

Payment Data Systems'

Second Quarter 2017 Earnings Conference Call

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Eastern

CORPORATE PARTICIPANTS

Louis Hoch - *President, Chief Executive Officer*

Tom Jewell - *Chief Financial Officer*

Preston Graham - *Investor Relations*

PRESENTATION

Operator

Good afternoon and welcome to the Payment Data Systems' Second Quarter 2017 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 telephone keypad, to withdraw that question, press "*" then "2." Please note this event is being recorded.

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

Preston Graham

Thank you and welcome to Payment Data Systems' second 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 under the news. On the call today are Louis Hoch, President and CEO and Tom Jewell, Chief Financial Officer. Management will provide prepared remarks and then we will open the call up 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 involves 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 closing of the proposed Singular acquisition, the realization of the anticipated opportunities from the proposed 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 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 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. While we experienced a decrease in ACH transactions this quarter, which resulted in less revenue versus the same period a year ago, we have a strong sales pipeline, which we believe will result in improved revenues in the fourth quarter and early 2018.

As a result of our accelerated sales and marketing campaigns to increase revenue, we expect to see an increase in transaction growth from both existing merchants, for whom we provide credit and debit card processing for, and new merchants, that should increase our transaction volumes and the associated revenues. Our prepaid card transactions, as well as our recently implemented PIN-less debit transactions, should also continue to grow.

In March, we announced our intent to acquire Singular Payments, enhancing our ability to deliver robust FinTech solutions to the developer community and further accelerating our growth. We believe the combined companies will add thousands of new merchants for us, which will increase revenues and the associated operating metrics of dollars and transactions processed.

Last week, we announced that both companies needed additional time to finalize the acquisition process, now that Singular has concluded their audit of their financials. We expect to close the transaction in the upcoming weeks, if not sooner.

Total operating expenses decreased when compared to the same period a year ago, and we continue to generate cash from operations. Our balance sheet remains strong, with cash of \$3.2 million and no debt as of June 30. Above all, we remain diligently focused on our sales and marketing campaigns, and today, I am pleased to share with you some updates.

We continue to invest in technology to deliver innovative services to our clients. In Q3, we will be one of the first ACH processors to implement same day debits, which should give us an early mover advantage and strengthen our relationships with our current customers. This service will allow customers to debit their client's checking and savings accounts the same day that their customer initiates payments for services.

In the last quarter, we implemented a new ACH sponsoring bank, giving our clients more flexibility in managing their payment's risks. We will continue to seek more banking partnerships to grow our payments network. Houston Frost, our Senior Vice President of Prepaid Services is out of our office on personal time, so I will provide an update of our prepaid business.

We continue to experience positive traction in prepaid. Since the last earnings call, we have launched two custom prepaid card programs, including one for our primary issuing bank. Their selection of our service, demonstrates a significant vote of confidence in our platform. We have two additional custom card programs that are currently in implementation. These four custom prepaid programs are projected to start generating reoccurring revenue in the current quarter Q3.

For the remainder of the year, our prepaid services team is focusing its efforts on growing sales with our digital gift and incentive solutions, as well as marketing our direct-to-consumer product, Akimbo. We have partnered with two new resellers that are

helping with the distribution of our gift and incentive cards, and they have already had a significant impact on our sales pipeline.

The monthly enrollment rate for the Akimbo card has more than tripled over the last two months, due to increased marketing efforts and new distribution partners. Akimbo is a prepaid card solution for household budgeting and allowances, and allows users to create up to six cards per account.

We saw more than 2,500 cards in total created in the last 30 days, indicating almost two cards per new enrollment. This level of engagement is exciting, as past results indicate that consumer's who create and load multiple cards, are particularly sticky.

This low attrition rate leads to a significant increase in customer lifetime value. We expect the pace of enrollments to continue for the remainder of the year, and the monthly reoccurring revenues from the Akimbo consumer program to double within the next six months.

Also in July, the Akimbo app began allowing enrollments for consumers aged 13 to 17 years old. Teenagers can now download the Akimbo app, and immediately provision a card to their Apple wallet, and invite their parents to load their new Akimbo card. This is a first of its kind, for a prepaid card offered to teenagers. We are excited to see the results, as the new school year ramps up.

Now I will turn over the call to Tom, for a financial review.

Tom Jewell

Good afternoon. Thank you, Louis. Thanks a lot for joining us today. We are excited to see your interest in Payment Data Systems. I am going to provide a brief review of our financial results, before we turn the call over to questions.

Overall, we continue to have a strong balance sheet with \$3.2 million in cash, we have no debt and a clean capital structure. For the six months of 2017, we generated net cash from operations of a little more than \$13,000.

I'd like to take you through revenues, and we will cover both the quarter and the year-to-date. For the second quarter, we reported revenues of \$2.6 million; that was down 11.8% from the second quarter of last year. For the six month period, ended June 30, 2017, revenues were \$5.4 million, down 12.4% compared to \$6.1 million for the six months ended June 30, 2016.

The reason primarily for the decrease in revenue was we had a customer selling a portion of their portfolio and starting the process to rebuild it. Over the near future, we expect to see that revenue come back to Payment Data.

From a gross margin perspective, gross margin dollars were \$696,000 or 27.3% of revenues compared to \$855,000 or 29.6% of revenues in the second quarter of last year. For the six month period, gross margin dollars were \$1.6 million or 30.6% of revenues compared to \$1.9 million or 31.5% of revenues in the corresponding prior year period. The decline in gross margin dollars was due, primarily to lower revenue and partially offset by a corresponding decline in cost of service expenses.

From an operating loss perspective, our second quarter operating loss was \$548,737 compared to an operating loss of a little more than \$455,000 in the second quarter of last year. Operating losses for the six months ended June 30, 2017, were \$870,675 compared to an operating loss of a little more than \$501,000 in the six months ended June 30, 2016.

One of the metrics we look at is adjusted EBITDA. Adjusted EBITDA was a negative \$103,705 compared to a positive \$54,081 in the second quarter of last year. Adjusted EBITDA for the six months ended June 30, 2017 was income of \$10,822 or 0.2% of revenue, compared with income of \$519,580 or 8.5% of revenue in the six months ended June 30, 2016.

From a net loss perspective, our net loss for the quarter was \$534,337 or \$0.06 per basic and diluted share, compared with a net loss of \$355,301 or \$0.05 per basic and diluted share for the second quarter of last year.

For the six months ended June 30, 2017, our net loss was \$820,920 or \$0.10 per basic and diluted share, compared to a net loss of \$387,000 or \$0.05 per basic and diluted share in the six months ended June 30, 2016. The increase in our loss was due to a lower revenue base, coupled with that overall; our operating expenses were down a little more than \$388,000 for the six months ended June 30, 2017 versus same prior year period.

The company remains well positioned for future success, with a tremendous technology platform and the ability to structure solutions that are easy to implement and cost effective for the consumer. We are aggressively pursuing, as Louis mentioned, new opportunities to satisfy the evolving needs of existing and new customers.

In addition to pursuing base business growth, we are very excited about the potential acquisition of Singular Payments LLC that will add talented leadership, sales, and a robust credit card processing portfolio to the Payment Data team.

In closing, we are confident that the strategies and investments we put in place have laid the groundwork for resumed top line growth.

At this time, I'd like to thank our shareholders and employees for their dedication and support, and we look forward to speaking with you next quarter.

Operator, please open the call for questions. Thank you.

QUESTION AND ANSWER

Operator

We will now begin the question and answer session. To ask a question, please press “*” then “1” on your touchtone phone, if you are using a speakerphone, please pick up your handset before pressing the keys, to withdraw that question, press “*” then “2.”

And our first question comes from Marco Rodriguez with Stonegate Capital. Please go ahead.

Marco Rodriguez

Good afternoon, guys. Thank you for taking my questions. I was wondering if maybe, you could talk a little bit more about the ACH business. Obviously, it faces some headwinds here in the last few quarters. If you could just maybe put some color on some of the main drivers that is kind of causing the declines?

Louis Hoch

Well, the main one was one of our largest customers sold their portfolio of customers, and it was a significant volume. They are still a customer. They still believe in Payment Data, and they are going to rebuild their portfolio. They have already started increasing their transaction growth. But it's going to take them a few months before they ramp back up. We are adding new customers every week, and our pipeline is strong when it comes to ACH, and we remain an industry leader in ACH and we are doing some innovative things there with...next month we will implement ACH same day debits, which is...just recently became available, and we are excited about our ACH possibilities.

Marco Rodriguez

Gotcha. And can you talk a little bit about the pipeline? I mean, where does this stand in terms of where it was last quarter, and maybe this time last year as well, what sort of growth have you seen there?

Louis Hoch

Well the pipeline is rich. I don't give too much detail about who we are in negotiations with, but it's definitely going to help us grow, as we close those customers.

Marco Rodriguez

Gotcha. Then maybe, you can talk a little bit about your confidence level then I suppose in terms of having that one customer that sold its portfolio. How quickly can they turn that back around, and then with your pipeline, if you can maybe talk about your confidence levels of having the ACH transaction just kind of start showing growth again?

Louis Hoch

Well, the customer who sold their portfolio is an industry leader. We believe that they will be successful. Obviously, we don't control how fast they will rebuild their customer base. But even if they don't, our pipeline is...will do more than cover the downturn in there that we lost.

Marco Rodriguez

Gotcha. And can you maybe talk a little bit about the pipeline. I mean, what is the sort of conversion that we should be kind of thinking of, as far as how quickly you can convert the pipeline into revenues or recognize revenues rather?

Louis Hoch

Well to implement an ACH customer is pretty quick. Well, users go through like a week of testing, and then they go live. And so if they have an existing customer base, we will see immediate volume, and if there is some type of startup period, then we will grow with them. And there is really not a long implementation time for ACH, as compared to prepaid there is. So we can see some immediate gains, as we close more of those customers.

Marco Rodriguez

Gotcha. And kind of shifting gears just a little bit here, just maybe you could give...add a little more color around the PIN-less and the prepaid on your prepared remarks...on the press release, you talked about these two areas acting as revenue drivers. I am just trying to get a sense here, as far as maybe what sort of percentage they represent currently, and how that could impact positive revenue growth, when it comes to reporting quarterly basis?

Louis Hoch

Well we don't do segment reporting, as you know. But PIN-less implemented late last year. It continues each last quarter to provide more and more volume to us, and we are excited about that product, because it's higher margin, and it's...we don't have a lot of competitors in the marketplace for that, so we are one of few sources that...if you want to do that, you can come to us or just a few competitors. And PIN-less allows for transactions to settle without a user typing in their PIN-code, their personal identification code, through the debit networks, and it's primarily for bill payments. And so, we have signed some partnerships that we have announced like, with the mortgage servicer, it works great for mortgage loans, because they can repay their loan using their check card or their debit card. And prepaid, prepaid we are doing some really innovative things there. We were the first prepaid card company to implement Apple Pay. We are now live on Apple Pay, Google Wallet and Samsung Pay. We can deliver cards virtually, so that no plastic has to be traded, if the consumer chooses not to have it. So you can have an Akimbo card in your Apple wallet today, if you want to go sign-up at akimbocard.com, which by the way is...there is no cost for that card to acquire the card.

Marco Rodriguez

Gotcha. And here, maybe you can talk a little bit about the quarter here we are coming into and Q3 historically, you guys have shown last three years or so, sequential revenue growth from a seasonal standpoint. Should we be thinking, that should recur again this particular year, or are there some other drivers that might be kind of weighing on that?

Louis Hoch

Well, the third quarter and fourth quarter are usually our best. The fourth quarter is because, we do a lot of charity processing for charitable organizations and churches and there tends to be a lot of giving that occurs at the end of the year. Third quarter is just kind of a ramp, people go back to school and I don't know why, but we get more payments. But third quarter is...and we should close the Singular acquisition during this quarter as well, so we already talked about. So all those factors, we should see growth in Q3 and Q4.

Marco Rodriguez

Gotcha. And then, speaking of the Singular transaction, I am not sure I caught this in your prepared remarks, but the kind of the delay in closing that transaction, is did I hear you correctly, that was mainly because of them trying to close their audit?

Louis Hoch

Yes. Obviously, we had to have audited financials, they have completed that task. So now we are just down to some minor checklist type items, and hopefully should wrap it up in the near future.

Marco Rodriguez

Gotcha. Great, well I appreciate your time, guys. Thanks.

Louis Hoch

Thank you.

Tom Jewell

Thank you.

Operator

Again, if you have a question, please press "*" then "1." The next question comes from Ronald Nisser, private investor. Please go ahead.

Ronald Nisser

Good afternoon, Louis.

Louis Hoch

Good afternoon, Mr. Nisser.

Ronald Nisser

Well sir, I know that you and Michael have been application service providers in the bill-serve, pay-serve industry since 1998. I also know that you spent some money on...the company has spent money on digital upgrades. So I know you are on track. Today, for your information, if you didn't see it already, Bitcoin soared past \$4,000 today. My question is kind of, in the future, but could [indiscernible] cards of networking opportunity join with Bitcoin to provide military grade networking security in the foreseeable future?

Louis Hoch

I mean, the whole Bitcoin phenomenon is exciting. We have...the quick answer is yes, prepaid cards and Bitcoin are a good fit together, and we have had people reach out to us about doing programs with Bitcoin. We do not have any current customers that are using Bitcoin, but we are looking at opportunities to combine the two.

Ronald Nisser

Okay. I understand that, and I know that rules and regulations governing the payment industry are some of the headwinds you will have to fight before things can come to fruition, transactions between...the travel between points A to B, in between and through the automatic clearinghouse. I think that with the artificial intelligence chips in the news, they can take the place of many back office servers. That being said, do you think that the company will position themselves, so that when and if artificial intelligence chips become, for lack of other words, commonplace, that you could handle some high tech transactions with these smart chips in the loop?

Louis Hoch

We are already doing stuff with Near Field Communication and contactless. I am not sure, what else you would mean by artificial intelligence chips. But as we have talked about before, we are doing a lot with contact list [ph], when it comes to mobile we are in everybody's wallet. And Near Field, the same thing, we are using that. And if you can give me some more information on what you mean by artificial intelligence chips?

Ronald Nisser

Well, we are talking about artificial intelligence chips; so that they can store so much information and then chips talking to chips are back office servers talking to the other

servers, create some artificial intelligence that can be used to see what is selling and what isn't selling. Of course, this is forward-looking, and you have to wait on new rules and regulations to be revised, before people that want to come off the sidelines and invest can get an idea when they will get return on their investment. But the AI chip thing is in the news, every once in a while, and I think that it could be on us, before we know it. So I am just thinking ahead of those networking curve, or trying to, and I believe that Payment Data Services, Payment Data Systems is in the right place at the right time, and we are smack-dab in the middle, where billing and payments, e-verification, security and record-keeping crosses paths. One other question, since I am on that subject matter. I know we have got a lot of rain in Texas. I was wondering if the headquarters, it looks to be out of the flood zone, have you had any problems with flooding at your headquarters?

Louis Hoch

Thank god, no. Our main datacenter here in San Antonio is not in the flood zone, and of course, we have auxiliary datacenters throughout the United States. So even if it were to occur here, we would run on one of our other datacenters.

Ronald Nisser

Outstanding, that was the detour I was questioning in the past conference call, you asked me what did I mean. And I know from working in the deregulated railroad industry, that the banking industry...deregulated banking industry, is going to have to run over the same tracks that the railroads have already run over. So you have a derailment upfront. You have to have some tracks that you can detour around the derailment until the bridge is fixed. So by you mentioning the last, that gives me more confidence in following Payment Data Services aka Systems, and I will hang up on that and I wish you all the best.

Louis Hoch

Thank you, Ron.

Tom Jewell

Thank you, Ron.

CONCLUSION

Operator

This concludes our question and answer session. The conference has now concluded. Thank you for attending today's presentation. You may now disconnect.