

Payment Data Systems Inc.

Second Quarter 2016 Earnings Conference
Call

Thursday, August, 11, 2016, 5:00 PM Eastern

CORPORATE PARTICIPANTS

Louis Hoch - *President and Chief Operating Officer*

Habib Yunus - *Chief Financial Officer*

Julie MacMedan - *Investor Relations*

PRESENTATION

Operator

Good afternoon, and welcome to the Payment Data Systems's, Second Quarter 2016 Earnings Conference Call. All participants will be in 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 your touchtone phone. To withdraw your question, please press "*" then "2." Please note this event is being recorded.

I would now like to turn the conference over to Julie MacMedan, Investor Relations for Payment Data. Please go ahead.

Julie MacMedan

Thank you, Austin, and welcome to all of you who have joined us for today's call to discuss Payment Data Systems's second quarter 2016 financial results. Our earnings release, which we issued earlier this afternoon, is available on our Investor Relations website at paymentdata.com/invest under Press Releases. I'm here today with Louis Hoch, President and CEO; and Habib Yunus, Chief Financial Officer. On today's call, management will provide prepared remarks and then we will open up the call to your questions, as well as answer questions that have been emailed to us by investors.

Before we begin, I would like to remind you that comments on today's call will include forward-looking statements. Forward-looking statements can be identified by the use of such words as estimate, anticipate, expect, believe, intend, may, will, should, seek, approximate, or plan, or the negative of these words and phrases or similar words and phrases. Forward-looking statements by their nature involve estimates, projections, goals, forecasts, and assumptions and are subject to risks and uncertainties that could cause actual results or outcomes to differ materially from those expressed in the forward-looking statements.

These forward-looking statements speak only as of the date of this conference call and should not be relied upon as predictions of future events. Payment Data expressly disclaims any obligation or undertaking to update or revise any forward-looking statements made today to reflect any change in Payment Data's expectations with regard thereto or any other changes in events, conditions, or circumstances on which any such statement is based, except as required by law. Please refer to our SEC filings and our Investor Relations website for additional information.

With that, I would now like to turn the call over to Louis Hoch, President and CEO of Payment Data. Louis...

Louis Hoch

Thank you, Julie. Before I discuss our operating results, I want to personally thank our Co-Founder and Chairman, Michael Long, for his 18 years of service as our Chief Executive Officer. As we announced earlier this week, our board has accepted Michael's resignation as CEO. He will continue in his role as Chairman of the Board.

Michael and I have worked together for many years and he's been instrumental in growing our company and developing our powerful operating platform. The board and I are looking forward to continue working with him to shape our company's growth strategy.

On today's call, I will review our operations and strategy and our CFO, Habib Yunus will discuss our second quarter financial results in more detail. During the second quarter, we reported a decrease in revenues year-over-year due to lower ACH transaction volumes and returned check processing levels compared to the same period last year. On the positive side, our second quarter credit card processing volumes were the fourth highest to-date and increased year-over-year.

More importantly, we achieved higher gross margins as a percentage of our revenue compared to the prior year, which underscores the strength of our business model. Our second quarter results reflect market-related headwinds including merger and acquisition activity with some of our partners and some small customer attrition. In response, we have taken strong actions to increase revenues. These actions are: one, to expand our ACH network; two, to continue to innovate our ACH and credit card and prepaid platforms; and three, launch a new sales and marketing campaign for our prepaid business.

In late July, we announced the addition of a new processing bank that will expand our ACH network capacity. It will help us better serve the needs of our existing customers. This new strategic bank relationship provides additional stability to our existing and future customers by offering them an additional channel to transmit payment traffic through the Federal Reserve network.

Operationally, it adds redundancy and better risk management to our systems and will ensure that we can provide the highest level of service in our industry. Once this capacity comes online about 60 days from now, we expect to immediately generate increased traffic from existing customers who have expressed interest in maintaining multiple banking relationships. We also expect to attract new customers with our expanded capabilities.

In addition to expanding our ACH network with a new strategic banking relationship, we continue to innovate within our own platform. In June, we rolled out a brand new client-facing web application that allows customers to easily manage their payments. We also rolled out an Apple iOS SDK that enables developers to easily integrate payment acceptance into their apps for phones, iPads and other Apple-related devices. We are hopeful that this SDK will increase our visibility into new industry verticals.

This month, we will integrate our payment gateway directly with debit networks. That will enable our existing ACH customers to perform real-time debits and also provide near real-time credits to most bank accounts in the United States. This has been a feature that's been requested by a number of our merchants, and we expect it will increase transaction volumes and associated revenue over the next coming quarters.

In addition, we are continuing to find ways to use our vast data set in merchant processing to provide risk protection services to our clients. Over the long-term, we believe leveraging our data is a highly effective way to set ourselves apart from the competition.

We continue to drive innovation from our exciting high growth prepaid business. Today, we offer the most sophisticated consumer incentive prepaid card products on the market. Our digital incentive card solution, Akimbo Now, provides businesses with a new way of delivering rewards to customers and employees. We are the only solution available in the US that can deliver a reward card by email or text message that can be instantly provisioned within Apple Pay and immediately used for both in-store and online purchases.

Our prepaid products team anticipates support for Android Pay and Samsung Pay within the next two months, further expanding the reach of the technology as well as our lead on the competition. This fully digital card platform has several competitive advantages. It provides a simple and secure experience for cardholders and allows them to utilize the promotional rebate card immediately. Development in this product has not been trivial and additional developments in the future are underway to keep Akimbo Now on the cutting edge of technology.

Expanding our ACH network and investing in innovation are important competitive advantages and growth drivers. We are also committed to increasing our awareness of our products and driving associated revenues. This is particularly true in our prepaid business, which while today is small, holds much promise as a high growth opportunity for our company.

As for our consumer-focused prepaid card product, the Akimbo Card, we've been making substantial investments in brand development. We hired a marketing agency in July that is working on new positioning through a comprehensive marketing campaign. We are excited with the progress so far and we look forward to launching our initial efforts of the new marketing campaign as early as October of this year.

In addition to organic growth, we are constantly evaluating acquiring one or more credit card processing portfolios or companies that could be accretive to our credit card business. In June, we engaged Preston Todd Advisors to target and identify acquisitions. We don't have anything specific to announce in this area today, but we continue to be diligent in evaluating these opportunities.

Our balance sheet is strong with \$4.4 million in unrestricted cash and we are debt free. This positions us well for future growth opportunities both through organic growth and through acquisitions. We will continuously evaluate the best use of our capital among these opportunities.

In summary, we saw a decline of revenues in the second quarter but we are taking strong actions to drive revenue growth. These include expanding our ACH network, innovating our ACH credit card and prepaid card offerings to deliver best-in-class solutions to our customers, and executing a focused sales and marketing campaign for our high-potential prepaid business. With our strong balance sheet, Payment Data is well-positioned to deliver sustainable growth over the long term.

With that, I'll now turn over the call to Habib to review the financials.

Habib Yunus

Thank you, Louis. I'm going to provide a brief review of our financial results and then I'll turn the call over for questions. For the second quarter of 2016, we reported revenues of \$2.9 million, down 16% from the second quarter of last year. This was due to a decline in ACH processing volumes and return transactions processed, as well as some customer attrition.

As Louis mentioned, we are taking actions to drive revenue growth including investing in technology and increasing our sales and marketing efforts. Gross margins were \$855,621 or 30% of revenues. This is compared to \$998,144 or 29% of revenues in the second quarter of last year. Even with lower revenue, we are encouraged by our ability to maintain margins.

Our second quarter operating loss was \$455,220 compared to operating income of \$91,833 in the second quarter of last year. This reflects higher SG&A and higher amortization related to

the assets acquired from Akimbo. Adjusted EBITDA was \$54,081 compared to \$578,306 in the second quarter of last year.

Net loss was \$355,301 or \$0.05 on a per share basis compared to net income of \$24,850 or \$0.00 per diluted share for the second quarter of last year. As Louis mentioned, we have a strong balance sheet with \$4.4 million in cash and we have no debt. During the second quarter, we generated net cash from operations of \$185,047 and we will continue to reinvest free cash flow into the business. Our team is focused on making prudent investments in sales, marketing, and technology to support our long-term growth.

Operator, we'll now turn the call over for questions.

QUESTION AND ANSWER

Operator

Thank you. 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 pickup your handset before pressing the keys, to withdraw your question, please press "*" then "2." At this time, we will pause momentarily to assemble our roster.

And our first question comes from Gregg Hillman with First Wilshire Securities Management. Please go ahead.

Gregg Hillman

Hi. Good afternoon. Could you talk about the thing in Las Vegas with the Akimbo Card, whether that will be important or material in the second half of this year?

Louis Hoch

C2Go - we don't believe will be material this year.

Gregg Hillman

You said...I didn't quite...you said it will be or?

Louis Hoch

It will not be.

Gregg Hillman

Okay. Will it be material next year?

Louis Hoch

We are hopeful.

Gregg Hillman

Okay. And then in terms of any other...could you speak to any other new initiatives that you are engaging in currently? And just Akimbo in general whether you are kind of getting traction with that whole product line to do alliances with big customers?

Louis Hoch

Well, we landed a Fortune 100 customer that's using the product now. As you know, Gregg, we are already providing services to Eli Lilly, Merck, Medtronic and Pfizer for their clinical trials. But we are getting more exposure to the Akimbo Now product that's allowing us to get more and

more leads from clients that typically weren't on the radar set before. So we are definitely excited about Akimbo Now.

Habib Yunus

And great. Hi, this is Habib, we have...Houston presented at Finovate in the Bay Area a few months ago and as a result of that, we have four or five really big opportunities where we would co-brand or white label that they can reprogram for a financial partner.

Louis Hoch

And Gregg, if you are not familiar with that show, it's for financial institutions to get exposed to innovators in financial tech, like our company. There were over 100 financial institutions that came to our presentation. The presentation is actually on our Investor webpage under presentations, and you can watch the video. Our executives did a really good job and generated quite a bit of interest from that conference.

Gregg Hillman

Okay. Just kind of in general, I think your core business is...is the core business growing, you know, your original business as opposed to these newer initiatives or is the core business kind of flattish or do you expect it to grow on a go-forward basis?

Louis Hoch

Well, a couple of things we are doing, we talked in our prepared remarks. We are adding another sponsoring bank; we know that our customers are...even though we are the primary processor, they hold relationships with secondary processors, just because they want to minimize banking risks. Those customers would love to process all of their traffic through us. By adding that new bank we think we are going to capture a lot of that existing traffic that exists today. So we are definitely excited about that. That will grow our core business and that's important. Credit cards are growing nicely on their own, and we are reviewing some acquisitions.

Gregg Hillman

Okay. And that would just be another like credit card processor or would it be...would you actually acquire for some new technology?

Louis Hoch

Well, it could be either. We definitely want to be accretive, so we could buy a collection of customers, like a portfolio or we are also looking at companies that have complementary technology, strong management teams, sales engines and verticals that we aren't in today. So we are kind of pursuing aligned opportunities.

Gregg Hillman

Okay. So basically you expect like a year from now that some of these things are going to get some traction and then the revenue should trend up a year from now from where it is right now?

Louis Hoch

Exactly.

Gregg Hillman

Okay. That's all I have. Thanks.

Louis Hoch

Thanks, Gregg.

Operator

And again, if you would like to ask a question, please press “*” then “1”, again that’s “*” then the number “1” to ask a question. At this time, I am showing no further questions. I would like to turn the conference back to Louis Hoch for any closing remarks.

CONCLUSION**Louis Hoch**

Thank you. We had one e-mail question from an investor, and it was targeted to me and my selling plan and asked if I was going to continue with that. I just want to let people know that it expires this month, and I currently have no intentions of renewing that plan. It might change for me personally in the future, but right now I have no intentions of renewing that plan. Other than that, we don’t have any more e-mailed questions. And if nobody else jumps in the queue here quick, we are going to go ahead and close the call.

Operator

The conference has now concluded. Thank you for attending today’s presentation. You may now disconnect.