

Payment Data Systems, Inc.

Fourth Quarter and Fiscal Year End 2017
Conference Call

Thursday, March 29, 2018, 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, Prepaid Services*

Scott Gordon - *Investor Relations, CORE IR*

PRESENTATION

Operator

Good afternoon and welcome to the Payment Data Systems', Fourth Quarter and Fiscal Year End 2017 Conference Call. All participants will be in listen-only mode. And 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 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 Scott Gordon with CORE IR, the company's Investor Relations firm. Please go ahead.

Scott Gordon

Thank you, Austin. Thank you and welcome to Payment Data Systems' fourth quarter and year end 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 under News.

On the call today are Louis Hoch, President and CEO, Tom Jewell, Senior Vice President and Chief Financial Officer and Houston Frost, Senior Vice President of Prepaid Services. Management will provide prepared remarks and we will then open the call to your questions.

Before we begin, please remember that comments on today's call include forward-looking statements. Forward-looking statements can be identified by the use of words, such as, estimate, anticipate, expect, believe, intend, may, will, should, seek, approximate or plan or the negative of these words or 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 proposed Singular acquisition, management of the company's growth, the loss of key resellers, the relationships 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 laws and 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 and 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?

Louis Hoch

Thank you, Scott and welcome everyone. The year 2017 ended with a significant increase in revenues, nearly doubling in a year-over-year comparison of the fourth quarter and a 16% increase in the 12-month revenues compared to 2016. Each of these revenue figures are all time records for the company and we attribute these results to the execution of our revenue growth plan announced earlier the year.

Credit card processing transaction volumes were up 90% over the fourth quarter of 2016 and the associated dollars processed increased 274% as compared to the fourth quarter of 2016. While electronic check transactions volumes were down 13% for the quarter and 15% for year end, and return check transactions process were down 18% to the same time periods in 2016 and 13% for the year. The electronic check transaction volumes during Q4 continued their upward trend at 7% and the associated return check transactions processed remain flat as compared to the third quarter of 2017.

During the fourth quarter, we also achieved Third-Party Sender Certification through NACHA, which is the governing body of payments made via ACH. This process took PDS many months to accomplish, and is a testament to our company's focus on regulatory and risk management and speaks favorably to the credibility of our company within the payments industry.

We also closed a registered direct stock offering of \$3 million before expenses to three institutional firms. In terms of highlights for the year, it warrants reminding you of our acquisition of Singular Payments from which we added talented leadership, sales and robust customer base for whom we now performed credit card processing for.

Finally, I want to spend some time discussing the outlook for 2018. As I previously stated earlier in 2017, we initiated a revenue growth plan, which included the acquisition of Singular Payments, as well as, multiple improvements to our technology and the launch of several additional products.

As you can see from the revenues for Q4 and our year-end revenue figures, this plan is clearly yielding record setting results. And we anticipate even further revenue growth throughout 2018.

Our credit card processing volume during the fourth quarter was more than 2.5 times from the previous year and the associated transactions doubled. This has more than exceeded our expectations early on in terms of transaction volume and resulting revenue.

In the meantime, we remained focused on continuing to execute our revenue growth plan, and of course, remain committed to providing secure payment processing solutions to the markets that we serve, that will be effective in terms of attracting new customers and developing meaningful relationships with integrated software vendors, each serving as a fundamental component of our go forward growth and operating strategies.

Now, I will turn the call over to Tom Jewell, our Chief Financial Officer.

Tom Jewell

Thank you, Louis. I am going to provide a brief overview of our financial results before we turn the call over to questions. First of all, Payment Data Systems remains in solid financial condition with \$4.8 million in cash and cash equivalents at the end of the fourth quarter and that compares to \$4.1 million in 2006 at the end of the year.

For the fourth quarter, I am pleased to report our revenues were \$5.6 million up 94% from the fourth quarter last year. The major driver of the revenue increase was the acquisition and resulting revenues from the portfolio of Singular Payments which accounted for a significant increase in the revenues.

From a gross margin dollar perspective, in the fourth quarter, the dollars were \$1.3 million or 23.2% of revenues. This compared to \$0.9 million and 30.7% of revenues in the fourth quarter of last year. From a gross margin dollar perspective for the 12 months ended December 31, 2017, the margin dollars were \$3.8 million or 25.9% of revenues compared to \$3.8 million comparable number or 31.3% of revenues in the corresponding period in 2016.

Our fourth quarter operating loss was \$1.1 million compared to an operating loss of \$300,000 in the fourth quarter of last year. Operating losses for the 12 months ended December 31, 2017 were \$2.8 million compared to an operating loss of \$1.4 million for the same period ended December 31, 2016.

From adjusted EBITDA perspective, we had a loss of \$0.3 million compared to positive adjusted EBITDA of \$0.2 million in the fourth quarter of last year. For the year, our adjusted EBITDA was a loss of \$0.6 million or negative 4.2% of revenue compared to \$0.9 million or 4.9% of revenues for the period December 31, 2016.

From a net loss for the quarter, we came in at \$1.3 million, again loss or \$0.13 per basic and diluted share compared to in 2016, a loss of \$0.2 million or \$0.03 per share. For the 12 months ended December 31, 2017, our loss was \$3 million or \$0.33 per share compared to the 2006 number of a net loss of \$1.2 million or \$0.15 per share.

Operating expenses, including cost of goods sold, were \$17.4 million in 2017 versus \$13.4 million in the same prior period.

In closing, as Louis has talked about we are very confident with the strategies and investments we put to place that have laid a groundwork for continued top line growth. I want to thank our shareholders and employees for their dedication and support and we look forward to speaking with you next quarter.

Thanks a lot for joining our call. Operator, we will open the call for questions.

QUESTION AND ANSWER

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 pick up your handset before pressing keys, to withdraw your question, please press "*" then '2.'

And our first question comes from Brian Kinstlinger with Maxim Group. Please go ahead.

Brian Kinstlinger

Hi, good evening, guys.

Louis Hoch

Hi, Brain. How are you?

Brian Kinstlinger

Great. Can you talk about how, I think you brushed over pretty quickly, how the NACHA certification helps differentiate you? And then when and why might it help drive new business for you?

Louis Hoch

Well, NACHA is the governing organization that regulates payments made through ACH, through the Federal Reserve system. The certification is very prestigious and took us a long time to achieve. We are the second company in the United States to receive it, the first company being TeleCheck, much larger organization than us. And they do a thorough review of our regulatory systems, our risk and compliance systems and just following the rules associated with initiating payments. They also do a financial review of our company and look at reputation within the industry. They review our customer base and our history, and it's a complicated process, we are really thrilled to achieve it, and it puts us in a different place and credibility within the payments industry and it allow us to get more banking sponsorships and it's was also allowed us to achieve some recent sales because of it.

Brian Kinstlinger

And so, you've already started benefiting and you think that in the near-term, you begin to benefit more in 2018 as a result?

Louis Hoch

Definitely, we are just starting to get the word out about the achievement. There has been a joint press release with NACHA, we are on the NACHA certified website now as a listed company that's completed the certification and we are starting to use it in our marketing efforts.

Brian Kinstlinger

But if I am a small merchant, how do I know that you are, unless you tell me, how do I find who the NACHA or why would I even find who are NACHA certified? Is that something they do?

Louis Hoch

Yes, they maintain a website so that you can go search any potential providers that you are working with, think about working with, and see if they're certified or not. It's nachacertified.org. And if you go to that website, you'll see two companies, us and TeleCheck...

Brian Kinstlinger

Can you talk about the pipeline of opportunities in the healthcare space following the acquisition of Singular? Maybe talk about deal sizes you are pursuing as you maybe move upstream as a larger company? And when you think maybe you'll start to realize some of the benefits of some larger deals?

Louis Hoch

Yes, I will talk in general terms, our selling strategy is to sell to software integrators and we have gained some relationships with software providers that provide services to the healthcare market. And the strategy is to make one sale to an integrator and share some revenue with the integrator, and then they will integrate to us and we will in most cases, be the sole payment provider that is offered to those doctor's offices, some ideas of scale might sell to one integrator and then have as much as 10,000, 12,000 doctors offices using their platform. So we will start to see some of those come alive in Q2, and it's very exciting market for us, healthcare.

Brian Kinstlinger

Yes, okay. And then maybe talk about, clearly it was expected the margins would come down given the more credit card processing from Singular. Are we at the building point from here to next year or we see a little bit of a step down one more time as the mix increases a little bit more towards credit cards?

Tom Jewell

Brian, this is Tom Jewell. Yes, we think we are pretty close to the bottom, I think there is a lot of very positive things that are going on to take that margin up going forward.

Brian Kinstlinger

Great, and then, with new capital and Singular complete, talk about how you think about the M&A markets going forward.

Louis Hoch

There is a lot of opportunity, a lot of consolidation going in the payments industry. There is a lot of opportunity for us to acquire portfolios and companies that would have strategic value to us and technology and people and customer bases are verticals that we like. And we are continuing to look and we are hopeful to close at least one deal this year.

Brian Kinstlinger

Great. Lastly, the first quarter is essentially complete, I think today is the last day of business. So can you give us a sense for, do the first quarter look a lot like the fourth quarter, just directionally, which way did you see it move?

Louis Hoch

Well, in the short term we will be announcing transaction numbers and I think you will get a good feel from that.

Brian Kinstlinger

Okay, but no other detail you think you can provide?

Louis Hoch

No, we are optimistic about 2018 in whole.

Brian Kinstlinger

Okay. Thank you.

Operator

And again, if you would like to ask a question, please press "*" then "1." Our next question is from Ronald Nisser, a private investor. Please go ahead.

Ronald Nisser

Hello there, Louis.

Louis Hoch

Hi, Ron.

Ronald Nisser

Hello, Louis.

Louis Hoch

Hello.

Ronald Nisser

Congratulations on your connection to the North American credit unions and also your record revenue. I would like to ask you a question about in the past. In the past, the company was connected to Microsoft.net, and I am concerned about some of the ransomware that's prevalent nowadays. And I would like to know if Payment Data Systems is cloud connected?

Louis Hoch

We definitely operate some of our systems within the cloud, some proprietary networks or proprietary data centers. But I can assure you our focus on technology security and keeping transaction data secure is really important to us in the industry. And we get audited quite a bit by our partners and reviewed, and we have to undergo a lot of standards and certifications throughout the year. Our data is encrypted, so if somebody were to hack us, they would get a bit glob of encrypted data.

Ronald Nisser

Okay, I understand, I know you have added some upgrades to your servers, digital wise. And I have read that hospitals, since now that you are in the healthcare industry, getting your foot in the door with them, that ransomware has shut down some hospitals in the past. And I was wondering, if you have been looking into email security which seems to be the sinkhole that's allowing hackers to get into computer systems and hospitals and other operations?

Louis Hoch

Our email systems, before it even gets delivered to employee or another subsequent program is screened pretty well and quarantined for anything that's suspect, so not really worried about in that getting through.

Ronald Nisser

I understand. With the Facebook data, and I would think that payment and billing data and email data will have to be policed 24/7, 365. And, of course, it is, as you know, it's changing every day. You come up with one solution and there is somebody else that wants to torpedo that solution. You have been in business since 1998. So my opinion is that if anybody can stay on a cutting edge of 21st Century security, it's Payment Data Systems. That being said, I'll let you go and listen to the rest of the conference call. Thank you.

Louis Hoch

Thanks Ron.

CONCLUSION

Operator

This concludes our question and answer session, as well as today's conference. We thank you for attending today's presentation and at this time you may disconnect your lines.