CPI Card Group Inc.

Q2 2021 Earnings Call Script

August 12, 2021

Investor Relations:

Thank you Harry and good morning everyone. Welcome to the CPI CARD GROUP second quarter and first half 2021 Earnings Webcast and Conference Call. On the call today from CPI Card Group is Scott Scheirman, President and Chief Executive Officer, and John Lowe, Chief Financial Officer.

SLIDE 2 – SAFE HARBOR STATEMENT

Before we begin, I'd like to remind everyone that this call may contain forward-looking statements, as they are defined under the Private Securities Litigation Reform Act of 1995. These statements are subject to certain risks and uncertainties that could cause actual results to differ materially from those expressed in the forward-looking statements. For a discussion of such risks and uncertainties, please see CPI Card Group's most recent filings with the SEC and on SEDAR. All forward-looking statements made today reflect our current expectations only and we undertake no obligation to update any statement to reflect the events that occur after this call.

Also, during the course of today's call, the Company will be discussing

one or more non-GAAP financial measures including, but not limited to, EBITDA, Adjusted EBITDA, Adjusted EBITDA Margin, and Adjusted Free Cash Flow. Reconciliations of these non-GAAP financial measures to the most directly comparable GAAP measures are included in the press release and slide presentation we issued this morning.

Copies of today's press release, as well as the presentation that accompanies this conference call, are accessible on CPI's investor relations website, investor.cpicardgroup.com. In addition, CPI's Form 10-Q for the quarter and six months ended June 30, 2021 will be filed with the SEC later today and will also be available on CPI's investor relations website.

And now, I'd like to turn the call over to Scott Scheirman, President and Chief Executive Officer of CPI…

Scott…

SLIDE 3 - AGENDA

Scott Scheirman, Chief Executive Officer

Thanks Brian, and good morning everyone. Thank you for joining us today for our second quarter conference call. During today's call I will provide an overview of CPI's financial performance, recent highlights and our company's vision and strategic priorities. John will then discuss the financial results in more detail before I conclude the call.

SLIDE 4 – STRATEGIC UPDATE

SLIDE 5 – 2Q 21 HIGHLIGHTS

CPI had a strong second quarter and first half of 2021 and we are proud of our team and accomplishments. Here are some highlights from the second quarter:

- We delivered a 31% increase in net sales over the prior year by winning new customers, growing with existing ones, and continuing to support our customers during the ongoing transition to contactless cards.
- Diluted earnings per share was $0.53 cents in the second quarter, nearly 5 times the $0.11 cents diluted earnings per share during the second quarter last year.
- Net income was $6.2 million dollars, 387% higher than last year, and
- Adjusted EBITDA increased by 91% to $19.3 million dollars.

Our second quarter and first half net sales growth was driven by earning new customers, including in the FinTech space. Additionally, the ongoing shift to contactless cards drove net sales growth and higher average selling prices in our Debit and Credit segment. We also won new business and increased volumes with existing customers in our Prepaid Debit segment.

Our performance has resulted in strong cash flow and we further executed on our capital strategy during the first half of 2021. We refinanced our debt in the first quarter and paid down the $15 million dollar balance on our ABL revolver to zero in the second quarter, continuing to de-leverage the balance sheet. We accomplished this while investing nearly $20 million dollars in the business to meet our customer needs as the partner of choice.

In addition, we are excited about our recent listing on the Nasdaq stock exchange. We are now trading under the ticker PMTS on the Nasdaq Global Market.

I want to say how proud I am of the organization and the progress we have made. We extend our gratitude to our employees for their dedication and commitment to safety and serving our customers through the difficult and unpredictable COVID-19 pandemic.

Turning to slide 6…

SLIDE 6 – VISION & STRATEGIC PRIORITIES

We continue to maintain a steadfast commitment to achieve our Vision and Strategic Priorities. Executing on these priorities has resulted in customer growth and strong financial performance in the first half of 2021. Our priorities are:

- First, deep customer focus,

- Second, market-leading quality products and customer service,
- Third, continuous innovation, and
- Fourth, a market-competitive business model.

Turning to slide 7…

SLIDE 7 – VISION & STRATEGIC PRIORITIES

Beginning with our first priority, deep customer focus. We continue to listen to the needs of our customers and focus our energy on helping to deliver unique and differentiated solutions that elevate their customers' experience. We strive to be the trusted partner in payments and exceed expectations through collaboration and the delivery of high quality and innovative products and services.

Evidence of our focus on this first priority is our ability to deliver end-to-end solutions to our thousands of direct and indirect customers, including the acquisition of new customers in the attractive small-to-medium financial institution space, and the fast growing FinTech space. These customers are choosing CPI to design, produce, personalize, and fulfill their payment solution needs through our innovative products and services.

We continue to succeed in our Prepaid Debit Segment, where our high-quality, tamper evident packaging and innovative, robust designs make CPI the market leader. Our strong position was

demonstrated by earning new portfolios, including another large U.S. national chain, and additional volumes with our existing customers that drove net sales growth in the first half of 2021.

We are proud of our longstanding trusted customer relationships which include large, medium-size and small financial institutions, bank platforms and processors that support those institutions, and program managers that support the prepaid industry.

Our second priority is to provide market-leading quality products and "five star" customer service. By effectively executing on this priority, we further establish CPI as a partner of choice.

For example, in the first half of 2021, we launched an Earthwise™ card made with Recycled PVC, featuring up to 85 percent upcycled plastic, dependent on design. The recycled plastic card joins the Earthwise™ High Content Card and our Second Wave® card, the first-to-market payment card featuring a core made with recovered ocean-bound plastic.

We are proud of our Earth Elements™ portfolio, which now includes the three different eco-focused options. We are the U.S. market leader in the growing eco-focused payment card space, as evidenced by selling over 33 million eco-focused cards since introducing this portfolio in 2019. We believe our eco-focused portfolio not only helps our customers in providing eco-focused solutions to their customers, it also allows them to support their own

corporate ESG goals.

Our third priority, continuous innovation, means collaborating with our customers to deliver unique and differentiated products and solutions that elevate their customers' experiences and enhance their brands.

This comes in the form of:

- eco-focused solutions,
- payment card solutions that support the migration to contactless payments,
- the flexibility of our CPI On-Demand and centrally issued personalization solutions,
- our Card@Once® solution that utilizes our plug-and-play Software-as-a-Service Platform to instantly issue payment cards in branch, and
- our market-leading prepaid solutions.

A recent example of providing our customers end-to-end solutions is our collaboration with Unifimoney, a premium digital banking service, which now offers our Second Wave® card solutions for its new Unifi Premier credit card. Our Second Wave® payment cards enable FinTech companies like Unifimoney to engage a growing market of environmentally conscious consumers while helping reduce first-use plastic and diverting plastic waste from entering the ocean. This is yet another example of a growing FinTech company that looks to CPI as they expand their offerings into the payment

card space.

In addition to growth in environmentally focused solutions, the U.S. payment card market continues its ongoing transition to higher priced contactless solutions, which has led to increased year over year demand across our Debit and Credit segment with Secure Card, Personalization and Card@Once® solutions.

We estimated that approximately 30% of U.S. debit and credit cards in circulation at the end of 2020 were contactless enabled and believe that number will be close to 50% by the end of 2021. This is consistent with recent statements by Visa regarding their penetration of contactless enabled debit and credit cards in the market. We believe the contactless transition will continue and expect approximately 80% of U.S. debit and credit cards will be contactless enabled by the end of 2025.

The latest innovation from Card@Once®, our Software-as-a-Service instant issuance offering, is the addition of our premium Spectrum printer solution, which enables issuers to produce a more defined, higher resolution payment card. Spectrum by Card@Once® contributed to 2021 net sales growth, and we now have over 12,000 Card@Once® instant issuance solutions installed across more than 1,700 U.S. financial institutions.

Our fourth strategic priority is a market-competitive business model, as we remain focused on driving increased productivity and

efficiency. We continue to invest in our core businesses to gain efficiencies and expand capabilities, enabling us to allocate resources to provide customers unmatched solutions, innovation, and world-class service.

To summarize, we believe CPI is well positioned to capitalize on market opportunities in an industry that continues to grow and evolve. Execution on our four strategic priorities of deep customer focus, market-leading quality products and customer service, continuous innovation, and a market competitive business model is enabling us to attract and retain our traditional customers as well as growing FinTech companies.

We are proud of the strong financial results we delivered in the first half of 2021 and look forward to continuing to successfully implement our strategic priorities in the future.

I will now turn the call over to our CFO, John Lowe, to review our second quarter and first half financial and operating highlights in more detail.

John…

SLIDE 8 – FINANCIAL REVIEW

<u>John Lowe – Chief Financial Officer</u>

Thank you, Scott, and good morning everyone. I will begin my overview of our results from the second quarter and first half of 2021 on slide 9.

SLIDE 9 – 2Q FINANCIAL RESULTS

Second quarter net sales increased 31% compared with the second quarter of 2020, to $93 million dollars. Net sales growth was driven by a 25% increase from our Debit and Credit segment and a 51% increase from our Prepaid Debit segment.

Results in both segments were primarily driven by new customer growth that Scott described earlier, and from the ongoing transition to contactless cards, as well as growth with existing customers. As a reminder, contactless cards have additional technology and generally have a higher selling price than contact-only cards.

Our prior year net sales in the second quarter and first half were also impacted in both segments by lower customer demand than expected, which we believe was primarily attributable to the COVID-19 pandemic.

Second quarter gross profit was $37 million dollars, up 61% over the second quarter of last year. Gross margins for the second quarter increased 750 basis points year over year to 39.8%, primarily due to operating leverage from higher net sales.

SG&A expenses increased in the second quarter compared to the

prior year, mainly due to higher selling and performance incentive compensation due to strong business performance, and from increased healthcare expenses.

During the second quarter, we generated net income of $6.2 million dollars, or $0.53 cents diluted earnings per share, compared to $1.3 million dollars of net income and $0.11 cents diluted earnings per share in the second quarter of 2020.

Adjusted EBITDA was $19.3 million dollars, an increase of 91% year over year, compared to $10.1 million dollars in the second quarter of 2020. The increase was largely due to net sales growth and operating leverage of the business. Our Adjusted EBITDA margin increased 650 basis points to 20.7%.

Turning to slide 10…

SLIDE 10 – YTD FINANCIAL RESULTS

First half net sales increased 25% year over year, to $182 million dollars, driven by a 21% increase in net sales from our Debit and Credit segment and 42% net sales growth from our Prepaid Debit segment. The primary growth drivers included growth of new and existing customers, the ongoing transition to contactless payment cards, and higher overall volumes in our Prepaid Debit segment.

Year to date, we generated gross profit of nearly $73 million dollars, up 49% from the first half of 2020, due to strong net sales growth

and operating leverage. On a year-to-date basis, we expanded gross margins by 640 basis points year-over-year.

SG&A expenses increased in the first half of 2021 compared to the prior year due to similar reasons as the second quarter increase I described earlier.

Additionally, we incurred incremental compliance costs beginning in the second quarter relating to CPI triggering accelerated filer status, and expect these costs to increase in the second half of 2021.

Year to date, our net income was $8.6 million dollars, or $0.74 cents diluted earnings per share. This is inclusive of pre-tax debt extinguishment costs of $5.0 million dollars and a $2.6 million dollar “make-whole” premium in interest expense, which resulted from the termination of our Senior Credit Facility and First Lien Term Loan in the first quarter of 2021. Excluding these items, and adjusted for the income tax effect, Adjusted Net Income was $14.4 million dollars in the first half of 2021, or $1.23 cents adjusted diluted earnings per share. This compares to $3 million dollars of net income or $0.27 cents earnings per diluted share in the first half of 2020.

Year to date, Adjusted EBITDA, which excludes the pre-tax debt extinguishment loss and “make-whole” premium, was $41.4 million dollars, up 84% compared with the first half of 2020.

Turning to our segments on slide 11.

SLIDE 11 – REPORTABLE SEGMENTS (DEBIT AND CREDIT)

Second quarter Debit and Credit segment net sales were up 25% year over year to nearly $73 million dollars. During the quarter, we benefited from new and existing customer growth, year-over-year volume increases in contactless card product sales and personalization, and growth in our Card@Once® instant issuance solutions and CPI On-Demand®.

Income from operations for the Debit and Credit segment for the second quarter increased $9.6 million dollars, or 89% year over year, to $20 million dollars. Higher net sales and operating leverage drove the strong performance in the second quarter.

For the first half, Debit and Credit segment net sales were up 21% year over year to nearly $143 million dollars and income from operations was up 74% year over year to $40 million dollars.

REPORTABLE SEGMENTS (PREPAID)

Net sales from our Prepaid Debit segment increased 51% year over year to $20.4 million dollars in the second quarter of 2021. The strong growth included greater sales volumes with existing customers including the replenishment of inventory as the prior year was impacted by lower retail store traffic associated with COVID-19 restrictions.

Prepaid Debit Segment Income from operations was $7.6 million dollars in the second quarter of 2021, up over 100% from the prior

year. The increase in net sales drove favorable overhead cost absorption resulting in operating income margins of 37% in 2021.

For the first half of 2021, net sales were nearly $40 million dollars, representing the highest net sales performance for Prepaid Debit during a first half since CPI became a public company. Net sales increased $11.8 million dollars, or 42% over the prior year. This growth was due to similar drivers as the second quarter.

Income from operations for the first half of 2021 was $14.6 million dollars, a 93% increase over the prior year, driven by strong net sales growth and favorable cost absorption.

Turning to slide 12…

SLIDE 12 – BALANCE SHEET, LIQUIDITY, CASH FLOW

Our cash balance as of June 30th 2021, was $30.7 million dollars. During the second quarter we paid off the outstanding balance on our ABL Revolver of $15 million dollars, resulting in $50 million dollars available for borrowing and bringing total available liquidity to more than $80 million dollars at the end of the second quarter. We ended the second quarter with total debt principal outstanding of $310 million dollars, down from $325 million at March 31st and more than $340 million at year end 2020.

Our net debt leverage ratio as of June 30th, 2021 was less than 4 times, a strong improvement from 5 times at the end of 2020.

In the first half of the year, we generated $22.7 million dollars in cash from operating activities and spent $3.7 million dollars on capital expenditures. This resulted in free cash flow for the first six months of $19.0 million dollars, an improvement of $8.6 million dollars compared to the prior year.

During the first six months of 2021, we invested over $15 million dollars in inventories to support the business and help mitigate supply chain constraints. Our cash flow from operations also included $6 million dollars in cash income tax refunds, primarily from CARES Act filings.

Our first half 2021 results exhibited our commitment to our capital priorities, which are:

- maintaining ample liquidity,
- investing in the business, and
- deleveraging the balance sheet.

To summarize, we believe the top- and bottom-line momentum we have achieved thus far in 2021 demonstrates our ability to grow the business and execute on our strategies.

While our focus is always on gaining share through new and existing customer growth, our quarter-to-quarter net sales can fluctuate. As we look forward, certain drivers of our sales growth in the first half

of 2021, including strong net sales growth due to new customer on-boarding volumes, may not repeat in the second half.

In addition, like many companies, we are experiencing increasing costs and operational impacts related to labor shortages and global supply chain constraints. While small in the first half, these impacts are expected to be greater as we look forward.

We are actively working on initiatives related to these impacts. In addition to our ongoing focus on our supply chain which has, and will continue to, include investments in inventory, we also plan to continue to invest in equipment to increase efficiencies and capacity and provide greater capabilities for our customers. We are also focused on our employee recruiting and retention strategies to support our operations. We will evaluate and pursue various initiatives to help address these impacts.

In summary, we are proud of the progress we have made to improve our financial performance in the first half of 2021 including strengthening our balance sheet and enhancing liquidity.

As always, we remain committed and focused on providing high quality products and solutions to our customers.

I will now pass the call back to Scott for some closing remarks.

Scott…

Scott Scheirman, Chief Executive Officer

SLIDE 13 – SUMMARY

Thanks, John.

We are pleased with our business performance in the first half of 2021, which I attribute to the hard work of our 1,000+ employees that strive every day to make CPI a better company. We believe that we are well positioned to deliver on our strategies as we enter the second half of the year.

We displayed solid execution throughout our business, which was reflected by our strong net sales growth and margin expansion.

In wrapping up, we remain committed to being the partner of choice by providing market-leading quality products and customer service through a market-competitive business model.

Thank you for joining our call today.