08-Mar-2022

CPI Card Group, Inc. (PMTS)

Q4 2021 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Welcome to CPI Card Group's Fourth Quarter 2021 Earnings Call. My name is Bailey and I will be your operator for today. The call will be open for questions after the company's remarks. [Operator Instructions] Now, I would like to turn the call over to [ph] Mike Salop, (00:00:22) CPI's Head of Investor Relations. Please go ahead.

Unverified Participant

Thanks, operator, and good morning, everyone. Welcome to the CPI Card Group's fourth quarter 2021 earnings webcast and conference call. Today's date is March 8, 2022. And on the call today from CPI Card Group are Scott Scheirman, President and Chief Executive Officer; and Amintore Schenkel, Chief Financial Officer.

Before we begin, I'd like to remind everyone that this call may contain forward-looking statements as they are defined in 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.

All forward-looking statements made today reflect our current expectations only, and we undertake no obligation to update any statements 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, net leverage ratio, and 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 of the company at this conference call are accessible on CPI's Investor Relations website, investor.cpicardgroup.com. In

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addition, CPI's Form 10-K for the year ended December 31, 2021 will also be available on CPI's Investor Relations website.

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

Scott T. Scheirman

President, Chief Executive Officer & Director, CPI Card Group, Inc.

Thanks, Mike, and good morning, everyone. During today's call, I will provide an overview of CPI's performance in 2021, give some thoughts on our strategy, future and 2022 expectations. Amintore will review the quarterly and annual financial results in more detail, then we will open up the call for questions.

Overall, as we look back at 2021, we delivered very strong performance for the year. Net sales increased 20%, raising our compounded annual growth rate in sales to 14% over the last four years. Profitability has improved at even a greater rate than the top line, moving from a net loss of $22 million in 2017 to 2021 net income of $16 million and adjusted EBITDA exceeding $76 million which translates to a compounded annual growth rate of 35% over the past four years. We believe our high-quality and innovative products and solutions have propelled us to significantly outpace market growth over the past four years. In addition, we believe our team's ability to navigate the supply chain and labor environment has given us a competitive advantage.

Some of the highlights from 2021 include strong sales from new customer additions as our comprehensive end-to-end solutions helped us gain business from fintech customers as well as traditional financial services providers. We also continue to help facilitate the US market's gradual transition to higher priced contactless cards. We believe approximately 40% of the estimated $2 billion financial payment cards outstanding in the US at the end of 2021 were contactless with small- and mid-sized financial institutions well below that level.

For CPI, almost 70% of the secure cards we sold in 2021 were the higher average selling price contactless cards which was up more than 10 percentage points from the prior year and contributed to our operating margin growth. Secure cards include EMV contact and dual interface, which we refer to as contactless and account for the significant majority of our card revenue in the Debit and Credit segment. We expect the contactless sales percentage to grow further as our customers continue to convert to issuing these faster-to-use and more convenient cards. The card networks have noted that tap to pay increases card usage which gives additional incentive to issuers to drive the transition in the US. We remain a leading market provider of eco-focused payment card solutions in the US, selling more than 20 million cards in 2021 to reach nearly 50 million cards sold since launch in late-2019. As these cards were predominantly contactless, they also helped drive higher average selling prices.

Card@Once, our market-leading SaaS-based instant issuance solution grew faster than the company overall in 2021, reaching nearly 10% of the company's net sales and delivering strong profitability. Card@Once's growth was aided by expanded distribution channels and the success with our high-end Spectrum solution and we now have nearly 13,000 installations across financial institutions in the US. Our personalization business brought us growth from new customers including fintechs who are attracted to our end-to-end solution offerings including design, production, packaging, and fulfillment capabilities. And our Prepaid business had a record year as we leveraged our innovative, tamper-evident packaging solutions to enhance our leadership in the US retail prepaid card and packaging market.

Net income for the year was down 1% due to prior-year income tax benefits and debt refinancing costs in the first quarter of 2021, but adjusted EBITDA increased 33% and the adjusted EBITDA margin increased 200 basis

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points to 20.4%. We also improved our balance sheet in 2021, reducing outstanding debt by more than $30 million during the year and driving our net leverage ratio down below 4 times as of year-end.

As we noted in our third quarter earnings release, we expected our fourth quarter results to be impacted by increased labor, materials and certain other costs. Those impacts largely happened as anticipated, bringing fourth quarter margins down from prior year and the first nine months' levels.

However, as we look forward, we believe the full year 2021 adjusted EBITDA margin of 20.4% is more indicative of the full-year 2022 expected profitability level than the fourth quarter margin. This is a result of implementation of various business initiatives, including price increases, operating leverage from higher expected sales and expected reductions in the level of certain fourth quarter expense items.

Turning to slide 5, given the current market dynamics with labor and supply chain challenges and the related inflationary environment as well as some specific comparison items for our prepaid business, today we are providing some high-level expectations for 2022 performance.

First, let me state that I am very confident in our future. We continue to experience strong customer demand and we believe our innovative and differentiated payment solutions, longstanding customer relationships and participation in attractive growing markets position us well for continued market share gain and long-term growth.

Over four years ago, we focused the company on a vision of being the partner of choice in payment solutions by providing market-leading quality products and customer service while operating a market-competitive business model. We made deep customer focus and continuous innovation in key strategic priorities, increasing our capabilities to offer tailored products and services and comprehensive end-to-end solutions.

Since that time, we have established ourselves as a top payments card solution provider in the US, serving thousands of banks, credit unions and fintechs. Today, we are a leading provider of eco-focused payment card solutions in the US which is a rapidly growing space. We are also a leader in personalization and Software-as-a-Service-based instant issuance solutions for the small and medium-sized US financial institutions as well as for US retail prepaid debit card solutions.

Our markets are healthy and growing. Based on the figures reported by Visa and Mastercard, US credit, debit and prepaid cards in circulation have grown at a compounded annual growth rate of 8% over the three-year period ending September 30, 2021. In addition, a recent report by credit data agency, TransUnion, noted that a record 196 million Americans held credit cards at the end of 2021 and US lenders issued more payment cards than ever last year. According to the report, an all-time high of 20 million new payment cards were issued in the third quarter of 2021, the latest period for which detailed numbers were available.

As a reminder, we estimate that historically 90% of annual card issuance has been for replacement cards. So, we believe increases in new card customers will have positive, ongoing, long-term effects. We expect US market revenue growth will continue to be aided by further financial payment card issuance growth as well as the gradual transition to higher-priced contactless cards, including eco-focused cards.

We believe we have gained significant overall market share over the last four years with our high-quality products and services and end-to-end solutions and see strong opportunities for additional share gains going forward.

For 2022, we do have some unique dynamics. Supply chain and labor shortage challenges continue to impact the industry affecting lead times, raw materials, availability and costs. We have navigated these challenges with

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proactive inventory management, hiring and retention incentives at our production facilities and other operational actions and expect to continue to be able to be nimble and [ph] adept (10:33).

Our current high-level financial expectations for 2022 are to deliver mid-single-digit net sales and adjusted EBITDA growth compared to last year with an adjusted EBITDA margin similar to last year's full-year level of 20.4%. We expect our Debit and Credit segment, which includes our secure card, personalization and instant issuance solutions and represented 79% of 2021 net sales, to provide strong growth as demand remains robust and we are in a good position to serve our customers and benefit from the contactless trends including with eco-focused card solutions. Based on current orders, we expect our eco-focused card sales to increase by more than 50% in 2022.

Customer demand for our Debit and Credit segment is generally higher than our outlook but we have factored certain capacity and material constraints into our forecast. We will attempt to alleviate some of these constraints through operational initiatives by partnering with our suppliers where we can throughout the year. We expect Debit and Credit segment growth to be partially offset by declines in sales and EBITDA in our Prepaid Debit segment.

Prepaid had a record year in 2021, growing sales 25% in what is usually a slower growth market. Last year's Prepaid sales were aided by a large new portfolio addition as well as retail inventory replenishment by our customers who reduced purchases in 2020 due to COVID-related concerns. Although we expect the decline for Prepaid in 2022 due to the comparisons with a record 2021, the business remains healthy and customer relationships are strong and we would expect Prepaid sales to be between the 2020 and 2021 levels. Finally, before I turn the call over to Amintore, I would like to mention our announcement today that we have notified holders that we plan to redeem $20 million of our 8.625% senior secured notes due in 2026 at a redemption price of 103%. We expect this retirement to help improve our leverage ratio by year-end and providing ongoing interest expense savings. As we generate more cash flow, we will continue to review capital allocation alternatives to maximize value for our stockholders.

Now, I will turn the call over to Amintore to review our fourth quarter and full-year financial and operating results in more detail. Amintore?

Amintore T. X. Schenkel

Chief Financial Officer, CPI Card Group, Inc.

Thank you, Scott, and good morning everyone. I will begin my overview of 2021 with the fourth quarter results on slide 7. Fourth quarter net sales of $93.2 million represented an increase of 11% compared to the prior-year quarter, driven by an 11% increase in our Debit and Credit segment and a 6% increase in the Prepaid Debit segment. The Debit and Credit segment increase was primarily due to the ongoing transition to higher priced contactless cards, including strong growth in our eco-focused cards, strong increases in Card@Once instant issuance solution and new customer growth.

Prepaid Debit segment growth in the quarter was driven by higher volumes with existing customers. As we noted in our third quarter earnings release, we expected fourth quarter sales growth and profit margins would not be as strong as the first nine months, and we expected increased labor, materials and certain other costs to be more impactful than earlier in the year. We did see those factors materialize and impact our fourth quarter results.

Our fourth quarter 2021 gross profit, up $30.9 million, was essentially flat with prior year while gross profit margins decreased 360 basis points to 33.2%. The decrease in margin was primarily driven by higher labor costs, and to a lesser extent, increased freight and material costs with declines partially offset by operating leverage from sales

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growth. SG&A expenses increased by $3.4 million in the quarter compared to the prior year, primarily due to $1.3 million of increased consulting and accounting costs related to Sarbanes-Oxley and increased healthcare and other employee-related expenses. We are continuing to work on remediation efforts regarding identified internal control deficiencies, so we do expect incremental SOX cost to continue into 2022. Our plan is to complete remediation by the end of the year.

Employee healthcare expenses which vary by quarter depending on employee usage, increased $700,000 compared to the prior-year fourth quarter and we also incurred a $600,000 expense tied to a new state law regarding paid time-off compensation. Net income in the quarter decreased 91% to $700,000, primarily due to increased income tax expense compared to an income tax benefit in the prior-year fourth quarter and increased interest expense. The 62% income tax rate into 2021 fourth quarter reflects the effect of some state tax and the uncertain tax position adjustment items.

Adjusted EBITDA decreased 23% to $13.6 million as the benefits of higher net sales were offset by increased labor costs and the SG&A items previously mentioned. Adjusted EBITDA margins declined from 20.8% in the prior year to 14.6% in the 2021 fourth quarter. As Scott mentioned, we do not expect the fourth quarter adjusted EBITDA margin to be the ongoing level. We expect improvements in 2022 from pricing and other initiatives, operating leverage from sales growth and reductions from certain high fourth quarter expenses to result in the full-year 2022 adjusted EBITDA margin to be similar to the 2021 full-year level, although sales growth and margins may vary by quarter.

Turning to the full-year results on slide 8, while the fourth quarter results were impacted by the items discussed, overall for the year we again delivered very strong results. Net sales increased 20% to $375.1 million, driven by strong growth from both segments. Debit and Credit sales increased 18% to $296.2 million and Prepaid Debit sales increased 25% to $79.2 million. Sales growth was strong at 2021 across our portfolio of products and services. The primary drivers of the increase in the Debit and Credit segment included new customer growth and sales of contactless cards and related card personalization. Card@Once instant issuance and CPI OnDemand were also strong contributors to growth. Prepaid Debit sales growth for the year was driven by higher volumes from existing customers, including the acquisition of new portfolios and replenishment of inventory by those customers. Full-year gross profit for the company increased 28% to $141.4 million, while gross profit margin increased 240 basis points to 37.7%, primarily due to operating leverage from higher net sales, partially offset by increased labor costs.

SG&A expenses increased $9.9 million for the year, primarily due to higher compensation-related expenses including performance incentive compensation, higher professional fees and other compliance costs which were primarily related to Sarbanes-Oxley and increased healthcare expenses. The compensation-related increase included $2.2 million of higher performance incentive compensation and $1.1 million of stock compensation. SOX-related consulting and accounting fees accounted for $2.1 million of the SG&A increase and employee healthcare costs increased $1.6 million for the year.

Net income for the full-year of $15.9 million decreased 1% due to income tax benefits in the prior year and debt refinancing costs in 2021, including $5 million of debt extinguishment costs incurred in the first quarter and $2.6 million of make-whole interest expenses.

As a reminder, in 2020, we recorded an income tax benefit for the year as a result of discrete items, including benefits related to the CARES Act. Our 2021 income tax rate of 33% was a more normalized rate and we expect the 2022 rate to be slightly higher due to the impact of regulatory changes that will further limit interest expense deductions.

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Adjusted EBITDA in 2021 increased 33% to $76.4 million, primarily due to net sales growth and the related operating leverage. The adjusted EBITDA margin increased 200 basis points to 20.4% for the year.

Turning now to our segments on slide 9, I mentioned the Debit and Credit and Prepaid Debit segment sales drivers earlier. So, I will just discuss segment profitability on this slide. Income from operations for the Debit and Credit segment increased 10% in the quarter to $18.6 million and 45% for the full year to $79.5 million.

Higher net sales and operating leverage drove the increases. Although these benefits were partially offset by increased labor costs, the fourth quarter income was also impacted by increased freight costs. Prepaid Debit segment income from operations decreased 16% in the quarter to $3.9 million and increased 35% for the year to $26.9 million. The full-year profitability increase was driven by the 25% sales growth, while the fourth quarter was negatively impacted by increased labor, materials and freight costs.

Turning to the balance sheet, liquidity and cash flow on slide 10, our cash balance as of December 31 was $20.7 million and we had no borrowings outstanding on our $50 million ABL revolver which gave us total liquidity of more than $70 million at the end of the year. Total debt principal outstanding of $310 million was down more than $30 million from year-end 2020 and our net leverage ratio as of December 31 was less than 4 times.

For the year, we've generated $20.2 million in cash from operating activities and utilized $10.1 million on capital expenditures. This resulted in free cash flow of $10.2 million. This was down from $15 million in the prior year, primarily due to increased investment in inventories, partially offset by collections of tax refunds. We invested more than $33 million in incremental inventories to support the business and helped mitigate supply chain constraints during the year and collected $9.8 million in income tax refunds related to the CARES Act.

Given our strength and financial position, our capital structure and allocation priorities is now focused on maintaining ample liquidity, investing in the business, including possible strategic acquisitions, deleveraging the balance sheet and potentially returning funds to stockholders. If we were to return funds to stockholders in the future, our priority would be to do so through share repurchases.

Although we filed an S-3 last September that registered shares for possible future issuance, we currently do not have any plans for the company to sell shares to raise capital. The registration will simply provide us the flexibility over the next three years if an opportunity were to arise as well as registered the shares of our private equity investor for possible future sale.

As Scott mentioned earlier, we are in the process of redeeming $20 million of our senior secured 8.625% notes which will reduce our long-term debt levels and save us significant interest expense on an annualized basis. Finally, to provide us additional liquidity and flexibility, we recently expanded our ABL revolving credit facility from $50 million to $75 million. This facility is committed through to December of 2025.

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

Scott T. Scheirman

President, Chief Executive Officer & Director, CPI Card Group, Inc.

Thanks, Amintore. As mentioned, overall, 2021 was another strong year for CPI with growth across our portfolio. I would like to thank all of our employees for working hard to deliver these results.

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Since implementing our vision to being the partner of choice in payment solutions by providing market-leading quality products and customer service through our market-competitive business model, we have now posted four consecutive years of strong sales and profitability growth and believe we have gained significant overall market share over that time.

We are well-positioned in attractive growing markets with strong capabilities and customer relationships. Although the industry continues to face near-term labor and supply chain-related challenges, we have various initiatives that we expect to benefit from in 2022. We're also pleased to be able to pay down $20 million of our senior notes in the first quarter of this year and we will continue to pursue capital strategies that provide value to our stockholders. We are excited about our long-term growth opportunities and we look forward to updating you on our progress as we move forward.

Thank you for joining our call today and we will now open the call for any questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. [Operator Instructions] Our first question today comes from Jaeson Schmidt of Lake Street. Jaeson, please go ahead. Your line is now open.

Jaeson Allen Min Schmidt
Analyst, Lake Street Capital Markets LLC

Q

Hey, guys. Thanks for taking my questions. Scott, you mentioned factoring in capacity and material constraints into your outlook which makes complete sense, but just curious if you could quantify the impact or the amount of demand you think you are unable to be satisfied just given these current dynamics?

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

Yeah. Again, I won't give you specifics Jaeson and I appreciate you joining the call today. But if I just walk you back through our guidance to kind of give you some color on that, again for the company, we guided mid-single-digit revenue growth, mid-single-digit adjusted EBITDA growth but it's the tale of two business units. And in our Debit and Credit segment for sure demand is generally higher than our outlook. But to your point, we do have some constraints with supply chain and labor and we're working hard with our partners and our suppliers to alleviate that. But customer demand is very strong, and in Debit and Credit segment, it's robust. But we'll continue to work through that.

The other business unit is Prepaid. Prepaid has been a great business for us. We have strong customer relationship. It's a business in really good shape. But it had a record 2021 where sales were up 25% due to two primary factors: One is COVID inventory replenishment that happened in 2021; and then with one of our partners, we won a large portfolio and so there was some initial stocking there.

The good news that will be reoccurring business as we move forward but Prepaid has a tough comparison in 2022 versus 2021. So, we see the sales of Prepaid for 2022 to be somewhere between what we did in 2020 and 2021. But again I'd come back to customer demand is really strong. We've profitably gained market share over the last four years. That's our objective on a go-forward basis. And we believe our high-quality, our differentiated products such as eco-focused cards, our SaaS-based instant issuance solution, prepaid quality, innovative packaging; all those things we believe will help us to continue to win share.

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Jaeson Allen Min Schmidt
Analyst, Lake Street Capital Markets LLC

Q

Okay. That's helpful. And then just looking at gross margin, I understand the dynamics that impacted Q4 but given sort of the supply chain and labor costs which likely will persist, at least here in the near-term, how should we think about gross margin trending here in 2022? And relatedly are you able to pass along some of these inflationary costs?

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

Yes. To your second question, we are passing along the inflationary costs. And so what I'd probably take you back to is just broadly our guidance where we guided the mid-single-digit adjusted EBITDA growth but also we believe our 2022 margins will be similar to our 2021 margins that were 20.4%. And so there were some things that we expected in the fourth quarter with labor and inflation and so forth. But to your question on customer pricing, many of our pricing initiatives are going into effect in the first-half of 2022.

Also we believe the sales we generate; the operating leverage will be helpful to the gross margins and also to the adjusted EBITDA. And then we're also, like we always, have is continuing to try and drive efficiencies, operational improvements. And so we're quite comfortable that we believe our 2022 adjusted EBITDA margins will be similar to 2021 full-year of 20.4%. And knowing Jaeson that gross margin is kind of a number in between sales and adjusted EBITDA, right but it's kind of all the things work together to drive strong margins as we move forward.

Jaeson Allen Min Schmidt
Analyst, Lake Street Capital Markets LLC

Q

Okay. And just the last one from me and I'll jump back in the queue. I mean you mentioned taking share over the past few years. I assume you expect that to continue going forward. But just curious if you've seen any change in the competitive landscape and I guess specifically sir with the rumors surrounding IDEMIA?

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

Yeah. I won't speak to any specific competitor but clearly there are some competitors out there that are struggling in the marketplace. And it's evident that over the last four years, we've gained share. We significantly outpaced the market growth. Jaeson, I say this broadly I feel there's two reasons we're gaining share, a variety of reasons for sure. But if I put them in two broad buckets: One is I would put around our quality and included in that quality I would say is some of the strategic decisions we made to purchase inventory. We spent – our inventory increased over $33 million in 2021 as Amintore mentioned on the call.

So, I believe we've got very strong quality with the quality of our products, on-time delivery. We've been able to I believe navigate the supply chain better than some of our competitors. But the second thing that I think is critically important too is we really got some innovative and differentiated products that are in high demand in the market. To give you a couple of examples: One is our eco-focused cards. Again, financial institutions have ESG goals. All of us as consumers want the businesses – we do business with to be more environmentally conscious. So our eco-focused cards are clearly differentiated. We've sold $50 million of those since we launched them in 2019. And more importantly in 2022, we believe sales of eco-focused cars will be up over 50%.

Another key, just as an example of a differentiated product is our SaaS-based Card@Once instant issuance. It is clearly the market-leader for SMEs. There was no one that is even a close second in my opinion. And with that business, it's a great business in that it's plug-and-play. It's easy for the bank or the credit union to use. We get an

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initial revenue from the sale of the machine but it's got a great reoccurring revenue model with a quick charge. Every time a card is printed, we earn a fee. There's fees for some consumables, printer ribbons, things of that nature. So, highly differentiated.

But I'd also hop to our prepaid business, record sales year in 2021 with 25% growth, but again a high quality there. We've got innovative packaging that helps prevent fraud, drives shelf appeal. So, a consumer pulls that package off the J-Hook versus somebody else's package.

So, again, we do see competitors struggling. I believe our quality, our proactive strategy with inventory supply chain management and then just our highly differentiated products are allowing us to win over the last four years and I'm really confident that our objective is to continue to gain market share as we move forward.

Jaeson Allen Min Schmidt
Analyst, Lake Street Capital Markets LLC

Q

Okay. Appreciate the color. Thanks, guys.

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

Thanks, Jaeson.

Amintore T. X. Schenkel
Chief Financial Officer, CPI Card Group, Inc.

A

Thanks, Jaeson.

Operator: Thank you, Jaeson. [Operator Instructions] The next question today comes from Joseph Thomas from Voya Investment. Joseph, please go ahead.

Joseph Thomas
Analyst, Voya Investment Management

Q

Hi. Good morning. Quick question on how you see margins progressing through the year. I mean you noted that higher pricing is coming into effect during the first half. Does that imply margins will be stronger in the second half versus first half? And I have a follow-up.

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

Yeah. The color I would give you is we provided full-year guidance. So, any given quarter, there could be some variability both in sales and margins and it could relate to the timing of onboarding customers. Our Prepaid business has seasonality in the third quarter. That's generally the highest demand going into the holiday season. Some of it can be when the pricing initiatives kick in or investments we make.

So, I don't want to give you specific color quarter-by-quarter, but I think the important thing is that on a full-year basis for 2022, we expect our adjusted EBITDA margins to be similar to 2021 adjusted EBITDA margins of 20.4%

Joseph Thomas
Analyst, Voya Investment Management

Q

Perfect. Okay. And from a leverage standpoint, what is your target leverage range?

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Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.
A

If I just walk you back through our priorities for our capital, first is to have ample liquidity. Second is to – testing the business, including if there's acquisitions that would make sense for us. The third item to your question, Joseph, is reducing our leverage.

Our leverage at the end of the year was about 3.8 turns. Today, we announced we're paying down the senior secured notes by $20 million. So, I would describe that we would like our leverage to be less compared to where it was at yearend. But I think the other important thing to keep in mind is that we have a much improved financial condition compared to about a year ago; stronger balance sheet.

So, that really gives us I would say more strategic flexibility, whether that's to make more investments in the business through acquisitions, paying down the debts or returning funds to shareholders. If we were to do that, that would likely be through stock buyback.

So, again I'd like the leverage to be less, but I don't have a target that we want to share publicly. Just so that as we move forward, we've got some flexibility within testing in the business, acquisitions and including reducing the leverage and returning funds to shareholders.

Joseph Thomas
Analyst, Voya Investment Management
Q

Okay. And that was helpful. And final question for me, obviously working capital was a headwind last year as you had the stock inventory, how do you see working capital move this year?

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.
A

Yeah. I'll let Amintore, our Chief Financial Officer, walk you through our thinking there.

Amintore T. X. Schenkel
Chief Financial Officer, CPI Card Group, Inc.
A

Yeah. Joseph, I think one of the things that's a little difficult to predict this year is when you think about, kind of the inflation and supply chain issues that exist out there, those were obviously two key drivers that caused us to increase our inventory investment. And ultimately inventory kind of caused our working capital to be a use of about $17 million and that was the primary driver.

But we're going to continue to kind of monitor supply chain situations out there. We would anticipate that the increases would not be as high as what we had in 2021. But that clearly will be something that we'll continue to monitor out there. The key for us is making sure that we're managing the business well and continuing to grow our sales and our profits overall. But I do think 2021 was kind of a year that was a bit unique in terms of us having to build up our inventory reserves in order to make sure that we had appropriate inventory to make sure we can deliver on what we're planning to deliver on here in 2022.

Joseph Thomas
Analyst, Voya Investment Management
Q

Thanks so much.

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Operator: Thank you, Joseph. The next question today comes from Bill Charters from Sabal Capital. Bill, please go ahead.

William Charters
Analyst, Sabal Capital Management, LLC

Q

Hi. Thanks for taking my call. If I look at your guidance, that kind of implies a little over $2 of earnings, maybe $2.40. If you'd normalize that, what that comes out to is roughly a 20% free cash flow yield at this point. And I believe reading your indentures you have the ability to buy $20 million of stock. I didn't know if the $20 million in buying bonds reduced that amount but I guess that's my first question.

And then the follow-up to that question obviously is with the 20% of free cash flow, I would strongly encourage you to buy stock because there's just very few returns out there that you can get that or exceed 20%.

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

And, Bill, I appreciate your – hey, Bill. This is Scott.

A

Go ahead. Sorry, Scott. This is Mike.

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

Go ahead, Mike.

A

Yeah. I was going to say that the bond redemption does not affect the basket available for the share purchase.

William Charters
Analyst, Sabal Capital Management, LLC

Q

Okay.

Scott T. Scheirman
President, Chief Executive Officer & Director, CPI Card Group, Inc.

A

And I appreciate your input on how we should utilize our capital, so I appreciate that, for sure, Bill. Thank you.

William Charters
Analyst, Sabal Capital Management, LLC

Q

Yeah. Thank you. That's all the questions I had.

Operator: Thank you, Bill. There are no further questions registered. So, I'd like to hand the call back over to Mike Salop for closing remarks.

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Thank you. I'd like to thank everybody for joining our call today. Feel free to contact the company or myself if you have any follow-up questions. And I hope everyone has a good day. Thanks.

Operator: That concludes today's CPI Card Group's fourth quarter earnings call. Thank you. You may now disconnect your line.

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