

Payment Data Systems Inc.

First Quarter 2016 Results Conference
Call

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CORPORATE PARTICIPANTS

Habib Yunus - *Chief Financial Officer*

Louis Hoch - *President and Chief Operating Officer*

Julie MacMedan - *Investor Relations*

PRESENTATION

Operator

Good day and welcome to the Payment Data Systems' First Quarter 2016 Results 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. 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' first 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 am here today with Louis Hoch, President and COO 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, 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 in our Investor Relations website for additional information.

And with that, I would now like to turn the call over to Louis Hoch, President and COO of Payment Data Systems. Louis?

Louis Hoch

Thank you, Julie. Michael Long, our CEO cannot be with us today due to illness. We expect him back in office though in the near future.

On today's call, I will review our operations and strategy and our CFO, Habib Yunus, will discuss our first quarter financial results in more detail. We reported a 14% decrease in first quarter revenues year-over-year, with the total ACH transactions and ACH dollars processed down

versus the first quarter of last year, and a 28% decrease in return check processing compared to the same period last year.

On the positive side, our first quarter credit card processing volumes were the fourth highest we have processed to date. For the first quarter, our credit card transaction volumes and dollars processed increased 6% and 5%, respectively, over the same period in 2015.

In addition, the decrease in returned check fees was somewhat offset by an increase in our new eCheck Verification Service. This service has significantly improved the transaction quality for our merchants and provides us with high-margin revenue.

We have a strong sales pipeline for new ACH business that we expect will generate year-over-year revenue growth for us, starting in the second half of 2016. Also, despite lower ACH revenue this quarter, we continue to generate significant cash flow from our ACH business which we are using to invest in our technology and marketing platforms to grow our overall business.

Now, turning to credit card processing; our organic growth in this area is driven by increased adoption of our payment processing services as well as our hosted or cloud-based payment service. We provide a secure cloud-based environment for our customers, removing the compliance risk from the merchants so they can focus on running their business. Through this solution, we help our customers comply with mandatory PCI data security standards.

As we mentioned on our last earnings call, we provide payment processing to many churches and charitable organizations. In February, we announced an agreement with Spark Development Network, the creator of Rock RMS, as their premier payments processor for their customers.

Rock RMS powers internal ministry sites, user portals, manages external church websites, and all aspects of ministry data and recordkeeping. Two weeks ago, we announced the launch of our Kind Hand giving and registration management platform for churches and charitable organizations that is built on the Rock RMS open source platform.

We expanded our offerings from just payment processing to a complete solution for this important industry vertical. We look forward to expanding our reach in this market.

Our hosted payments solution is applicable to numerous industry verticals and customer segments. In the future, we plan to expand into new areas such as medical and dental clinics, new non-profit segments, and property management and homeowners associations.

In addition to organic growth, we are constantly evaluating acquiring one or more credit card portfolios that could be accretive to our credit card business. We don't have anything specific to announce in this area today, but continue to be diligent in evaluating opportunities for accretive growth through acquisitions.

Turning to our prepaid business; prepaid is an exciting growth area for us. We offer a comprehensive, complete end-to-end solution for prepaid and incentive cards that delivers what customers want--speed and mobility. We continue to work on expanding our Stream Prepaid MasterCard offering, which is an ideal solution for businesses, such as insurance companies, that make real-time payments to individuals. Our goal is to help businesses use our prepaid platform to deliver real-time payments such as rebates, rewards and incentives to cardholders. We expect to report on some exciting announcements for the Stream Card in the near future.

I am pleased that we are ramping up our marketing efforts for the Akimbo prepaid platform. Just last week, we demonstrated the Akimbo Platform at the Finovate-Spring 2016 Conference in San Jose. With more than 1,400 people in attendance representing industry leaders, investors, and media, Finovate showcases the best and the most innovative financial and banking technologies.

We were pleased to have been selected to demo our Akimbo prepaid solution at this prominent industry event and expect to generate new business from our participation. We are seeing increased adoption with our Akimbo card offering due to our integration with Apple Pay. As such, we are now actively marketing online to potential cardholders about the availability of Apple Pay on Akimbo. Akimbo was the first general purpose card to adopt Apple Pay in the industry.

We are also marketing our Akimbo card through strategic partnerships, such as our C2Go agreement. C2Go is an electronic payment solutions provider to businesses and to individuals participating in today's increasingly variable workforce. Their solution is currently targeted to the hospitality and attractions industry in Las Vegas.

Using the C2Go platform, restaurants, attractions, night clubs, shows and special events can compensate concierges, street marketing teams, event planners, and taxi drivers for referrals to their venues. The venues move funds directly to their C2Go cards in real-time. With our funding, C2Go will expand their commission services in the Las Vegas market, and will accelerate growth into new workforce solutions for independent contractors and freelance workers.

We believe the addition of the C2Go customers could double the number of Akimbo card holders we have in the marketplace by the end of this year. While it is still small today, we expect our prepaid and incentive card business to be the fastest growing part of our portfolio this year and become a significant long-term growth driver for our business.

In summary, we expect to deliver growth and profitability in the second half of 2016 and our investments in ACH credit card and prepaid technology will drive the growth over the long-term. We look forward to updating you on the progress in future calls.

With that, I will turn the call over to Habib to review the financials.

Habib Yunus

Thank you, Louis. I am going to provide a brief review of our financial results before we turn the call over to questions.

For the first quarter of 2016, we reported revenues of \$3.2 million, down 14% from the first quarter last year. This was due to a decline in ACH volumes, return transactions and some customer attrition. Gross margins were \$1.1 million or 33% of revenues compared to \$1.4 million or 38% of revenues in the first quarter of last year.

As Louis mentioned, cost control remains the top priority of 2016, and we expect to return to profitability when our revenue growth returns in the second half of this year. Compared to the fourth quarter of last year, our operating expenses, excluding cost of services, decreased slightly in the first quarter of 2016 and we expect to maintain operating expenses at a consistent level for the remainder of 2016.

Our operating loss in this quarter was \$46,613 compared to operating income of \$694,721 in the first quarter of last year. This reflects higher SG&A to support growth, including higher non-cash compensation expense and higher amortization related to the assets acquired from Akimbo.

Adjusted EBITDA was around \$465,000 compared to \$850,000 in the first quarter of last year. Our net loss was \$32,002 or zero cents on a per share basis, compared to net income of \$708,617 or \$0.06 per diluted share in the first quarter of last year.

We still have a strong balance sheet with \$4.2 million of cash and no debt. During the first quarter we generated cash flow from operations of \$472,239, and we continued to reinvest free cash flow into the business opportunistically. We have a strong operating platform and our future growth is very exciting and we are excited about the opportunities ahead.

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 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.

Our first question comes from William Gibson with ROTH Capital Partners. Please go ahead.

William Gibson

Hi Louis, you talked about returning to growth and profitability in the second half. Is...will we see a positive comp in the third quarter or do we have to lap the introduction of eCheck in the fourth quarter before we see that?

Louis Hoch

Well, as we stated earlier, we have a strong pipeline and based upon that pipeline, we believe those customers become operational in Q3 and Q4, and some of them are substantial. So we feel like Q3 and Q4 are going to be good quarters.

William Gibson

Good. Thank you.

Operator

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

Ryan Fisher

Hi guys. Thanks for taking my question. So I wanted to try and get a little more color on what's going on with margins, because they declined about 500 basis points both sequentially and year-over-year. And I was kind of under the impression that the new ACH service you guys introduced was going to boost margins on that side, and you were sacrificing revenue to get better margins. So with margins going up on the ACH side, I mean, are they getting compressed somewhere else in the business or what's going on with that?

Louis Hoch

The verification service is definitely higher margin than ACH, and we should see an even further increase in margins because more customers come on verification service. When we rolled out verification service at the end of last year, a third of our customers took on that service, and it was

pretty quick, and we are looking to add some more customers to that service. So as we get more customers on that service you will see the margin increase even more.

Ryan Fisher

Okay. And so, just to clarify, is Akimbo, is that still losing money or do you guys, I mean, do you have a grasp on, I assume it's still losing money, but do you have a grasp on maybe how much money it is losing or that you could share with us?

Louis Hoch

Yes, we don't report segments, but Akimbo is doing well. It is not at breakeven yet, but it's very close.

Ryan Fisher

Okay. And then looking into Q2, do you guys see kind of similar to what you reported in Q1 or are we going to be around the same...in the general revenue and income area?

Louis Hoch

Yes, Q3 and Q4, we think are going to be good. We think Q2 is...we'll start seeing a little bit of ramping up on some of these customers that we are in various stages in our pipeline, our implementation. But Q2 would be similar.

Ryan Fisher

Okay. That's it for me then. Thanks guys.

Operator

And again, if you would like to ask a question, please press "*" then "1". And at this time, I am showing no further questions. I would like to turn the conference back over to Louis Hoch, President and Chief Operating Officer for any closing remarks.

CONCLUSION

Louis Hoch

We had one emailed in question and the question was, how has the expansion of your sales channel progressed? So since we don't have any more questions we would like to go ahead and read this question. We continue to expand our relationships and sales primarily through resellers and integrators. Churches and charitable organizations remain an important vertical for us, and we are excited to partner with Rock RMS to deliver our Kind Hand giving and management solution. With our strong in-house technology capabilities and our team, this year we still plan to expand into new industries and verticals such as medical and dental clinics, additional non-profit segments and property management and homeowners associations, and our pipeline is, again, strong. So we are excited about the second half of the year. And with that, we would like to conclude our call.

Operator

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