8% to \$1,040,000 versus \$967,000 for the same period last year. Our SaaS revenue was \$651,000 for Q3 of 2018 but increased 25% or \$130,000 from approximately \$521,000 for Q3 2017. The Company continues to maintain a strong gross profit. As a percentage of revenue, our gross profit was 89.1% for the quarters ending September 30, 2018 and September 30, 2017. Operating expenses that consist of selling, general and administrative and research and development expenses, increased by 7% or \$138,000 to \$2,082,000, for the three months ending September 30, 2018 versus \$1,944,000, for the three months ending September 30, 2017. This increase was primarily driven by higher headcount for our sales and development personnel, and accelerated marketing research and development expenses, offset by lower legal fees, facility expenses, and stock-based compensation costs.

The Company posted a net loss of \$1,131,000 for the three months ending September 30, 2018 compared to a net loss of \$1,075,000 for the quarter ending September 30, 2017. Net loss per diluted share was \$0.07 versus \$0.08 in the prior year. Adjusted EBITDA for the quarter ending September 30, 2018 was negative \$1,048,000 compared to a negative \$888,000 in the quarter ending September 30, 2017.

A reconciliation of our Adjusted EBITDA can be found in the tables of our earnings release issued today. Interest and other income was negligible for the quarters ending September 30, 2018 and September 30, 2017.

I'd like to now focus on the Company's liquidity and capital resources. As of September 30, 2018, the Company had cash of \$5.4 million, working capital, defined as current assets minus current liabilities, of \$4.8 million, total assets of \$15.3 million, and stockholders equity of \$13.6 million. During the nine months ending September 30, 2018, the Company used net cash of \$2,621,000 compared to net cash provided of \$5,849,000 during the nine months ending September 30, 2017. Net cash used in operating activities was \$3,207,000 for the nine-month period ending September 30, 2018 compared to \$2,896,000 for the same period in 2017. Net cash used in investing activities was \$102,000 for the nine months ending September 30, 2018 compared to net cash provided by investing activities of \$17,000 for the nine-month period ending September 30, 2017, and we generated \$688,000 from financing activities for the nine months ending September 30, 2018 compared to \$8,728,000 for the nine-month period ending September 30, 2017.

The Company has a revolving facility with Northwest Bank that allows for maximum borrowings of \$2 million and is secured by collateral accounts. The facility bears interest at Northwest money market rate plus 3%. As of today, there are no amounts outstanding under this facility, and we currently anticipate that our available cash, as well as expected cash from operations and available under this facility, will be sufficient to meet our anticipated working capital and capital expenditure requirements through at least the next 12 months. As of December 31, 2017, the Company had a net operating loss carry forward of approximately \$10 million.

I will now turn the call back over to the Operator, who will take questions from our analysts and institutional investors. Operator?

Operator:

Thank you. At this time, we'll be conducting a question-and-answer session. If you'd like to ask a question, please press star, one on your telephone keypad and a confirmation tone indicate your line is in the question queue. You may press star, two if you'd like to move your question from the queue. For participants using speaker equipment, it may be necessary to pick up your handset before pressing the star keys. One moment please while we poll for questions.

Thank you. Our first question is from the line of Mike Grondahl with Northland. Please proceed with your question.

Mike:

Hi, this is Mike (inaudible) on for Mike Grondahl, thanks for taking our questions. Maybe just on the per scan change for the large private-label credit card company. Is that something that will be noisy (phon) at all for 1Q, and is there any other larger accounts that are going to be switching to that model over time?

Bryan Lewis:

This is Bryan. You said, is it going to be noisy?

Mike Grondahl:

Just as far as how that plays out in 1Q for 2019.

Bryan Lewis:

The transition will take a while as we move the clients over to the new model. We already have multiple clients that are in play now that we have, and have had for a while, that transition will be as we move them onto our pure SaaS model versus the hosted model, so that will go on throughout 2019.

Mike Grondahl:

Okay. Then, just on the top-five bank, seems like a really nice win there. Can you just talk about the opportunity a little bit more between the retail side and the brand side and how you guys look at that?

Bryan Lewis:

Well, there is a lot more retail locations than there are branch locations, and a lot more scans that will happen at a retailer than there will be happening at a branch location, so as much as I love both bits of business, to me, the retail side of it is significantly larger.

Operator:

Thank you. Our next question is from the line of Ishiq Farooq with WestPark Capital. Please proceed with your question.

Ishiq Farooq:

Hi, good afternoon. Thanks for taking my questions. Two questions please. First one, Bryan or Bill, can you give a sense for the size of the top-five bank contract, and do you have similar size contracts in the pipeline right now?

Bryan Lewis:

The contract is, as we said, a bank can be certainly sizeable. From our end of it, a major retailer can be from \$800,000 to \$1.5 million in revenue, from what we've seen from existing clients. We believe this can certainly be a sizeable client.

Ishiq Farooq:

In terms of, do you have similar-sized customers in the pipeline or are you in negotiations with some at this point?

Bryan Lewis:

That's certainly what I pay the sales force for. We are in different levels of engagement with multiple banks. As I said, we certainly believe the market is coming our way, people are becoming more aware of the problem of identity theft, and realizing that we are, as I said, a very simple cost-effective solution that stops the vast majority of this fraud from happening no matter what the channel.

Ishiq Farooq:

Okay, my last question. Your R&D expenditure on this quarter really picked up, was that a one-time thing or is that a trend going forward?

Bryan Lewis:

There was headcount that we added. Certainly necessary to bring on these clients. A good portion of that would be ongoing.

Ishiq Farooq:

All right. Thank you very much.

Operator:

As a reminder, to ask a question, you may press star, one.

The next question is from the line of Roger Ladelle with Clear Harbor Asset. Please proceed with your question.

Roger Ladelle:

Thank you. Bryan, the wording of the Hospitality Insurance Group partners, that the Hospitality Insurance Group is offering the high-tech age ID. I don't know whether it's equipment. There may not be equipment required for the service. I'm not clear as to, therefore, the role of hospitality in terms of driving acceptance among its member organizations through that discount. Could you clarify just how this works?

Bryan Lewis:

Sure. The first thing is, they are making all of their clients aware of age ID. Certainly, the price point of age ID, which is much lower than a previous company that is no longer in business that was providing these services. They offer a discount, which depending on the sales volume of the client, so the bar, the liquor store, the price of their insurance is dependent upon their volume. The discount goes up the greater the amount that they are paying for their insurance. For many of the clients, it appears as though that discount would cover, or more than cover the cost of age ID, which, more often than not, it does not require them to buy anything because almost everybody in the stores, they've got smartphones and things, or just a minor purchase of a smartphone.

Roger Ladelle:

Okay. Several months back, there was an announcement about a relationship with, perhaps a partnership with, the Massachusetts Package Store Association. Is that Package Store Association the type of customer that Hospitality Insurance Group would have, or are these unrelated?

Bryan Lewis:

They certainly could be, but they are unrelated events. The Hospitality Insurance Group does a lot of it, but it's not the vast majority of their business in the Northeast; and a lot of it in New England. While there is a two-pronged approach, Mass Pack is pushing it because they think it's an important thing for their membership to be doing, is verifying age before they sell age-restricted products, and certainly the hospitality group believes that it is good prudent business to verify age, again, which is why they give the discount if you have the age verification tools in place.

Roger Ladelle:

I've noticed one of the states covered by Hospitality, to your point, all of New England, except Maine, is an area for Hospitality, but also North Carolina was mentioned. I know Intellicheck is active on a number of efforts. The ABC, as I recall, there may be others in North Carolina. Is that just serendipity, or is there one reason Hospitality is interested in being with Intellicheck is that you're already in North Carolina?

Bryan Lewis:

I think that was serendipity. It worked out well. You are correct. We're very well represented in state and local enforcement agencies with age ID in North Carolina. The more we have, the more it helps. Having Hospitality Group giving a carrot, and the amount of enforcement agencies that we have with the stick, it certainly should help us in North Carolina.

Roger Ladelle:

Okay. The last would be, the swipes versus the contract model. That's not quite the right term that I was used to previously. I think my view was correct that we should be indifferent between a swipes method of opening up relationships. It gets the door open, it gets business done. Truly, are margins roughly the same, or is there any way to correlate a swipes approach versus monthly or annual subscription? Is one preferable to the other?

Bryan Lewis:

It's sort of a two-part answer, and it depends on who we are selling to. When we sell to the retailers themselves, who are thinking about just their stores and their use cases, it seems that the per store license makes the most sense for them, and gives us the margins that we're looking for. When we're looking at very high volume trend—scan rates, which is what typically a bank who is offering credit cards to a hundred or more retailers, from their end of it, they're looking at all their clients as one unit. We felt that we could both extract more value by giving them a model that works for all the clients, as well as provide them incentives to bring on all the clients. One of the things that we had heard a lot was, "Well, I'm only going to put it in my high-risk stores." Now we've given them an incentive to bring everybody on board, across all their clients, because they get hit by the fraud everywhere. It is a tiered structure, and the more that they bring on board, their marginal cost of reducing fraud goes down, while our revenues go up.

Roger Ladelle:

Thank you. Well done on execution here.

Bryan Lewis:

Thanks, Roger.

Operator:

Thank you. At this time, we've come to the end of our question-and-answer session, and I would like to turn those floor back to Management for closing remarks.

Bryan Lewis:

I just want to say thank you, everybody, for attending the call. Very happy, as I said, with the performance of the team, and it's performance that I'm going to expect them to keep up. Have a good day, everyone.

Operator:

This concludes today's conference. You may disconnect your lines at this time. Thank you for your participation.