

# Payment Data Systems

## Third Quarter 2017 Conference Call

Tuesday, November 14, 2017, 5:00 PM  
Eastern

### **CORPORATE PARTICIPANTS**

**Louis Hoch** - *President, Chief Executive Officer*

**Tom Jewell** - *Senior Vice President, Chief Financial Officer*

**Houston Frost** - *Senior Vice President of Prepaid Services*

**Preston Graham** - *Investor Relations*

## **PRESENTATION**

### **Operator**

Good day, everyone, and welcome to the Payment Data Systems' Third Quarter 2017 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. And to withdraw your question please press "\*" then "2" and please do note that today's event is being recorded.

I would now like to turn the conference over to Preston Graham of Investor Relations. Please go ahead.

### **Preston Graham**

Thank you, and welcome to Payment Data Systems' third quarter 2017 financial results conference call. The earnings release which Payment Data issued earlier this afternoon is available on the company's investor relations website at [paymentdata.com/invest](http://paymentdata.com/invest) under the News section.

On the call today are Louis Hoch, President and CEO, Vaden Landers, Executive Vice President and Chief Revenue Officer, Houston Frost, Senior Vice President of Prepaid Services, and Tom Jewell, Senior Vice President and Chief Financial Officer. 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 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, including risks related to the integration of the recently acquired Singular assets, the realization of the anticipated opportunities from the Singular acquisition, management of the company's growth, the loss of key resellers, the relationship with the Automated Clearinghouse network, bank sponsors, third party card processing providers and merchants, the loss of key personnel, growing competition in the electronics commerce market, the security of the company's software, hardware and information and compliance with complex federal state and local regulations. 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 the company's SEC filings on its Investor Relations website for additional information.

With that, I would now like to turn the call over to Louis.

**Louis Hoch**

Thank you Preston, and welcome everyone. The company's revenue growth plan is now yielding results, and we're pleased to report a strong third quarter.

Revenues increased 17% year-over-year, credit card processing transaction volumes were up 33% over the third quarter of 2016, and the associated dollars processed increased 77% as compared to the third quarter of 2016. Both these operating metrics for transactions and dollars processed achieved all-time records for the company.

We expect that trend to continue in the fourth quarter of 2017 and throughout all of 2018. While electronic check transactions were down 18% and return check transactions processed were down 16% compared to the same time period in 2016, the electronic check transaction volumes during Q3 were up 3% as compared to the second quarter of 2017, and the return check transactions processed in Q3 were up 16% over the second quarter of 2017.

In addition to growing our existing business through the introduction of new services and newly acquired customers, we closed the Singular Payments acquisition in September. We added talented leadership, sales and a robust customer base that we now perform credit card processing for.

Vaden Landers, former CEO of Singular Payments, has assumed the role of Executive Vice President and Chief Revenue Officer, we are fortunate to welcome him as a senior leader in our company. Also in the third quarter, we announced the availability of same-day ACH debits.

This offering facilitates a faster service that extends to all US bank accounts and enables businesses and consumers to send and receive payments on the same banking day through the ACH Network.

This service demonstrates our commitment to being an innovator in ACH processing services. With our well established electronic check and credit card processing service, and our growing prepaid card and PINless debit businesses, we believe the company is well positioned for future growth.

Finally, I want to spend some time discussing the outlook for the fourth quarter of 2017 and the year of 2018. As I previously stated, our growth plans are yielding results. Already, the credit card processing volumes for just the month of October have exceeded the volumes we experienced in the whole fourth quarter of 2016.

We expect to set another all-time record in the fourth quarter for both transactions and dollars processed for credit and debit cards. We are expecting credit card transactions in the fourth quarter to grow over 150% as compared to the fourth quarter of 2016, and the credit card dollars process to grow more than 250% as compared to the fourth quarter of 2016.

We believe that the growth in our credit and debit card processing will cause us to experience resulting revenues that will be the highest for any previous quarter in the history of our company. We are expecting the revenues to surpass \$5 million in the fourth quarter of 2017. In line with this trend, we are expecting to achieve record annual revenues in 2018.

We remain focused on continuing our plans...continuing executing our plans for both organic growth and growth through acquisitions. We remain committed to building secure payment processing services that will attract new customers and new relationships with software integrators that are focused on various industry segments.

Now, I'll turn the call over to Tom Jewell, our Senior Vice President and Chief Financial Officer.

### **Tom Jewell**

Thank you, Louis. I'm going to provide today a brief overview of our financial results before we turn the call over for questions. Payment Data Systems is in solid financial condition, with \$2.2 million in cash and cash equivalents, positive cash flows from operations for the year, no debt and the recent acquisition of Singular Payments. For the first nine months of 2017, we generated net cash from operations of \$33,000.

Going into the third quarter, we reported revenues of \$3.6 million, up 17% from the third quarter last year. For the nine months, revenues were \$9 million, down 2.6% compared to \$9.2 million for the nine months ended September 30, 2016.

For the nine months, the decrease in year-to-date revenues was primarily due to decreased ACH transactions and return transactions processed, offset by one month of robust credit card revenues as mentioned previously.

Gross margin dollars in the third quarter were \$825,000 or 23% of revenues compared to \$965,000 or 31.5% of revenues in the third quarter of last year. Gross margin dollars for the nine months ended September 30, 2017, were \$2.5 million or 27.5% of revenues compared to \$2.9 million or 31.5% of revenues in the corresponding prior year period. The decline in gross margin dollars was also due to the lower ACH and return profit dollars, offset by higher credit card gross margin dollars.

For the third quarter, our operating loss was \$892,000 compared to an operating loss of \$575,000 in the third quarter of last year. Operating losses for the nine months ended September 30 were \$1.8 million compared to an operating loss of \$1.1 million for the same nine months ended September 30, 2016.

On an adjusted EBITDA basis, for the quarter, we had negative \$347,000 compared to a prior year period of \$85,000. For the nine months, our adjusted EBITDA was negative 337,000 or 3.8% of revenue compared with income of 435,000 or 4.7% of revenue in the nine months ended September 30, 2016.

The net loss for the quarter was 890,000 or 10 cents per basic and diluted share compared to a comparable loss of 566,000 or 7 cents per basic and diluted share for the third quarter last year.

For the nine months, our loss is 1.7 million or 20 cents per basic and diluted share compared to a net loss of 953,000 or 12 cents per basic and diluted share in the nine months ended September 30<sup>th</sup>, 2016. The higher loss was again primarily attributable to the decreased ACH and return revenues and profits and also incremental operating costs.

Operating expenses were up \$451,000 for the nine months ended September 30<sup>th</sup>, 2007 versus the same prior period. You know, in conclusion, it's great to see our growth plan gathering steam. The Company remains well positioned for future success with a tremendous technology platform and ability to structure solutions that are easy to implement and cost effective for the consumer.

We are aggressively pursuing new opportunities to satisfy the evolving needs of existing and new customers. In closing, we are confident that strategy and investments we put in place has laid the groundwork for continued top line growth.

I want to thank our shareholders, our employees including our new Singular Payment employees that have joined Payment Data for the dedication and support and look forward to speaking to you next quarter.

Operator, I will turn the call over for questions at this time.

### **Operator**

Thank you sir, 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 speaker phone, please pick up your handset before pressing the keys. To withdraw your question, please press "\*" then "2" and at this time, we will pause momentarily to assemble our roster.

And our first questioner today will be Laura Engel with Stonegate Capital. Please go ahead.

**Laura Engel**

Good afternoon. Thanks for the good information and some of the updated guidance as well. We need to see if you could just give us a little more detail on the lower gross margins for the quarter and then you said that this could be attributed to some of the credit card business being brought over with the acquisition. Can you just tell us a little bit more about the length of those contracts and maybe how we should think about that going forward for the next few quarters?

**Tom Jewell**

Thanks Laura. Good to hear from you. Yes, they are clearly longer-term agreement as we talked a lot about. What we are doing is we are signing up customers through software integrators and so we are an add-on product as a part of that and typically those customers have very long life. You know in the analysis of the acquisition we were looking at the lifetime of the customer and we are very pleased with our ability to retain our customers.

**Laura Engel**

Great, okay. And then also just related to the P&L, can you remind us what's in this other expense category, had a little bit of a jump this quarter to about 1.2 million. What is in that and other expenses in there that are nonrecurring or maybe related to the acquisition or the transition?

**Tom Jewell**

Yes, that's our SG&A expense and so we have you know obviously some costs associated with the acquisition and then there were some legal expenses that were incurred during the quarter that we do not expect to reoccur in the fourth quarter to the extent that they did.

**Laura Engel**

Okay, great. Well, great quarter and I appreciate you taking my questions. I will get back in the queue.

**Tom Jewell**

Thank you.

**Laura Engel**

Thank you.

**Operator**

And our next questioner today will be George Doss with Wells Fargo. Please go ahead.

**George Doss**

Yes, George here. I was just wondering about on the gross margin going forward, what should we expect? I think you said you were 23% this past quarter. Do you see improvement in that each quarter going forward? What are you striving for?

**Tom Jewell**

Yes. We expect to see improvements. We're doing a lot of things to decrease the cost and increase the profits. I guess, as you integrate an acquisition, we look to probably see some modest increases in the fourth quarter and then into the early part of 2018.

**George Doss**

Okay, all right. And any other acquisitions on the horizon now that you filed for, I guess, more money?

**Louis Hoch**

We're definitely looking at...always looking at potential acquisitions. We filed an S3. It's a shelf offering, if you're familiar with it. It's limited in what we can raise, and that's the primary purpose of that offering. But, we haven't announced anything about potential acquisitions at this time.

**George Doss**

Okay, thanks.

**Louis Hoch**

Thanks, George.

**Operator**

And our next questioner today will be from Ron Nisser a private investor. Please go ahead.

**Ron Nisser**

Yes, Louis.

**Louis Hoch**

Hi Ron.

**Ron Nisser**

I've got a few things that I'm juggling to try to figure out how soon profits will rise with Payment Data Systems. In 2003, the percent of part of the billing and payment equation was placed on the back burner, and pay serves on the front. The stock was trading at \$0.03 at that time and we've come a long way. You can't develop and avoid a complete end-to-end payment network without billers. Can you tell me at this juncture how many biller names are in the tried and true digital modular service at PDS headquarters?

**Louis Hoch**

We're able to send bill payments electronically to almost 4,000 billers in the United States.

**Ron Nisser**

4,000, okay, that's quite a few more names or billers than you had in 1998. That being said, there's such a tremendous demand for helping hand prepaid card solutions. I was wondering, with your background, lots of you people...only a few people know you're educated with running a call center. Do you see getting more involved with donation cards or cards that could become a helping hand during the cleanup and rebuilding process after the floods and fires?

**Louis Hoch**

Ron, Houston Frost, who heads up our prepaid, I'll let him answer that question because he had some success delivering cards to hurricane victims through charities. Do you want to answer that, Houston?

**Houston Frost**

Hi, Ron. Yes so this is Houston Frost, SVP of prepaid products. We actually ran a campaign after the hurricanes whereby we offered sort of discounted, even free plastics for hurricane victims. And we have had several nonprofits take us up on that. Part of that was, one, to help out the victims obviously of the hurricane. But, the other was to kind of promote the use obviously of these cards for the purpose you're referring to. So, we actually sent out a couple of thousand cards over the last quarter, specifically on those use cases. We had several small orders and a couple much larger orders with foundations. And we hope to see that use case continue on our gifts and incentive programs.

**Louis Hoch**

Do we have a dollar amount that went out?

**Houston Frost**

Over \$250,000 went out.

**Ron Nisser**

Also, I'd like to add, I know that Jason Moore is listed as one of the insiders or one of the people helping run the company. I would think that his expertise with being Paris Hilton's agent at one time, he could contact some celebrities and help promote these helping hand load and reloadable prepaid cards, which, I believe, would streamline the cleanup and the rebuilding process. And Houston, while I have you on the phone here, I'm not quite...I'm not familiar with your PhD in biometrics, and I was wondering how it might tie in with Near Field Communication, if any, voice, face recognition. Can you comment on your expertise?

**Houston Frost**

Hi, Ron. So...my PhD is actually in chemical engineering. It's certainly...my experience as an academic researcher and as an engineer helps out my day-to-day just problem-solving and other things. It's a little bit hard to comment specifically on biometrics because unfortunately, that wasn't a focus of mine during my academic career. In general, I'll say my education has been a good foundation for me in my professional career.

**Ron Nisser**

Yes. I understand the Payment Data Systems management is highly educated. And what I see coming down the pike as fast as it can develop and deploy at web speed is iPhones that can be waved in front of the readers once the readers are set in place and you have this Near Field Communication that will create more recurring revenue and click fees than cards in the foreseeable future. And if you could combine smartcards with smartphones then you might have some military-grade security. Maybe I'm pushing the envelope too hard here, but the iPhone...or the Apple iPhone and iTunes, I think it could meld seamlessly with games, and there's some click fees involved in that juncture or that pursuit. That being said, do you see in the foreseeable future that you'll be using...or being handling and processing recurring transactions from NFC-enabled iPhones?

**Houston Frost**

Well, I think on the issuing side on the prepaid card side, card tokenization and digital cards have been at the forefront of our thinking and really our product development. We've made announcements of this in the past that we are really the first to market period full stop with a fully digital gift or incentive card. And in fact, we have several large clients...large companies leveraging that platform today primarily for R&D. But we see a lot of areas where those companies can use our digital card platform.

So we're able to deliver cards both instantly and digitally direct to an Android phone, an Apple phone and those cards can be immediately provisioned into the mobile wallet. And that's really kind of in the first of its kind. We are starting to see some of the competition catch up there but we've been so early that I think we're just starting to see some of the benefits from being first to market there. There's innumerable applications for that kind of platform. And in my opinion, we're just at the very early days of seeing cards move from a plastic form to a digital form that will be in a variety of devices, not just mobile phones but they'll be encoded in a chip in your car, on your watch, on a keychain.

So I think long-term, we fully believe plastic will go away, and it'll be completely replaced by electronic devices and tokenized cards within these electronic devices. And we want to continue to be right at the forefront of that. It's a long-term trend. We're in just the first few years of it. But certainly, we want to continue to be pioneers and leaders in that. And I think some of the applications you mentioned are interesting, and there are several others. I can tell you, we're in close contact with MasterCard's, [indiscernible] team about all sorts of new things that they have been working on and empowering. And so we're excited to be kind of close to those guys and see what's coming down the pipeline in terms of new devices and new products. And so I think you're going to see a lot of exciting stuff over the next couple of years when it comes to digital cards.

**Ron Nisser**

Yes sir. Inch-by-inch is a cinch and yard-by-yard is hard. Just so happens I have a couple of friends that came back from China and Taiwan and they were amazed how much ahead they

are of the United States when it comes to using smartphones and voice and face recognition. Wave your iPhone in front of a card or whatever and you make your payment for your meal or go through a turnstile and it registers when you got on or off a train and knows when to bill you and how to bill you correctly.

And if you don't have one of the cards in Japan, you can't get through to the train or can't go through the turnstiles when you got off the train. For that, and other reasons, I focus on 21<sup>st</sup> century Payment Data solutions and, I believe you're sitting in the catbird seat. And if you can get the right backing, it's "Katie bar the door", but again, inch-by-inch is a cinch, yard-by-yard is hard. I'll hang up on that note and wish everybody the best.

**Houston Frost**

Thanks Ron.

## **CONCLUSION**

### **Operator**

Once again, if you would like to ask a question, please press "\*" then "1". And there look to be no further questions, so this will conclude the question-and-answer session and today's conference call. Thank you all for attending today's presentation. You may now disconnect your lines.