

Payment Data Systems, Inc.

Q3 2016 Earnings Conference Call
Edited Transcript

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CORPORATE PARTICIPANTS

Louis Hoch - *President, Chief Executive Officer*

Habib Yunus - *Chief Financial Officer*

Kristen Papke - *Investor Relations*

PRESENTATION

Operator

Good day and welcome to the Payment Data Systems Q3 2016 Earnings Conference Call. All participants will be in listen-only mode. Should you need any 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 telephone keypad, 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 Kristen Papke, Investor Relations of Payment Data. Please go ahead.

Kristen Papke

Thank you and welcome to Payment Data Systems third quarter 2016 financial results conference call. Our earnings release, which we issued earlier this afternoon is available on our investor relations website at paymentdata.com/invest, under news. A corresponding 8-K has been submitted to the SEC for immediate filing.

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 the call to your questions.

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 in 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, Kristen, and welcome to everyone. On today's call, I will review our operations and strategy, and our CFO Habib Yunus will discuss our third quarter financial results in more detail.

During the third quarter, we reported a decrease in total revenues year-over-year due to lower ACH transaction volumes and returned check processing levels compared to the same period last year.

However, we were pleased with our progress on a quarter-over-quarter basis, delivering sequential growth in revenues and gross margin driven by our accelerated efforts in marketing and sales.

In fact, total dollars processed for the third quarter of 2016 exceeded \$760 million, representing the highest quarter total dollars processed to-date for 2016. And our overall transaction volumes in dollars processed in the third quarter compared to the second quarter is a positive trend that we expect to continue into the fourth quarter and into next year 2017.

As I discussed on our earnings call last quarter, we continue to take strong actions to increase revenues. These actions are, one, expanding our payments network; two, continuing to innovate our ACH credit card and prepaid platforms; and three, launching new sales and marketing campaigns. I will comment on the recent progress of each of these areas.

First, in expanding our payments network, during the end of the third quarter, we completed the integration of our payment's gateway directly into various debit networks. This service provides near real time credit transactions to most bank accounts in the US and enables our customers to perform real time debits off checking accounts. The service has been very well received and we expect the offering will create a nice revenue stream for us over the next quarter and into 2017.

Second, in continuing the innovation of our ACH and credit card prepaid platforms, we continue to build solid traction through innovations that support, enhance customer operations. And we are excited to share what our prepaid platform can do for businesses, banks, and developers.

Last month, we attended Money 20/20 in Las Vegas which is the main payment show and we debuted the use of our technology that allows for real time provisioning to mobile wallets like Apple Pay as well as the instantaneous issuance of delivery of gift and incentive cards.

The same technology that supports the Akimbo Prepaid MasterCard and the Akimbo Gift MasterCard can be utilized by businesses and banks to offer real time instantaneous access to funds such as the ability to sign up for new account and have a card in their Apple Wallet moments after completing the enrolment process. There is no longer any need to wait for plastic card to arrive by mail before being able to use it as a prepaid account.

Businesses and consumers can also send customizable gift and incentive and reward cards via email or text. So whether they are looking to launch their own prepaid card program or are just seeking a novel and inexpensive way to send incentives, rewards, and other payments, banks and businesses can put our prepaid platform to use for innovative solutions that are unmatched by any other providers today. As far as we know, we are the only company in the market with gift cards that can be provisioned directly into the Apple Wallet.

In October, we furthered our competitive lead by adding supports for both Android Pay and Samsung Pay with our reloadable and gift prepaid card options. We are really excited about the interest we received on these cutting edge innovations.

Also in prepaid, this has been a busy year for us and we've executed a number of processing and program management agreements with several new clients seeking to launch their own branded prepaid card program. In total, we have executed five agreements for co-branding, and during this last quarter, we successfully implemented three of the five.

We are excited to announce more details on the partnerships in the upcoming months. We believe these agreements combined with the organic growth from our existing card programs and revenue from our prepaid card segment of our business will increase nicely this year and continue into 2017.

Our third category of actions to increase revenue is launching new sales and marketing campaigns. In October, our marketing agency launched a focused sales and marketing campaign for high potential prepaid business including our digital card platform for Apple Pay that I discussed earlier. We are excited about this campaign and look forward to sharing the progress as it proceeds forward.

Moving on to a couple of corporate announcements, today, we announced that our board of directors has appointed two new board members, Tom Jewell and Steve Huffman. Both of these individuals bring decades of financial business leadership to our board along with high level of counsel and advisory on management transaction, audit, and governance matters.

Tom has over 35 years of business leadership experience focused on management, auditing, accounting, internal controls and finance. He is a CPA and he will serve on our audit, nomination and compensation committees.

Steve Huffman has over 30 years of experience in developing commercial real estate and began his real estate career in 1983 while also running a successful public accounting practice. Steve is also a CPA and will serve as our audit committee chair and will also be a member of nomination and compensation committees. It is our pleasure to welcome Tom and Steve to our board and we look forward to their contributions.

At the same time, we announce the departure of our long-time director Peter Kirby who retired last week. He has been on our board since the inception of our company in 1998 and has distinguished himself as a professional in community activities in a career that spans many years. We are grateful for his 18 plus years of service to Payment Data and we wish him the best in his retirement.

Also our board authorized to repurchase up to \$1 million of our company's common stock. Our management team and the board believe our current stock price offers a compelling value and the repurchase program reflects the confidence we have in our long-term growth prospects.

As of September 30th, our balance sheet remains strong with over \$4.3 million of unrestricted cash positioning us to pursue future growth opportunities both through organic growth and through acquisitions.

With that, now I turn over the call to Habib to review the financial results.

Habib Yunus

Thank you, Louis. I'm going to provide a brief review of our financial results and then will turn the call over to questions.

For the third quarter of 2016, we reported revenues of \$3.1 million, down 14% from the third quarter of last year. Similarly, for the nine months ended September 30th, revenues were down 14% to \$9.2 million. These are both due to a decline in ACH processing volumes and returned transactions processed. As Louis mentioned, we are taking actions to drive revenue growth including investing in technology and sales and marketing efforts.

Gross margins were \$965,485 or 31% of revenues compared to \$1.2 million or 34% of revenues in the third quarter of last year. Our third quarter operating loss was \$574,897 compared to operating income of \$23,332 in the third quarter of last year.

For the nine months ended, September 30th, our operating loss was \$1,076,530 compared with operating income of \$809,886 for the same period last year. These decreases are due to higher SG&A and higher amortization related to the assets acquired from Akimbo.

The SG&A increase year-over-year is mainly due to two reasons. The first is higher headcount as we build up our operations for the growth we expect in the coming quarters. We think that the overhead portion of SG&A has stabilized and the run rate is going to be stable for the next few quarters.

The other reason for the increase in SG&A in the third quarter was due to a computer malfunction that resulted in overfunding merchants' customer's accounts by \$236,850. We continue to attempt to recover the funds, and for those amounts that we cannot recover from any customers, we may request that our merchants reimburse us as we are entitled to under our merchant processing agreement.

In addition, we are exploring a claim with insurance as wire fraud. Although we do not expect similar losses in the immediate future, management has decided to fund the reserves with an additional \$200,000 in the event we are unable to recover all or a portion of the funds. This \$200,000 expense impacted SG&A during the period ended September 30, 2016.

For the three months ended September 30, 2016, adjusted EBITDA loss was \$129,859 compared to adjusted EBITDA of \$589,161 in the third quarter of last year. However, adjusted EBITDA for the nine months ended September 30th was still positive at \$389,719 although it is down from \$2,219,717 from the same period last year.

Net loss for GAAP purposes was \$565,957, or \$0.07 on a per share basis, compared to net income of \$117,780 or \$0.01 per diluted share for the third quarter of last year. Net loss for the nine months ended September 30th was \$953,259 or \$0.12 on a per share basis, down from net income of \$851,246 in the same period last year, or \$0.07 per diluted share for the nine months last year.

As Louis mentioned, we have a strong balance sheet with \$4.3 million in cash. We don't have any debt and we have a clean capital structure. For the nine months ended September 30, we generated cash from operations of \$585,581. We continue to reinvest free cash flow to the business.

Operator, we will 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 telephone keypad. If you are using a speakerphone, please pickup your handset before pressing the keys, to withdraw your question, please press "*" then "2."

Our first question comes from Ronald Nisser, a Retail Investor. Please go ahead.

Ronald Nisser

Hello, Louis, this is Ron. And now that new rules and regulations are in print governing paying with plastics solutions, I believe you can overcome some headwinds. That being said, on some brokerage accounts, online brokerage accounts, the symbol FFID non-compliance is showing up and now that you've appointed two more people to the board of directors, could you tell me if that FFID symbol will disappear?

Louis Hoch

I'm not familiar with what you mean by FFID, but I can...I'm familiar with what you are talking about with our compliance with NASDAQ governance rules. Obviously, the reason why we came out of compliance was our head of our audit committee left our board. We've replaced that person and now and we've replaced him with two CPAs instead of one. They are both qualified to lead our audit committee based upon NASDAQ and SEC rules. So we expect that NASDAQ will be pleased with our activities and we should be in compliance.

Ronald Nisser

Okay. Well again, the symbol is FFID and it shows up on online brokerage accounts and if you click on, it will tell you non-compliance, so that's the reason I asked that. One other question I would like to ask, and that is most non-banks or almost all non-banks consumers do not carry plastic. But, they do carry smartphones or cell phones. Can you tell me if you are making any headway in finding ways to enable the non-bank masses to transfer or make transactions I should say using cell phones?

Louis Hoch

Well, Ron I just talked a lot about Samsung Pay and Apple Pay and we are continuing to have innovations when it comes to digital wallets that occur on phones. And we are definitely focused on that. And we enjoy a first mover advantage in a lot of cases there. So, getting the message out to those people to download wallets using one of our cards like the Akimbo prepaid card is definitely a focus of our sales and marketing efforts and hopefully we will see some headway with that.

Ronald Nisser

Okay. I believe my outside opinion looking in, and if you have a combination [indiscernible] smartcards, and cell phones, you have military grade security. Could you tell me if you are still working with Futurex?

Louis Hoch

Definitely, we maintain a relationship with Futurex.

Ronald Nisser

Okay. That is all the questions I have. Again, I do think you are overcoming some headwinds and I look forward to some progress or greater progress in the foreseeable future. Thank you.

Louis Hoch

Thanks, Ron.

Operator

Once again, if you have a question please press "*" then "1" to enter the queue. This concludes our question and answer session. I would like to turn the conference back over to Louis Hoch, President and CEO. Please go ahead.

Louis Hoch

Operator, I think we got one more call we can do.

Operator

Pardon me. Our next question comes from George Doss from Wells Fargo Advisors. Please go ahead.

George Doss

Yes, I was just wondering if there is any on your acquisition front, if you had any progress that you can talk about, are you still in the same plans with your advisors there and what can we possibly expect over this next year?

Louis Hoch

Well, hopefully we can actually complete a transaction. We've looked at a few and we haven't had anything to announce. And I would tell you that there is lot of properties out there that you don't want us to buy that we have looked at, and of course we realized we don't want to buy either. But we definitely have been looking and we will continue to look.

George Doss

Okay. So, you are still active is what I was wondering?

Louis Hoch

Yes. We are definitely active, definitely active.

George Doss

Okay. Thanks.

Operator

Once again, if you have a question please press "*" then "1" to enter the queue. All right, this concludes our question and answer session. I would like to turn the conference back over to Louis Hoch, President and CEO for any closing remarks.

CONCLUSION

Louis Hoch

Thank you, everybody for participating today on our call and we look forward to talking to you again next quarter.

Operator

Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation. You may now disconnect.